"Judgment: approved by the Court for handing down""

IN THE HIGH COURT OF JUSTICE
CHANCERY DIVISION

HC 1999 04155

BEFORE: **MR JUSTICE NEUBERGER**

BETWEEN:

NATIONAL WESTMINSTER BANK PLC

Claimant

-and-

(1) ROSEMARY DOREEN JONES
(2) HAROLD DELWYN JONES
(3) NEUADD GOCH FARM LIMITED

Defendants

Miss Georgina Middleton (instructed by Messrs. Addleshaw Booth & Co. Manchester) appeared on behalf of the claimant.

Mr Stephen Jourdan (instructed by Messrs. Burgess Salmon, of Bristol) appeared on behalf of the defendants.

This is an approved judgement of the Court and I direct that no further note or transcript be made.

The Hon Mr Justice Neuberger
Dated: 22nd June 2000

MR JUSTICE NEUBERGER:

INTRODUCTION

1 The claimant, National Westminster Bank plc ("the Bank") seeks declaratory relief in relation to its interest in two pieces of freehold agricultural land, and in relation to certain agricultural assets. The first piece of land is owned by Mrs Rosemary Jones, the first defendant, and is at Neuadd Goch farm and Neuadd Goch Hill, Powys ("Neuadd Goch") which consists of about 179 acres, most of it pasture land, together with a two storey farm house ("the house") and some farm buildings. The second piece of land is owned by Mr Harold Jones, Mrs Jones's husband, the second defendant, and consists of some 30.5 acres of agricultural land at Rhostwpa and Dolmarch, Adfa, Newtown, Powys ("Rhostwpa"). The agricultural assets are the livestock and deadstock used in the farming operations carried on at Neuadd Goch and Rhostwpa ("the farm").

THE BASIC FACTS

2 Mrs Jones's family have lived in the house, and have owned and farmed Neuadd Goch, for over 100 years. Mr and Mrs Jones ("the defendants") have lived in the house, and have carried on an agricultural business in partnership on Neuadd Goch since they married in 1975, and they extended that business to Rhostwpa in 1989. The partnership traded substantially in sheep and beef farming, for which Mr Jones, a more than competent farmer, was responsible. Mrs Jones is a teacher. The defendants initially rented Neuadd Goch from Mrs Jones's parents, but it was conveyed to Mrs Jones in 1989, a few months after Mr Jones had purchased Rhostwpa. The defendants are long standing customers of the Bank.

3 On 31st January 1990, Mrs Jones granted the Bank a mortgage ("the mortgage") over Neuadd Goch as security for all monies owing to the Bank from time to time by the defendants. The mortgage included the following clause:

> "6. The statutory powers of leasing or of accepting surrender of the leases conferred on mortgagors shall not be exercised by [Mrs Jones] nor shall [she] part with possession of the [farm] or any part thereof nor confer upon any person... any... right or interest to occupy the [farm] or any part thereof without the consent in writing of the Bank."

4 On 1st August 1998, Mr Jones consented to the mortgage up to a limit of

£323,000 plus interest and costs.

5 On or about 2nd April 1993, Mr Jones deposited with the Bank the pre-registration deeds and the land certificate relating to Rhostwpa ("the Rhostwpa deeds"). At the same time, he signed a document in the Bank's standard form ("the confirmation") in these terms:

> "I... hereby confirm the [Rhostwpa deeds] has/have been deposited with the Bank as security for all of my/our liabilities to the Bank from time to time of any nature whatsoever."

The confirmation was intended to be signed by the "Depositor(s)", and by a representative of the Bank to "acknowledge receipt of the completed copy of this document". Mr Jones duly signed the confirmation, but no representative of the Bank has done so.

6 On 1st November 1994, the defendants entered into three agricultural charges in favour of the Bank. These charges ("the charges") were effectively in identical terms, and were intended to confer security on the Bank in respect of all the borrowings of the defendant. Under the charges, the defendants charged "by way of floating charge all the farming stock and other agricultural assets as defined by the [Agricultural Credits] Act [1928] from time to time belonging to [them]". Clause 3 of each of the charges provided:

> "The floating charge hereby created shall become a fixed charge
> ...
> (iii) upon the dissolution of partnership in any case where the property hereby charged or any part thereof is partnership property..."

I shall refer to the assets charged by the charges (which included the livestock) as "the farming assets".

7 Thereafter, the defendants got into difficulties, and by the end of 1998, their circumstances had become seriously bad. In December 1998, one of their creditors issued bankruptcy proceedings against Mr Jones arising out of a judgment debt. A few weeks before this, Mr Jones had instructed a Mr Des Phillips of UK Mortgage and Finance Services Limited ("UK Mortgages") to advise the defendants. Thereafter, they took advice from the Farmers' Union of Wales ("FUW"), whose Mr J E James estimated that the agricultural business being carried on by the defendants could, with improvements, make a net profit of £13,500 over the next year, allowing for an annual cost of finance of £36,000 (and

assuming refinancing of the defendants' outstanding liabilities to the Bank).

8 Pursuant to instructions some six weeks earlier, UK Mortgages obtained a valuation from an agricultural valuer, Mr J G Lewis ARICS of Norman Lloyd & Co., on 7th January 1999. He assessed the open market value with vacant possession of Neuadd Goch at £346,000 and of Rhostwpa at £45,000. He also assessed its value on a forced sale basis at £308,000.

9 Thereafter, Mr Phillips put the defendants in touch with an insolvency practitioner, Mr Geoff Weisgard of Mitchell Charlesworth. Mr Weisgard visited the farm and prepared draft proposals for Individual Voluntary Arrangements ("IVA"s) for each of the defendants. Mr Phillips gave the Bank copies of these proposals on 8th March 1999, and told them that the defendants would be making an offer to the Bank in the near future.

10 Four days later, on 12th March 1999, the Bank made a formal demand of Mrs Jones for payment of £332,852.45, being the total sum due after the amalgamation of the defendants' various accounts with the Bank. Some two weeks later, Mr Phillips sent a proposal to the Bank, which involved the Bank voting in favour of the IVAs. This proposal was that the Bank would sell the farm to the Company for £200,000, and that the balance owing to the Bank would be subject to the proposed IVAs. The Bank turned that proposal down. On 9th April 1999, the Bank was sent details of the creditors' meeting, due to take place on 27th April 1999, by Mr Weisgard, as the nominee under the proposed IVAs. These proposals included, in the normal way, estimates of the income and expenditure of the defendants. The same day, the Bank wrote to the defendants demanding full payment of what was due, which had by then increased to £335,418.85.

11 In early April 1999, the defendants were advised by Mr Phillips that they could protect their home and farming business from action by the Bank as mortgagee by forming a company, granting it an agricultural tenancy of the farm, and selling it the farming assets, always provided that the tenancy and sale were for proper value. The defendants took valuation advice from an agricultural surveyor, Mark Sanders FRICS, a partner in Carver Knowles. Mr Sanders was instructed to advise the defendants, and he said in evidence that he had advised the defendants, by assessing the rent which would be payable in the open market under a tenancy of the farm, and the price which should be payable for the farming assets, on the basis, in each case that there was no element of the transaction which could be said to be at an

undervalue. On 7th April, Mr Phillips wrote to Mr Sanders, providing him with information “to enable [him] to put in a tenancy and an asset transfer agreement to a limited company”.

12 On 12th April, Neuadd Goch Farm Limited (“the Company”) was incorporated as an “off the shelf” company. The two directors of the Company are Mr and Mrs Jones, and Mr Jones is the Secretary. Although the only two issued shares in the Company are held by the original subscribers, it is common ground that they are beneficially owned by the defendants.

13 On 23rd April 1999, Mr Phillips told a representative of the Bank that the defendants had incorporated the Company, that they would be granting a tenancy of the farm to the Company, and that they had transferred the farming assets to the Company. It was made clear to Mr Phillips that the Bank would not consent to those transactions, and the Bank subsequently confirmed this in letters to Mr Phillips and the defendants on 26th April. In their letter to Mr Phillips, the Bank mentioned that it would not enter a claim in the IVAs as “the correct valuation of the farm is in the region of £400,000". On the same day, the bank informed Mr Weisgard that it did not intend to submit any claims in the IVAs. The Bank also wrote to Mrs Jones informing her that her liability to the Bank was nearly £337,000, with interest accruing at £34,565.50 p.a, and that, unless repayment proposals “within a period of no more than four months” were not put forward within 14 days, possession proceedings would follow.

14 On 27th April, the meeting of creditors took place, and the IVAs were approved. On the same day, the defendants signed two agreements (“the agreements”) with the Company. The first was a tenancy agreement (“the tenancy”) relating to the farm. Its duration was 20 years from 27th April 1999, expiring on 26th April 2019. The rent was recorded as consisting of two components. First there was a “base rent” of £1,000 p.a. for the first five years, rising to £4,276 p.a. for the remaining 15 years; secondly there was a further rent (which I shall call “the ordinary rent”) of £17,420 p.a. to be reviewed (upwards or downwards) to the then market rental value of the farm on 1st June 2004, 2009 and 2014. Both components of rent were payable half yearly in arrear, the first instalment falling due on 1st December 1999. The start date, term date, and actual figures for the base rent and ordinary rent were not actually recorded in the tenancy until about 4th June 1999, when they were inserted by Mr Sanders after discussions with Mr Phillips and Mr Jones as to the appropriate level of rent per acre for the farm.

15 The tenancy imposed a full repairing and insuring obligation on the Company. It also contained a clause entitling the defendants to forfeit in any event of the Company failing to pay the rent or to observe its obligations. Further, the Company had an unfettered right to determine the tenancy on 27th April in any year by giving between 12 and 24 months prior notice to the defendants. Otherwise the tenancy was in fairly standard form for a lease of agricultural land under the Agricultural Tenancies Act 1995.

16 So far as the other agreement entered into between the defendants and the Company is concerned, it was a sale agreement ("the sale agreement") relating to "livestock, deadstock, implements, machinery, feed and other items in store on or situated at" the property; in other words, it involved a sale of effectively all the farming assets of the partnership. The consideration was recorded as £341,880, payable by 20 equal instalments of £17,094, the first instalment being due on 27th April 2000.

17 The Bank sent Mrs Jones a letter before action on 12th July 1999, and, in reply, UK Mortgages sent the Bank copies of the agreements. On 17th September 1999, demands were made on the defendants by the Bank for payment of what they then owed, namely £350,774.34 pursuant to the charges. Four days later, on 21st September, the Bank appointed Mr Norman Duckworth and Mr Andrew Duckworth of S H M Smith Hodgkinson as receivers ("the Receivers") pursuant to the Mortgage and the Charges.

18 The Bank issued the current proceedings against the defendants and the Company on 28th September 1999. Two days later, it obtained an injunction ("the injunction") restraining the defendants and the Company from dealing with the farm and the assets without the consent of the Receivers. The terms of this injunction were subsequently varied on 7th October 1999 and 24th January 2000.

THE ISSUES

19 The two principal issues to be determined in these proceedings are:

A Whether the Bank's interest in the farm is subject to the tenancy;

B The extent of the Bank's interest (if any) in the assets.

Each of these issues involves sub-issues. Most of the sub-issues raised by each of the two issues are very similar.

20 Although the two issues have been in contention between the parties

from the start, the sub-issues which have been thrown up have increased, particularly as a result of some last minute amendments by the Bank to its pleaded case. With one exception, these amendments have, at least to an extent, been prompted by a late amendment to the Defence. However, in the case of one amendment (relating to the Issue B) the Bank seeks to raise an argument which it could have raised when the proceedings began, and which cannot be said to have been prompted by any late amendment to the Defence. I was somewhat reluctant, particularly in view of all the resources available to it, to permit the Bank to amend at such a late stage. However, Mr Stephen Jourdan, who appears for the defendants, fairly said that he was unable to identify any specific prejudice to the defendants as a result of the amendment so far as the conduct of the trial was concerned. Nonetheless, he forcefully argued that it was unfair to permit a late amendment which enabled the Bank to raise a new point which could have been put forward at any time. If it was the only ground upon which the Bank was ultimately successful on one of the two issues, it would have the result, he said, of dashing the cup of victory from the lips of the defendants. I have sympathy for that view. However, it seems to me that if, before a trial starts, a claimant has given notice to a defendant of a further argument it wishes to raise, and the defendant is unable to show any relevant prejudice, it would be wrong not to give permission to amend, save in exceptional circumstances. By "relevant prejudice" I mean a consequential substantial lengthening of the hearing, a consequential need for substantial further disclosure or proofing of witnesses, or anything else in the way of consequential unfairness (e.g. that the defendant had reasonably acted in some way in reliance on the fact that the point in question was not being taken).

21 To deprive a claimant of an argument which may be a good one, and which may result in his winning the case when he would not otherwise have done so, appears to me, at least in the absence of any relevant and real prejudice to the defendant as a result of giving the claimant leave to amend, to be an unduly harsh punishment for the claimant, and to result in an undeserved windfall for the defendant, at least in the absence of special circumstances. The position would obviously be different where the amendment was not notified until the trial was well under way, or where allowing the claimant to take the point late would cause real and relevant prejudice to the defendant. Neither of those exceptions apply here.

22 So far as Issue A is concerned, the defendants contend that the Bank's interest in the farm is subject to the tenancy. The Bank denies this on a number of grounds. They are as follows:

A1. In relation to Neuadd Goch, it is open to the Bank to rely upon clause 6 of the mortgage, assuming the tenancy is otherwise effective;

A2. On proper analysis, the tenancy was an attempt by the defendants to grant a tenancy to themselves, and is therefore ineffective;

A3. The tenancy is a sham transaction, which should not be given effect by the court, or which the court should set aside;

A4. The tenancy was a transaction at an undervalue within the meaning of Section 423 of the Insolvency Act 1986 (“Section 423").

23 As to Issue B, relating to the sale agreement, the Bank raises the following similar grounds for challenging the contention that the farming assets are beyond its grasp:

B5. The sale agreement was an attempt by the defendants to deal with themselves;

B6. The sale agreement was a sham transaction;

B7. The sale agreement was a transaction at an undervalue within the meaning of Section 423.

The Bank alternatively contends that, if the farming assets became validly vested in the Company, they were, and still are, nonetheless subject to fixed charges in favour of the Bank by virtue of the provisions of Clause 3 of the Charges and/or Section 7 of the Agricultural Credits Act 1928 (“the 1928 Act”). In this connection, the Bank contends that its floating charge was converted into a fixed charge because:

B8. The grant of the tenancy, and the transfer of the farming assets, to the Company, resulted in the dissolution of the partnership;

B9. When the defendants transferred the farming assets to the Company, the partnership ceased carrying on business.

24 I propose to take the issues in the following order. First, Issue A1, the effect of Clause 6 of the Mortgage; secondly, Issues A2, and B5,

whether the agreements involved self-dealing; thirdly Issues A3 and B6, whether agreements are shams; fourthly, issues A4 and B7, whether the agreements fell foul of Section 423; lastly Issues B8 and B9, whether the Bank's floating charge became a fixed charge over the assets at the time that they were transferred.

ISSUE A1: CLAUSE 6 OF THE MORTGAGE

25 On the face of it, Clause 6 of the Mortgage enables the Bank to contend that its interest in Neuadd Goch is free of the tenancy, because the tenancy was granted without the consent of the Bank; indeed, it was granted after the Bank had made it clear that it objected to its grant. Section 99 of the Law of Property Act 1925 ("the 1925 Act") makes it clear that, subject to certain exceptions, a provision such as Clause 6 of the Mortgage is effective. However, Section 99(13A) of the 1925 Act provides that a provision such as Clause 6 cannot be invoked "in relation to any mortgage of agricultural land made after 1st March 1948 but before 1st September 1995", in relation to a tenancy of all or part of that land which satisfies the other requirements of Section 99.

26 The only express requirement of Section 99 of the 1925 Act ("Section 99") which the Bank might contend has not been satisfied in relation to the tenancy is set out in sub section (6), which requires any tenancy:

> "[To] reserve the best rent that can reasonably be obtained, regard being had to the circumstances of the case, but without any fine being taken."

27 Although more complex and difficult issues arise when one turns to Section 423 of the 1986 Act, it seems to me that, where Section 99(6) of the 1925 Act mentions "the best rent that can reasonably be obtained", it is referring to the level of rent which can be obtained on the open market between a willing lessor and a willing lessee. In other words, in order to satisfy Section 99(6), the rent payable under a tenancy must be the rent which would be obtained if the premises concerned were competently marketed. The sort of considerations (with which I must deal in due course) which justify a more sophisticated, and less open market-orientated, approach to the consideration which the Mortgagor might expect to receive for the grant of a tenancy when one is considering the matter under Section 423, do not appear to me to arise when one is considering the issue under Section 99. I consider that, if the mortgagee is to be bound by a tenancy, it should reserve the best rent which could be obtained in the open market, not

least because that would be the best rent which the mortgagee could obtain if he were to let the premises. In reaching this conclusion, I have not overlooked the words “regard being had to the circumstances of the case” in Section 99(6). It appears to me that those words are directed towards what one might call objective considerations, such as the state of the market at the time, and the terms of the tenancy.

28 In the light of the expert evidence, it is clear that the rent reserved by the tenancy, particularly if one takes into account the unusual component of the base rent, £1,000, rising to £4,276, p.a., was actually more than the level of rent required by Section 99(6). It appears to be common ground between the two expert surveyors who gave evidence (and whose testimony I will have to consider in more detail below) that the ordinary rent of £17,420 p.a. was, on its own, a level of rent which actually went further than satisfying that Section.

29 The Bank further contends that Section 99(13A) cannot be relied on in relation to a tenancy which was solely created for the purpose of enabling a mortgagor, in this case the defendants, to prevent a mortgagee, in this case the Bank, of land, in this case Neuadd Goch, of obtaining possession of the freehold land. In other words, it is said that Section 99(13A) does not extend to a tenancy purely for the purpose of taking advantage of the statutory provision itself. Mr Stephen Jourdan, who appears on behalf of the defendants, rightly concedes that the only reason that the tenancy was granted, indeed the only reason that the Company was acquired by the defendants, was that it would or might enable the defendants to retain possession of their house and farm against the Bank. Assuming for the moment that the tenancy is not a sham and cannot be set aside on any other ground, it seems to be that the mere fact that it can fairly be characterised as an artificial transaction, entered only because Section 99(13A) permits it for this purpose, does not mean that the court should treat it as ineffective.

30 In the absence of a specific statutory provision to that effect, it appears to me that, as a matter or principle, it is not open to a party to challenge a transaction simply on the basis that it was entered into solely to obtain an advantage as a result of a statutory provision, and that, in the absence of the statutory provision, it would not have been possible to enter into the transaction at all. The fact that the purpose for which a transaction has been entered into can be characterised as artificial in no way invalidates the transaction, unless, of course, the transaction is actually a sham (as to which see below), but an artificial transaction is not the same as

a sham transaction or pretence (see the observations of Lord Templeman in A G Securities Limited -v- Vaughan [1990] 1 AC 417 at 462H). If transactions entered into purely for an artificial reason were ineffective for that reason, then there would be no need for the development of the jurisprudence in revenue cases such as W G Ramsay Limited -v- IRC [1982] AC 300.

31 In these circumstances, I consider that it is not open to the Bank to rely upon Clause 6 of the Mortgage as a ground for contending that it is not bound by the tenancy.

ISSUES A2 AND B5: SELF DEALING

32 On behalf of the Bank, Miss Georgina Middleton contends that, in reality, given that the defendants were the sole beneficial shareholders and the sole directors of the Company, what they have purported to do is something which the law does not recognise, namely to grant a tenancy to themselves.

33 I am prepared to accept (indeed I think it correct) that it is not open to the freeholder of land to grant a tenancy of that land to himself, save where he is acting in different capacities (e.g. he may own the freehold beneficially, and be granting the tenancy to himself as a trustee). However, it appears to me that Miss Middleton's point suffers from two incurable flaws. First, assuming that the tenancy is not a sham, it is a grant by individuals, namely the defendants, to a third party, namely the Company. The fact that the Company may be owned and controlled by those individuals does not alter the fact that it is a separate entity. As Mr Jourdan says, it is now clear that a person can grant a tenancy to a third party who holds the tenancy on bare trust for that person: see Ingram -v- Inland Revenue Commission [1992] 2 WLR 90 at 99A-E. That appears to me to be a substantially more difficult point (as is indicated by the fact that Ferris J and the majority of the Court of Appeal took the opposite view) from that which I am currently considering. In effect, Miss Middleton's argument involves piercing the veil of incorporation, and treating the interest of the Company as that of its shareholders and/or directors. I can see no warrant for that in the present case, unless it is another way of running the sham arguement.

34 Quite apart from this, even if one were to treat the tenancy as having been granted to the defendants rather than the Company, there is, on proper analysis, no identity of interest between landlord and tenant. The tenancy of the farm and of Rhostwpa would, on this hypothesis, effectively be vested in the defendants jointly. However, rather than

being vested in the defendants jointly, the landlord’s interest is severed: Mrs Jones owns the freehold of Neuadd Goch, and Mr Jones owns the freehold of Rhostwpa. Given that Mrs Jones could have granted a tenancy of Neuadd Goch to the defendants, and Mr Jones could have granted a tenancy of Rhostwpa to the defendants (particularly in light of the reasoning in Ingram [1999] 2 WLR 90, to which I have referred) it appears to me that they could join together in granting a single tenancy of the farm and Rhostwpa to themselves jointly. (Also in light of *Ingram* [1999] 2 WLR 90, the fact that Mr Jones and Mrs Jones held their respective freehold interests on trust for themselves jointly as partners in no way invalidates this conclusion).

35 Accordingly, I reject the Bank’s case on Issue A2. For the reasons set out in paragraph 33 above, I also reject the Bank’s case on Issue B5.

ISSUES A3 AND B6: THE “SHAM” ARGUMENT

Introductory

36 The Bank contends that the tenancy and the sale agreement are, on proper analysis, shams. As I have mentioned, it is conceded that the formation and acquisition of the Company, the grant of the tenancy, and the sale agreement were artificial, in that they occurred solely because the defendants wished to do their best to protect the farming business, and their home, from being taken from them and sold over their heads by the Bank. They were advised that, in light of the provisions of Section 99(13A), by setting up and acquiring the Company, and thereafter granting it a tenancy and selling it the farming assets, they could, or at least might, achieve that end. There was no other reason for the transactions.

37 It is equally clear, to my mind, that the mere fact that a tenancy, or any other contractual transaction, is entered into for such an artificial purpose, namely to avoid the contractual or statutory rights which a third party would otherwise enjoy, does not by any means of itself render the transaction a sham. The point was well put by Sir Thomas Bingham MR in Belvedere Court Management Limited -v- Frogmore Developments Limited [1997] QB 858 at 876D-F. In that case, an apparently artificial transaction entered into by the landlord of a block of flats with a Company it effectively owned significantly reduced the benefit of the rights which the tenants of the flats would otherwise have had under the provisions of the Landlord and Tenant Act 1987. The Master of the Rolls said this:

> "I share the Judge's view that these arrangements were not a sham. There was no element of pretence... The parties were not doing one thing and saying another. I would... accept the... view that the... leases were an artificial device intended to circumvent a result the Act would otherwise have brought about. But the signing of such a device did not defeat the reversioners in Jones -v- Wrotham Park Settled Estates [1980] AC 74 [a case involving the grant of what may be said to be an artificial tenancy to improve the landlord's entitlement to compensation under the leasehold enfranchisement legislation] nor the lessor in Hilton -v- Plustitle Limited [1989] 1 WLR 129 [where a prospective residential occupier was required to acquire a company for the purpose of a letting so that the landlord could avoid the rent restriction legislation] and I am for my part satisfied that in the field of real property the principles in W T Ramsay ...entitle the court simply to ignore or override apparently effective transactions which on their face confer an interest in land on the transferee. Many transactions between group companies may be artificial. That does not entitle the court in ordinary circumstances to treat such transactions as null."

38 These observations highlight a point emphasised by Mr Jourdan, namely that many artificial transactions, which are nonetheless valid, are normally rendered doubly artificial by the fact that they will involve a company itself an artificial person, whose artificiality is frequently increased, as in this case and indeed in the cases considered by the Master of the Rolls, by the fact that the company has solely been formed and acquired for the purpose of entering into the artificial transaction. Many partnerships form and own companies for tax, administrative, limited liability or other reasons, which can be said to be artificial.

39 Accordingly, while the palpable, and freely admitted artificiality of the agreements in the present case cannot be doubted, it certainly does not follow that, as a result, the agreements must be shams. However, in my judgment, that fact that a particular transaction is palpably artificial is a factor which can properly be taken into account when deciding whether it is a sham. Indeed, it would seem to me to require very unusual circumstances before the court held that a transaction which was not artificial was in fact a sham. I add this. If the court were to conclude that a transaction was artificial, in circumstances where the party relying on it was contending that it was not artificial, then that might be a further reason (although certainly not a conclusive reason) for deciding that the transaction

was a sham, given that a sham transaction involves a degree of dishonesty on the part of the parties involved. That is not the position here.

40 That a degree of dishonesty is involved in a sham is supported by what the Master of the Rolls said in the passage I have quoted, namely that "the parties [would be] doing one thing and saying another". It is also supported by the often cited definition of sham by Diplock LJ in Snook -v- West Riding Investments Limited [1967] 2 QB 766 at 802C-E:

> "It is I think necessary to consider what (if any) legal concept is involved in the use of this popular and pejorative word. I apprehend that if it has any meaning in law, it means acts done or documents executed by the parties to the sham which are intended by them to give to third parties or to the court the appearance of creating between the parties legal rights and obligations different from the actual legal rights and obligations (if any) which the parties intended to create. But one thing, I think is clear, in legal principle, morality and the authorities... for acts or documents to be a "sham", with whatever legal consequences follow from this, all the parties thereto must have a common intention that the acts or documents are not to create the legal rights and obligations which they give the appearance of creating."

41 In so far as it may be argued that, at least on one reading, Diplock LJ left open the question of whether the law recognises the concept of a sham at all, it appears to me that that point is disposed of, clearly and authoritatively by what was said in the House of Lords in AG Securities [1990] 1 AC 417, and indeed by what was decided in the appeal heard at the same time, Antonaides -v- Villiers. I refer to passages at 454E-F (per Lord Bridge of Harwich, who described a provision in the agreement as "an attempt to disguise the true character of the agreement which it was hoped would deceive the court"), 462F-H and 463D-G (per Lord Templeman, who used the words "sham" and "pretence"), 470A-B (per Lord Oliver of Aylmerton) and 475F and 476H-477A (per Lord Jauncey of Tullichettle).

42 AG Securities [1990] 1 AC 417 also established that, when considering whether a transaction is a sham, the court is not restricted to considering activities which took place before or at the time of the transaction: it is perfectly proper to consider how the parties subsequently acted. In AG Securities [1990] 1 AC 417 at 475E-F, Lord Jauncey said that the defendants contended that:

> "[A] lthough the subsequent actings of the parties may not be prayed in aid for the purposes of construing the agreements they may be looked at for the purpose of determining whether or not parts of the agreement are a sham in the sense that they were intended merely as "dressing up" and not as provisions to which any effect would be given."

It is clear that Lord Jauncey accepted that contention, because he said at 476G: "When subsequent events are looked at the matter becomes even clearer".

43 The same view was taken by Lord Oliver of Aylmerton (with whom Lord Ackner expressly agreed - see at 466E) at 469C:

> "[T] hough subsequent conduct is irrelevant as an aid to construction, it is certainly admissible as evidence on the question of whether the documents were or were not genuine documents giving effect to the parties' true intentions."

Lord Templeman (with whom Lord Ackner also agreed) concurred. At 463G, he referred "finally and significantly" to the fact that the right granted by the provision in question had never been exercised as a reason for concluding that the provision was a sham (or, as he preferred to put it, a pretence).

44 Mr Jourdan contends that the Bank's argument is self evidently wrong, because the reason it puts forward for saying that the agreements are artificial is the very reason why the defendants must have intended them to be genuine: only if the agreements were genuine do they achieve (albeit artificially) the result which the defendants intended. If the whole basis for entering into the agreements was that they must be effective, then, argues Mr Jourdan, they can scarcely be characterised as shams.

45 That is an attractive argument, but I do not accept it. If it were right, then no arrangement could ever be held to be a sham. For instance, in AG Securities, the provision which was held to be sham by the House of Lords was included by the landlord in order to evade the rent restriction legislation; on Mr Jourdan's argument, as the very reason for including that clause was that it should be implementable for the artificial purpose of avoiding the rent restriction legislation, it must have been genuine. In my judgment, the whole point of a sham provision or agreement is that the parties intend to give the impression that they are agreeing that which is stated in the provision or agreement, while in fact they have no intention of

honouring with their respective obligations, or enjoying their respective rights, under the provision or agreement.

46 Thus, in the present case, provided the Bank or the court accepts that the agreements are genuine, then (subject to any other point) the defendants have achieved their aim: it is not of the essence that the agreements are genuine, merely that they are accepted as genuine. Of course, having made that point, one should not lose sight of the fact that there is obviously a strong presumption, even in the case of an artificial transaction, that the parties to what appear to be perfectly proper agreements on their face, intend them to be effective, and that they intend to honour and enjoy their respective obligations and rights. That that is so is supported by the fact that an allegation of sham carries with it a degree of dishonesty, and the court should be slow (but not naively or unrealistically slow) to find dishonesty.

The arguments on the sham issue

47 In summary, Miss Middleton relies upon the following factors to support the contention that the tenancy and sale agreements are shams:

1 The sole purpose of the agreements was to ensure that the defendants remained in possession of the farm and retained control over their home and business, by defeating the Bank’s otherwise indisputable right to obtain possession, and to sell the farm and the farming assets over their heads;

2 The defendants imposed obligations under the agreements on the Company, in particular payment of rent and performance of the repairing covenants under the tenancy and payment of the annual instalment under the sale agreement, with which the Company could not comply and had no intention of complying;

3 The defendants had no intention of enforcing the Company’s obligations under the agreements and, in particular, of forfeiting the tenancy or putting the Company into liquidation: quite apart from anything else, that would have been quite contrary to the whole purpose of the agreements;

4 Given that it is permissible to look at events subsequent to the agreements, none of the rent or instalments due from the Company has been paid, and no steps to enforce payment have been taken by the defendants;

5 Ultimately, the agreements were entered into with a view to reaching a settlement with the Bank, whereupon they would have been put aside;

6 The sham nature of the agreements is demonstrated by the fact that Mr Jones had no idea whatever as to the level of rent under the tenancy or the level of instalments under the sale agreement; nor did he have any idea as to when those payments were due;

7 The agreements were arrangements which no sensible person in the position of the defendants would have entered into, save for the purpose of improving their position as against the Bank.

48 To an extent, but only to an extent, it appears to me that the factual basis for these contentions is made out. As I have mentioned, Mr Jourdan accepts that the sole purpose of entering into the agreements was to protect themselves against the Bank and, I believe, to improve their negotiating position with the Bank. As to the Company’s ability to meet its liabilities under the tenancy and the sale agreement, I think the position was as follows. First, the defendants never really considered that aspect, in the sense that any landlord or tenant (in relation to the tenancy) or vendor or purchaser (in relation to the sale agreement), entering into the agreements in normal circumstances, would have done. The aggregate of the yearly rent due under the tenancy and the annual instalments under the sale agreement appears to have been a little greater than the yearly amount of interest alone due from the defendants to the Bank. Given that the defendants were having difficulties even meeting their interest payments, and that the rate of interest could well increase, whereas the rent under the tenancy could not alter for five years, and the instalments under the sale agreement would not alter at all, Miss Middleton contends that there would have at least been scepticism, and more realistically pessimism, as to the ability of the Company to meet its obligations under the agreements.

49 Although I accept that Mr Jones had some input into the discussion as to the rent per acre that might be appropriate for the purpose of fixing and assessing the initial current rent under the tenancy, he did not think that the overall current rent, let alone the base rent, were matters of any significance; indeed, it is quite conceivable that he was never told what the levels of base rent, current rent, or instalments were. At any rate, if he was told, he thought that they were matters of such little importance that he did not take them in. It was clear from his evidence not merely that he did not know the

level of rent and instalments, but he had no idea whether they were to be measured in hundreds of pounds, thousands of pounds, or tens of thousands of pounds. He also had no idea when the rent or the instalments fell due.

50 However, the defendants did have material to enable them to consider whether the Company would be able to meet its obligations under the agreements. First, the aggregate amounts of rent and instalments were pretty similar to the interest liability which the defendants had to meet, and it is by no means clear that the defendants could not have reasonably taken the view that the Company would stand no reasonable chance of being able to pay the rent and instalments under the agreements, which in turn would enable the defendants to meet their obligations to the Bank, at least so far as the interest on their outstanding debt was concerned. Bearing in mind the bad state of the stock farming industry, and the poor outlook for that industry, that view would have been optimistic, but not ridiculously so, at spring 1999. Further, by the time the agreements were entered into, the defendants had taken professional advice. Mr Jones of FUW had prepared projections for the farming business, incorporating improvements which had been suggested by those advising the defendants, and figures were later prepared for the defendants’ IVA proposals. Both sets of figures give some support for the contention that a reasonable person in the defendants’ position could have believed that, if it took over the farming business on the terms set out in the agreements, the Company could well be able to meet its liability for the rent and the instalments. Nonetheless, those projections, and indeed the figures put forward in the IVA proposals, gave no cause for optimism. Certainly, I am satisfied that they would not have suggested that the farming business would be sufficiently viable to satisfy a Bank asked to provide finance. However, the question of whether the Company could, or would be likely to meet its obligations under the agreements was not something which I think that the defendants themselves directly considered; it does not appear that the projections were prepared for that purpose. However, it seems clear that some consideration was given to that point by the defendants’ advisers, UK Mortgages and Mr Sanders, at least to the extent of stepping the base rent.

51 The sham or pretence of the agreements can fairly be said to be supported by the fact that now, more than a year after the agreements were entered into, the Company has failed to pay any of the rent due under the tenancy, or any part of the first instalment due under the sale agreement. Further, no step whatever has been taken by the defendants to seek to recover these sums, or to enforce their rights

to recover these sums, as almost any landlord or vendor would do in normal circumstances.

52 However, there are two points which should be made. The first is a point of evidence, the second a point of principle. The first point is that the farming business carried on by the Company may well have been significantly less profitable than would have been expected, because of the involvement of the Receivers and because of the injunction which the Bank obtained. I took the view that it would have been an unjustifiable waste of court time and of costs to hear evidence and argument as to whether, and if so to what extent, the involvement of the Receivers and the existence of the injunction resulted in the business being less profitable than it otherwise would have been had there been. The issue would have required consideration of fairly detailed allegations by the defendants as to the effect of the injunction and the allegedly unreasonable and unhelpful activities of the Receivers, and counter-allegations by the Bank as to the way in which Mr Jones conducted the farming business. There would have been significant cross examination on the issues of at least two witnesses, Mr Jones and one of the Receivers, as well as poring over records of the way in which the Company had carried on the farming business from the beginning of May 1999; in addition, as I see it, it may also have required some input from the expert witnesses.

53 That brings me to the second point, namely the usefulness of such evidence. The ultimate question in this connection is not what happened after April 1999: it is what should or could have been known or anticipated or at April 1999. An analysis of the events after April 1999 is of little evidence (and may well be inadmissible) to the issue of what would or could reasonably have been anticipated in April 1999. In any event, I regard it as self evident that the existence of the present litigation, the existence of the injunction, and the involvement of the Receivers must, at the very least, have taken up significant amounts of time on the part of Mr Jones. Consequently, he was unable to put all his efforts and concentration into the running of the agricultural business, and it seems to me inevitable that this must have affected the profitability of the business. Accordingly, without reaching any conclusion as to the specific effect of the injunction, the appointment of the Receivers, or indeed this litigation, let alone as to the reasonableness or otherwise of the conduct of the Receivers, it appears to me self evident that the agricultural business will have been less effectively, and therefore less profitably, run over the past year, than would have been the case if there had been no injunction, no Receivers, and no litigation. In any event, it seems clear that the business has been substantially

less profitable than anticipated in April 1999.

54 Nonetheless, it remains the case that no attempt whatever appears to have been taken by the Company to pay any part of the rent due under the tenancy or any part of the first instalment due under the sale agreement, and no thought whatever appears to have been given by either of the defendants, as the controllers of the Company, as to what should be done about this. Equally, the defendants have taken no steps whatever in their capacity as landlords and vendors to enforce their rights.

55 In almost every normal case, a landlord’s primary interest is that he should receive the rent under the tenancy, and it is, to put it mildly, an unusual landlord who is wholly unaware of the level of rent and when that rent it is due. In a normal case, a landlord who does not receive his rent will at least consider exercising either of his two main consequential rights, namely forfeiture or insolvency proceedings against the tenant. Although the tenancy contained a forfeiture proviso, there can have been no real intention on the part of the defendants to forfeit the tenancy if the rent was not paid (or, if the tenant’s covenants were not observed). The whole point of creating the tenancy was to place an impediment in the way of the Bank obtaining possession of the defendants’ home, and the property where they carried on their agricultural business. The alternative course of winding up the Company would be almost equally fanciful in the present case. The current rent payable under the tenancy is, on the evidence, marginally above the market rental value, and there is the base rent payable in addition. Accordingly, the overwhelming likelihood would have been that the liquidator would have disclaimed the tenancy pursuant to Section 178 of the Insolvency Act 1986. It is right to say that I do not consider that the defendants, or probably even their advisers, gave any thought before or after 27th April 1999 to the possibility of forfeiting the tenancy or winding up the Company, but, had they done so, either at the time the tenancy was granted or during the currency of the tenancy, they would not have expected to invoke either procedure.

56 Further, I regard it as likely that if the defendants and their advisers had negotiated terms of settlement with the Bank (as Mr Phillips was seeking to do in March and April 1999), it would have involved the defendants raising a substantial sum from a third party to pay off the Bank. Indeed, it is clear from correspondence that this is what UK Mortgages were seeking to do on behalf of the defendants. The third party would obviously have required security from the defendants, and the security would no doubt have been the

farm and the farming assets. It is, I suppose, conceivable that the defendants and the third party would have been happy to keep the tenancy and sale agreement in place, always provided that the Company joined in any charge of the farm and the farming assets, but it appears to me that it would have been far more likely that, once the Bank had agreed terms, the tenancy and the sale agreement would effectively have been forgotten.

57 However, it is not as if any subsequent abrogation (to use a neutral word) of the tenancy and the sale agreement would automatically mean that they were shams. Although one could, in effect, tear them up (which might tend to support the view that they were always shams), it would be equally possible for the Company and the defendants to enter into a deed of surrender of the tenancy, and to enter into a sale back agreement in relation to the business assets. In any event, there is no evidence to suggest that the defendants’ advisers, let alone the defendants themselves, thought about this aspect at all.

58 So far as other changes are concerned, it does not appear that anything altered so far as activities on the farm were concerned: the defendants continued to live in the house and Mr Jones continued the business on the farm. However, as Mr Jourdan points out, this is not a case where nothing changed after the allegedly sham arrangement was entered into: in other words, it cannot be said that the only indication that the Company was involved with the farm business were the two paper transactions now attacked as shams. The defendants and the Company instructed accountants that the agricultural business was to be carried on through the Company, and the accountants have been instructed to prepare annual accounts for the Company. The Company opened a bank account with the Halifax Building Society, albeit only in July 1999. The Company has bought and sold stock, and purchased feed, hay and fertiliser (albeit that in some cases Mr Jones’s name appeared on the invoices). It has entered into a finance agreement relating to farm machinery (namely a tractor, a bailer and a wrapper) and purchased a Land Rover. It has had transferred to it the quotas formerly vested in the defendants, and has submitted an IACS return; it has claimed beef, and suckle cow, special premiums, and beef slaughter scheme payments. It has taken out an insurance policy in respect of the farm, and is in the process of having its VAT registration completed. Mr Jourdan accepts that these activities could have been undertaken in order to make a sham transaction look more convincing, but, when a transaction is under challenge, he says that the more that the parties to it have acted as if it was genuine, the more difficult it is to conclude that it was a sham.

Conclusion on sham

59 In one sense, lawyers find it difficult to grapple with the concept of sham, presumably on the basis that, subject to questions of mistake (which can give rise to rectification or rescission), there is a very strong presumption indeed that parties intend to be bound by the provisions of agreements into which they enter, and, even more, intend the agreements they enter into to take effect. The difficulty is perhaps illustrated by the way in which Diplock LJ expressed himself in Snook ("what (if any) legal concept is involved" and "if it has any meaning in law") and the fact that Lord Templeman found it necessary to reformulate the concept in AG Securities (where at 462H, having referred to his formulation of "sham devices and artificial transactions" in an earlier case, he said it would have been better if he had used the word "pretences"). A sham provision or agreement is simply a provision or agreement which the parties do not really intend to be effective, but have merely entered into for the purpose of leading the court or a third party to believe that it is to be effective. Because a finding of sham carries with it a finding of dishonesty, because innocent third parties may often rely upon the genuineness of a provision or an agreement, and because the court places great weight on the existence and provisions of a formally signed document, there is a strong and natural presumption against holding a provision or a document a sham. The fact that a document creates a tenancy, which is an estate in land, does not make it inherently more difficult to conclude that it is a sham: if the contract itself is a sham, then no tenancy can be created by it. However, a tenancy is a document which is particularly likely to be relied on by third parties (e.g. mortgagees and sub-tenants) which explains the court's reluctance to hold a tenancy to be a sham (see the observations of Sir Thomas Bingham in Belvedere [1997] QB 858 cited above).

60 However, I would suggest that the possible prejudice of innocent third parties who have relied on the document or the provision should not stand in the way of the court concluding that the document is a sham as between the parties thereto and as against a party who claims to be prejudiced thereby (and particularly the party against whom the sham is directed, if I can put it that way). If a tenancy agreement is a sham, and an innocent third party accepts it as security for a loan to the tenant, then it seems to me that the third party is entitled to treat the tenancy in existence as against the landlord and as against the tenant: it can scarcely lie in the mouth of either of them to contend that the tenancy agreement does not exist as against the mortgage in such circumstances. However, difficulties could arise

where the interest of one innocent party, who contends that the agreement is a sham, clash with the interests of another innocent party, who contends that it is genuine. That is a problem which will have to be considered if and when it arises. In the present case, there is no reason to think that the problem would arise: it is clearly in the Bank’s interest that the agreements are held to be a sham, and if any third party wishes to contend otherwise, then its claim would have to be considered in due course.

61 I accept that the agreements were highly artificial transactions for the reasons advanced on behalf of the Bank. So far as the sale agreement is concerned, I accept that it is most unlikely that anyone would sell valuable assets to an entity such as the Company, with no cash and no valuable assets (other than the tenancy which was at a rent in excess of the market value, and the farming assets themselves), on the basis that there would be no payment until the end of the first year, and thereafter payment would be by instalments over 20 years, without any security whatever being afforded to the vendor. Yet that was the position under the sale agreement. So far as the tenancy is concerned, it is most unusual for a tenancy to be granted at a rent significantly in excess of the market rent (i.e. at a rent including the base rent in the present case) particularly to a company with no significant property (other than the assets, in respect of which it had taken on a substantial liability under the sale agreement). However, the defendants, as vendors and landlords, did not really suffer because they were the sole owners of the purchasing Company. While that emphasises the artificiality of the transaction, these points do not render the agreements shams: they merely emphasise their artificiality.

62 The fact that Mr Jones, one of the two landlords under the tenancy, one of the two vendors under the sale agreement, and one of the two owners and directors of the tenant and the purchaser, did not know anything about the level of rent under the tenancy or instalments under the sale agreement, and did not know when any of those sums were payable, is of some significance. If he did not know, then I think Mrs Jones, the other landlord/vendor and director/shareholder of the tenant/purchaser would not have known either: it was Mr Jones who was much more closely involved in the business, and indeed it was he who was involved in the negotiations with UK Mortgages and the Bank.

63 Mr Jourdan contends that laymen, particularly relatively unsophisticated laymen, often form companies and enter into agreements which their advisers recommend, without appreciating the details, or even, often, the nature or terms of those of the agreements. An

obvious example is where parties enter into a complex series of agreements in order to avoid tax; subject to the principles laid down in cases such as Ramsay, the mere fact that the parties concerned may not understand the nature of the agreements they have entered into, and may not understand what rights and obligations those agreements give rise to, does not make the agreement shams. I agree with that contention, at least to this extent: in such a case, it can be said that, even though they do not know the effect of the agreements they have entered into, and may now know what rights and obligations arise as a result of such agreements, the parties are intending to enter into them and intending to be bound by them, in the sense that they are trusting their advisers. The transactions are genuine, because the parties are proceeding on the basis that, to the extent that they do not appreciate the effect of the arrangements they are entering into, they are happy to trust their advisers. Indeed, experience suggests that many reasonably sophisticated persons enter into complex agreements (such as commercial leases) without appreciating the terms and effect, or indeed even the existence, of many comparatively important provisions in the agreement. They are prepared to trust their advisers.

64 Particularly in light of the observations in AG Securities [1990] 1 AC 417, the fact there were no steps taken in connection with paying what was due (by the Company) or in connection with enforcement (by the defendants) under the agreements, is understandably relied on by the Bank on the issue of sham. There is no suggestion that any thought was given by the defendants or the Company to any of their respective rights or obligations under either of the agreements. However, the appointment of the receivers, the injunction, this litigation and a poorer economic climate for stock farming than had been anticipated by the defendants’ advisers in April 1999, provide a plausible explanation for this. It is quite possible that, had these things not arisen and resulted in substantial pressure, in terms of emotion, time, and finances on the defendants, the rent and instalments, or at least some part of them, would have been paid. After all, one way or another, the defendants needed the money due from the Company under the agreements in order to pay the interest due to the Bank.

65 If, in the present case, it had been established that, for instance, Mr Phillips had told the defendants that the agreements would be entered into purely for the purpose of negotiating terms with the Bank, and that the agreements would thereafter be abandoned, there would be a more powerful argument for saying that the agreements were shams. While it may well have been in the mind of UK Mortgages that, if terms could be successfully negotiated with the Bank, the

agreements would effectively be torn up, there are two reasons why, in my judgment, it would not establish the allegation of sham. First, the furthest I am prepared to go on the evidence is that UK Mortgages may have had that in mind as one possibility; they may also have had in mind other possibilities, such as maintaining the agreements for the very purpose for which they are now being invoked by the defendant, namely as a means to stave off a claim for possession. Miss Middleton very fairly did not seek to rely on the fact that no representative of UK Mortgages was called to give evidence: the contention that the agreements were shams was one of the issues which the Bank raised only at the last minute by way of amendment. Secondly, even if the attitude of UK Mortgages to the agreements would have helped the Bank’s case on sham, there is no evidence that it was communicated to the defendants, and, in the end, it is with the attitude of the defendants and the Company with which I am primarily concerned. Having heard Mr Jones give evidence, I have no reason to think that, whether in his capacity as landlord and vendor, or in his capacity as director of the tenant and purchaser, he had any intention other than genuinely to enter into the agreements. I am satisfied he did not appreciate or understand the details of the agreements. However, he appreciated that he and his wife were granting a tenancy for 20 years of the farm to the Company, that they were selling the farming assets to the Company, and that the purpose of the agreements was to improve their position as against the Bank.

66 The defendants gave no consideration to the financial terms of the agreements or the ability of the Company to meet its obligations to the vendor. However, their advisers did so, as is evidenced, in particular, by the fact that the base rent was stepped, as I have mentioned: the only reason for stepping the base rent was to reduce the initial financial burden on the Company. Further, there were two sets of figures (Mr James’s of the Welsh Farmers’ Union and Mr Weisgard; for the IVA proposals) which suggested that the Company could well be able to meet its obligation under the agreements. So far as the position after the agreements is concerned, the defendants steps in relation to third parties, such as accountants, suppliers, Government agencies and the like which were consistent, and only consistent, with the Company having taken over the farming business. Even taken together, these points are not conclusive against sham, but they render the sham argument obviously more difficult to maintain.

67 On the other hand, the fact that no attempt whatever appears to have been made on the part of the Company, to pay any of the sums due under the agreements, or, on the part of the defendants, to enforce such payments, is, on the face of it, a powerful point in favour of the

sham argument. However, unlike in AG Securities [1990] 1 AC 417, I do not consider that it is a very telling point here. First, in AG Securities [1990] 1 AC 417, there were no reasons for thinking that the provision in question was a sham in any event; there is no reason to think in the present case that the obligations of the Company under the agreements to make payments to the defendants were not intended to be operated. As I have mentioned, the defendants needed monies to pay interest to the Bank, and, apart from Mrs Jones's income as a teacher (which was not very substantial) the defendants' only real source of income would have been under the agreements. Secondly, unlike in AG Securities, there are plausible reasons, which were not anticipated when the agreements were entered into, as to why the payments were not made, namely an inherently less profitable business than expected, and the effect of the injunction, the receivership, and these proceedings.

68 In these circumstances, I have reached the conclusion that neither of the agreements was a sham. Each of them was an artificial transaction, and the points relied on by Miss Middleton serve to emphasise the extent of the artificiality. Both principle and the authorities indicate that the court is slow to find that an agreement is a sham, and that, before the court can reach such a conclusion, it must be satisfied that the purported agreement is no more than a piece of paper which the parties have signed with no intention of its having any effect, save that of deceiving a third party and/or the court into believing that the purported agreement is genuine. Taking all the evidence together, I think that the Bank has plainly fallen short of discharging the onus, which it undoubtedly has, of establishing that either of the agreements was a sham.

ISSUES A4 AND B7: SECTION 423 OF THE 1986 ACT

The approach of the court under Section 423

69 Section 423 of the 1986 Act provides:

> "(1) This section relates to transactions entered into at an undervalue; and a person enters into such a transaction with another person if-
>
> > ...
> > (c) he enters into a transaction with the other for a consideration the value of which, in money or money's worth, is significantly less than the value, in money or money's worth, of the consideration provided by himself.
>
> (2) Where a person has entered into such a transaction, the

court may, if satisfied under the next sub-section, make such order as it thinks fit -

(a) restoring the position... and

(b) protecting the interests of persons who are victims of the transaction.

(3) In the case of a person entering into such a transaction, an order shall only be made if the court is satisfied that it was entered into by him for the purpose-

(a) of putting assets beyond the reach of a person who is making, or may at some time make, a claim against him, or

(b) of otherwise prejudicing the interests of such a person in relation to the claim which he is making or may make."

70 In order to satisfy Section 423, it must be shown that a transaction was entered into "at an under value" within Section 423(1), and that the transaction was entered into for one or more of the purposes set out in Section 423(3). In the present case, Mr Jourdan unsurprisingly does not challenge the Bank's contention that the purpose of the defendants in entering into the agreements was for a purpose falling within Section 423(3). The point which divides the parties is whether the grant of the tenancy and the sale agreement (whether viewed as a single composite transaction or as two separate transactions) constituted a sale at an under value.

71 Mr Jourdan's first contention on behalf of the defendants is that it is unnecessary to consider the terms of the agreements, because, when considering whether they were transactions at an under value from the point of view of the defendants, one should look at the position of the defendants as a whole, rather than merely in their capacity as owners of the farm and the assets. Before the agreements were entered into, the defendants owned the freehold of the farm and the farming assets, subject only to the Bank's mortgage and charges. After the agreements had been entered into, the fact (if it is a fact) that, in their capacity as freeholders of the farm and owners or former owners of the farming assets, the defendants were less well off, says Mr Jourdan, is irrelevant. To the extent that their interests as freeholders and as owners of the farming assets were diminished as a result of the agreements, the defendants made a corresponding gain in their capacity as shareholders in the Company. In other words, their loss as owners of the farm and assets was effectively matched by their gain as a result of the Company receiving a corresponding benefit, which they, as the sole shareholders in the Company, effectively received.

72 Although I see the force of that argument, I reject it. First, it does not seem to me to accord with the language of Section 423. Secondly, I do not consider that it accords with the purpose of Section 423. So far as the language is concerned, Section 423(1)(c), the relevant paragraph of Section 423(1) for the purpose of these proceedings, refers to "a transaction... for a consideration". As a matter of ordinary language, it appears to me that the "transaction" or "transactions" in the present case was or were the tenancy and the sale agreement entered into between the defendants and the Company. I do not think that the acquisition of the Company could be said to be part of the "transaction" under consideration in the present case; the acquisition of the Company could no doubt be a transaction for the purpose of Section 423(1), but it seems to me that it was a separate transaction from the tenancy and the agreement, not least because it was entered into between the defendants and third parties and related to the Company as the subject matter of that transaction, whereas the transaction or transactions under attack in the present case consist of the tenancy and the sale agreements entered into between the defendants and the Company itself.

73 At first sight, it might be said that Mr Jourdan's argument accords more with the purpose of Section 423: after all, if the overall asset position of the debtor is not reduced as a result of a particular transaction, it can be said with some force that his creditors as a whole will be no worse off, and that therefore the legislature cannot have intended the court to be able to set aside such a transaction. However, it seems to me, by referring to "a person" in Section 423(3)(a)(b), the legislature has made it clear that the Section is not intended to be confined to transactions which may prejudice the body of creditors as a whole: it can be invoked in a case where a single creditor is the intended victim of the transaction. In the present case, other creditors of the defendants may have benefited from the tenancy and the sale agreement, but the question which has to be considered is whether a creditor, in this case the Bank, was a person to whose prejudice the transaction was, as it were, aimed.

74 In this connection, I think it is worth bearing in mind that, if it is established that a transaction satisfies the requirements of sub-sections (1) and (3) of Section 423, the court has a very wide discretion as to the appropriate court to take: see sub-section (2). In my judgment, in an appropriate case, even where the two requirements of Section 423 are satisfied, the court does not have to restore the position to what it was before the transaction was entered into, or otherwise protect the victims. No doubt, in the majority of

cases that may be the appropriate course, but in some circumstances another, less radical, solution may be appropriate, and, indeed, in an unusual case the court might decide that nothing need be done.

75 Having rejected Mr Jourdan's first point, I must turn to consider whether the tenancy and/or the sale agreement were at an under value. In this connection, the onus is plainly on the bank to establish that Section 423(1) is satisfied. The leading case on Section 423, which involved facts close to those in the present case, is Agricultural Mortgage Company plc v Woodward [1995] 1 BCLC 1. In that case, the Court of Appeal left open the question whether "mere detriment to the person entering into the relevant transaction [sc. the defendants in this case] unaccompanied by corresponding benefit to the other party [could] properly be treated as part of the consideration provided by such person for the purpose of applying the s.423(1)(c) unless the occurring of the detriment is actually part of the bargain, as opposed to being merely an incidental result of the transaction" - see per Sir Christopher Slade at 10e. It was unnecessary to decide the point, because the Court of Appeal concluded that the transaction in that case fell foul of Section 423 as it conferred a benefit on the other party to the transaction (sc. in the present case, the Company) for which the other party did not provide consideration. I will not decide that point either (unless I need to do so) but it is fair to say that my rejection of Mr Jourdan's first contention in relation to Section 423, which I have just been considering, tends to suggest a negative answer to the issue raised by Sir Christopher Slade.

76 In Woodward [1995] 1 BCLC 1, the freeholder of a farm granted a tenancy of the farm to his wife at full market rent, and the mortgagee sought to set aside on the basis that it contravened Section 423. The Court of Appeal held that the fact that a full market rent was paid did not take the tenancy out of Section 423, because, in addition to obtaining the right to occupy the farm for agricultural and other purposes, for which she paid a full rent, the wife also obtained (according to Sir Christopher Slade at 10g-h):

> "the threefold benefits of safeguarding the family home, enabling her to acquire and carry on the family farming business and a surrender value. Furthermore, and most significantly, the transaction, if effective, placed her vis-à-vis [the mortgagee] in... a "ransom" position. If the tenancy was effective, [the mortgagee] would have had to negotiate with and no doubt pay a high price to her before it could obtain vacant possession of the farm and sell it for the purpose of enforcing its security in repaying the debt owed to it by the [husband mortgagor]".

77 With the benefit of this decision and reasoning, those advising the defendants in the present cast drafted the tenancy on the basis that it did not merely reserve the open market rent of the property (namely the ordinary rent) but also the base rent. The base rent is said to represent a payment by the Company to the defendants primarily for the benefit of obtaining the surrender and/or ransom values referred to in the judgment of Sir Christopher Slade. So far as the benefit of owning the farming business is concerned, the Company in the present case (unlike the wife in Woodward) [1995] 1 BCLC 1, entered into the sale agreement, which involves the paying of substantial sums for all the assets of the business.

"Significantly less" in Section 423

78 When considering whether the consideration received by the defendants was "significantly less" than the consideration passing the other way, Mr Jourdan contends that the court should assess the consideration by reference to a band of values, and then ask oneself whether what was actually received was "significantly less" than the bottom end of the band. In that connection, he relied on Lord Hoffmann's speech in South Australia Asset Management Corporation -v- York Montague Limited [1997] AC 191 at 221F-G. When discussing how the court should approach the question of whether a particular valuation had been negligent, Lord Hoffmann said this:

> "The valuer is not liable unless he is negligent. In deciding whether or not he has been negligent, the court must bear in mind that valuation is seldom an exact science and that within a band of figures valuers may differ without one of them being negligent."

79 While I accept that the concept of a band or range of values is a useful guide, and may indeed normally embody the right approach, to determine whether a valuer has been negligent, I do not think that it is of assistance in the present case. As Lord Hoffmann went on to say at [1997] AC 221G-H:

> "[O]nce the valuer has been found to have been negligent, the loss for which he is responsible is that which has been caused by the valuation being wrong. For this purpose the court must form a view as to what a correct valuation would have been. This means the figure which it considers most likely as a reasonable valuer... would have put forward as the amount which the property was most likely to fetch itself upon the open

market.”

80 In a case where the court has to ask itself whether a transaction has taken place at an undervalue within Section 423(1)(c), I believe that the court has to form a view as to the price which the property would have fetched in the open market, which is the same as effecting “a correct valuation”. First, in so far as the observations of Lord Hoffmann are applicable to case such as this, it appears to me that the issue is closer to that of assessing damages in a negligent valuation case, than it is to assessing whether or not negligence has occurred. Secondly, it seems to me that a closer analogy is to be found in a recent decision of the Court of Appeal in Skipton Building Society -v- Stott [2000] 2 All ER 779, where the issue was whether a mortgagee had sold at an undervalue, and if so what the damages should be. Evans LJ (with whom Potter LJ and Alliott J agreed) said this at 783C-D:

> “The evidence enabled the Judge to assess what the market value was, and that figure would correspond with the price that could be expected to be achieved, given exposure to the market for a reasonable time. The question, what the figure was, was an issue of historic fact which had to be established on the evidence...”

81 Thirdly, I consider that Mr Jourdan’s approach would be too generous to a person in the defendants’ position. Section 423(1)(c) only applies where the consideration is “*significantly* less” than the value of what has been transferred. To my mind, the defendants would effectively be having their cake and eating it, if they could argue that the value of what had been transferred has to be assessed by reference to the bottom of the permissible band, and even if the consideration is below the bottom of that band, Section 423 will still not apply unless one is significantly below the bottom of the band.

82 In effect, it may well be that, in many cases, the band of values referred to by Lord Hoffmann would be very similar to the band of values within which the consideration could fall without being “significantly” more or less than the value arrived at by the court, which, as Lord Hoffmann went on to point out at [1997] AC 221H to 222A, will be the middle of the band. However, I must emphasise that there is no necessary equivalent between a band of values within which a surveyor may not be negligent, and a band within which a transaction would not be significantly higher or lower than the actual value of the asset concerned.

83 More generally, whether a transaction was for a consideration "significantly less" than the value of the consideration provided must depend on the figures in the particular case. Of course, the exercise to be carried out by the court will involve comparing actual figures - i.e. the consideration and the value. It will also involve the court considering, in percentage or proportionate terms, how much less the consideration is than the value. It may well be right also to take into account the shortfall in absolute terms.

The tenancy

84 The question which has to be considered is whether the value of the consideration provided by the Company for the grant of the tenancy was "significantly less than the value, in money or money's worth" than the benefits obtained by the Company from the grant of the tenancy (applying the relevant words of Section 423(1)(c) to the test approved by the Court of Appeal in Woodward). In this connection, as in Woodward, the benefit conferred on the Company as tenant can be divided into two parts. First, there is the right to occupy the property as a tenant; secondly, there is a parcel of incidental rights, including the surrender and ransom values (but it is to be noted that, unlike in Woodward, where the tenant was the wife of the farmer, the tenant has not been given the additional benefit of the right to remain in the family home). So far as the ordinary rent is concerned, this case essentially mirrors Woodward: the tenancy is said by the defendants to be a rent which reflects the ordinary right of a tenant to occupy the farm, that is, that the ordinary rent is the full open market rent. Unlike in Woodward [1995] 1 BCLC 1, however, the defendants are able to say that some consideration was paid in respect of the additional bundle of rights, namely the surrender and ransom values. It is on that which Mr Jourdan, on behalf of the defendants, fastens, in order to contend that the terms of the tenancy in the present case were such that, unlike in Woodward, it does not fall foul of Section 423 (1)(c).

85 I accept that the ordinary rent of £17,420 p.a., subject to review every five years, was, in light of the terms of the tenancy, the open market rental of the property as at 27th April 1999, as indeed I have already indicated when considering Section 99 (6) of the 1925 Act. In this connection, I heard evidence from Richard Williams BSc FRICS, a partner in RG & RB Williams of Ross-on-Wye, on behalf of the Bank, and Mr Michael MV Taylor BSc FRICS, a partner in the firm of Barbers of Market Drayton, on behalf of the defendants. Mr Williams put the open market rental value of the property as £15,000 p.a., whereas Mr Taylor considered that it was £16,900 p.a. There is not much difference

between these two figures, and, rightly, neither Mr Jourdan or Miss Middleton saw any need for much cross examination on the issue. In my judgment, Mr Taylor's figure of £16,900 p.a. is to be preferred. He appeared to give the question of the rental valuation rather closer attention than Mr Williams, and he provided a more detailed breakdown of his figures than Mr Taylor. Furthermore, it is not, I think irrelevant to take into account the fact that the valuation put on the farm by Mr Sanders was £17,420 p.a., and he considered that point with a certain amount of care. He struck me as a competent valuer. Although April 1999 is not a very long time ago, it is fair to say that he was carrying out a contemporaneous rental valuation, whereas Mr Williams and Mr Taylor were not.

86 In these circumstances, I consider that the open market rental value of the farm was £16,900 p.a. as at 27th April 1999. It therefore follows that so far as the first, and more traditional, component of the benefits granted to the Company under the tenancy was not provided at a significant undervalue: indeed, it was provided, in my judgment, at a little of an overvalue, namely £520 p.a.

87 The base rent of £1,000 p.a. (rising after five years to £4,276 p.a.) was intended to be the consideration payable by the Company for the benefit of being granted the surrender value and/or ransom value inherent in the tenancy. The surrender value of a tenancy arises from the fact that the value of a freehold subject to a tenancy is normally less than the value of the freehold with vacant possession: accordingly, if the landlord wishes to sell the freehold, it is worth his paying something to the tenant in order to obtain vacant possession. The ransom value arises from the fact that the value of the freehold with vacant possession is normally worth more than the aggregate of (1) the value of the freehold subject to the lease and (2) the value of the lease; this difference, often known as "the marriage value" can only be realised by the joint efforts of the landlord and the tenant.

88 The freehold value of the farm with vacant possession, if marketed on a prudent, as opposed to a forced sale, basis (i.e. the open market value) is agreed between Mr Williams and Mr Taylor as being £401,000. On behalf of the defendants, however, Mr Taylor said that, if the farm was being sold on a forced sale basis, it would only fetch around £341,000. It would seem, on Mr Taylor's evidence, that a forced sale basis could involve a marketing period of three months, but Mr Williams expressed the view that, if that was the marketing period, he saw no reason to depart from the figure of £401,000. The open market value of the farm subject to the tenancy at £17,420 p.a. was assessed

at £306,000 by Mr Taylor (although he produced an alternative valuation of £322,000) and at £257,187 by Mr Williams (although he said that he thought it would actually fetch only £200,000).

89 When considering the question of the benefit to the Company of having the surrender or ransom value, it seems to me that one should approach the matter by reference to the position as it actually was on 27th April 1999, and not by reference to hypothetical facts. As at April 1999, the Bank had an unanswerable claim to possession of the farm as against the defendants, in light of the terms of the mortgage, and the Bank was shortly intending to issue possession proceedings against the defendants unless they made a proposal acceptable to the Bank, which they had no realistic prospect of doing. The Company’s negotiating position would have been quite strong. The amount owing to the Bank was such that the Bank would have wanted to obtain possession. Even if the Bank had sold the farm subject to the tenancy, there must have been a reasonable prospect of the purchaser being keen to negotiate a surrender of the tenancy. (The only other possible purchaser who could have realised the marriage value would be the defendants, but, in the circumstances of this case, that is somewhat fanciful: they had just created the tenancy). The evidence shows that, if the tenancy was surrendered, the value of the freehold would be increased from (on Mr Taylor’s figures) £306,000 (or £322,000) to £341,000 or £401,000 or (on Mr Williams’s figures) from £257,000 (or £200,000) to £401,000.

90 In my judgment, the correct figure to take for the value of the freehold on the property with vacant possession is £401,000. Subject to Mr Taylor’s evidence about the forced sale value, that is an agreed figure. Although I thought Mr Taylor was in general a convincing witness, I am not persuaded that it is right to value the farm with vacant possession on the basis of an assumption of a forced sale, and therefore I reject his suggestion of a valuation of £341,000, assessed on the forced sale basis (or, as it is often inelegantly called, the estimated restricted realisation price). I am not persuaded that the full open market value of £401,000 would not have been achieved if the farm had been sensibly marketed over a three month period. The contention that a 15% discount would be needed if the farm was to be sold over a period of three months is not supported by reference to any convincing specific transactions, and not even by reference to any satisfactory anecdotal evidence. It is true that Mr Lewis, the chartered surveyor who had given written advice to the defendants in January 1999, appears to have taken the view that, if one could only market the farm with vacant possession for 90 days, it would fetch around £308,000 rather than the £390,000, his assessment of its open market value, and Mr Sanders appears to have based his assessment of

the base rent on that assumption. However, Mr Lewis did not give evidence and Mr Sanders does not appear to have carried out his own valuation. Further, while the employees of the Bank called in this connection were somewhat vague in their evidence, I am not by any means convinced that, if the Bank had been told that the farm would fetch around £400,000 if properly marketed, although it might take six months to fetch that price, it would have been prepared to sell for 85% of that price merely to clear the debt three months earlier. Further, I regard it as by no means clear that, if the Bank had accepted a lower price for that reason, it would have been immune from a claim for damages by the defendants, and the Bank, I think, would have been concerned about this.

91 Further, I note that in April 1999, the Bank gave the defendants four months to clear their debts. I believe that that is of significance in relation to the issue. First, it is a contemporaneous indication of the Bank’s attitude to urgency. Particularly in light of the Bank’s concern about the size of the defendants’ debts, it does not suggest a perceived need for hurry. This tends to support the idea that the Bank would not have pushed for a forced sale. It also means that, looked at from the point of view of the defendants, as possible vendors of the freehold, they would not have felt under any extraordinary time pressure so far as a sale is concerned. However, the idea of the defendants as the possible vendors and purchasers of the tenancy seems a little fanciful, as I have mentioned. The fact that the Bank’s four months for repayment was in the context of the proposal having to be put to them in 14 days does not alter that view. If the Bank was proposing repayment in four months, it is hard to believe that it would not have been prepared to wait six months for complete repayment from the proceeds of sale of the farm: the outstanding loan to the Bank was well covered on the basis of the open market value of the farm. There would have been a risk of a forced sale (after expenses) not covering the amount due to the Bank (subject to the fact that the Bank may have been able to look to the farming assets).

92 Quite apart from this, to take a lower, forced sale, value for the farm with vacant possession would lead to an inconsistency. The exercise I have to carry out is to assess the marriage value, which, as I have indicated, is assessed by reference to the value with vacant possession and the value subject to the tenancy. The valuations which each surveyor has ascribed to the farm subject to the tenancy appear to have been on the open market basis rather than on a forced sale basis. If it is appropriate to apply a discount to the open market value when valuing the freehold in possession to allow for a forced

sale, it seems to me that it must be appropriate to apply a discount to the open market value of the freehold subject to the tenancy for the same reason: one has to arrive at a marriage value on an internally consistent basis. As I have said, neither surveyor put before me a valuation of the farm subject to the tenancy, on anything other than the open market basis. However, a farm subject to the tenancy would be such an unusual property to put on the market, at least so far as this type of farm is concerned. Accordingly, I would have thought that, if a deduction for a forced sale was appropriate, the deduction would be proportionally greater for a sale subject to the tenancy than for a sale with vacant possession.

93 Having assessed the open market value of the freehold in possession at £401,000, I turn to consider the value of the freehold subject to the tenancy at £17,420 p.a. The value of the freehold of the property subject to the tenancy has two components, namely the right to receive the rent for the duration of the tenancy, and the right to possession at the end of the tenancy. Mr Taylor arrived at a value of £306,000 by applying a 6.5% p.a. yield to the rent and a 6.5% p.a. rate for the deferment of possession. Mr Williams while not disagreeing with these rates in principle, considered that they did not properly take into account the comparatively weak nature of the Company’s covenant which, he said, justified a rate of 8% p.a., rather than 6.5% p.a., producing a value of £257,000. Indeed, as I have said, Mr Williams thought that the sale of the farm subject to the tenancy would be such an unusual thing that he doubted that it would fetch more than £200,000. While I reject that opinion, given that his valuation was £257,000, it was not as absurd a view as Mr Jourdan intimated. Mr Williams’s opinion highlights the unusualness of offering a freehold subject to a tenancy to the market (at least in the context of farms of this sort in this locality). It underlines the point I made earlier, namely that, if one is to assume a forced sale, at a discount, the discount is likely to be relatively greater for this unusual commodity than for the more familiar freehold with vacant possession.

94 Mr Williams’s valuation approach to the farm subject to the tenancy prompted Mr Taylor to produce an alternative valuation with differential rates: accepting that there might be something in the point that the rent should be discounted at a higher rate, he applied 8% p.a. to the rent, but he saw no reason for applying any rate other than 6.5% when considering the value of the deferred right to possession, because that would not be altered by the weakness of the tenant’s covenant.

95 In my judgment, it is right to take a rate of 8% p.a. when assessing

the value of the right to receive the rent, because of the relatively weak nature of the Company's covenant. On the other hand, I see no reason to depart from the 6.5% p.a., as originally adopted by Mr Taylor, when valuing the deferred right to possession. In those circumstances, I conclude that the value of the freehold of the property subject to the tenancy is £285,000. (For those interested in the details, the rent of £17,420 p.a. is multiplied by 9.8181, as it is receivable for a period of 20 years and I am taking a rate of 8% p.a.; the value of the deferred right to possession in 20 years is worth £113,803, arrived at by multiplying the present value, £401,000, by 0.2837970, that figure being based on deferring for 20 years at 6.5% p.a.)

96 Accordingly, by granting the tenancy on 27th April 1999, the defendants reduced the value of the freehold from £401,000 to £285,000, or, to put the point slightly differently, they created a marriage value of £116,000.

97 It clearly would be wrong to treat that marriage value as having all been given to the Company when the tenancy was granted: the Company could no more realise this marriage value of £116,000 without the assistance of the defendants or the Bank, than the Bank or the defendants could have realised it without the assistance of the Company. I can see no sensible basis, at least on the facts of this case, for doing anything other than splitting the marriage value in half: in other words, I consider that the surrender or ransom value obtained by the Company as a result of the grant of the tenancy was £58,000. I arrive at the conclusion that there should be an equal split in the marriage value between landlord and tenant for three reasons. First, the marriage value can only be released if those two parties agree; neither of them can invoke a third person who could enable the marriage value to be realised (and in this connection I treat the Bank and the defendants as being essentially in the same interest). It is not like many cases of ransom strips of land in relation to developments sites, where the owner of the development land might well negotiate an alternative means of access with another party. Secondly, in the circumstances of this case, the Bank would have been very interested in obtaining possession: on the figures I have adopted, it would not have been able to recover all that it was owed from the sale of the farm subject to the tenancy, because that would have fetched £285,000 (from which must be deducted expenses) and the Bank was owed over £335,000. By paying the Company £58,000 for surrender of the tenancy, the Bank could expect virtually to get all its money back: the total outstanding would be increased from £335,000-odd to £393,000-odd, and, after expenses, the sale of the

property for £401,000 would more or less cover what was due. Thirdly, I derive assistance from the Leasehold Reform Act valuation cases (see the discussion in Hague on Leasehold Enfranchisement, 1999 Edition, paragraphs 9-25 and 9.41).

98 If an asset worth £58,000 was bestowed on the Company when it was granted the tenancy, then it is necessary to consider whether the sum paid for this benefit by the Company was "significantly less" in value than £58,000. Ostensibly, what was paid by the Company was £1,000 p.a. for five years, and thereafter £4,276 p.a. for the next 15 years. However, having assessed the open market rental value of the property at £16,900, it seems to me that the defendants are entitled to say that £520 p.a. (being the sum in excess of £16,920 which is payable by way of the ordinary rent) should be added as part of the consideration paid by the Company. Accordingly, the question I have to consider is whether the Company's obligation under the tenancy to pay £1,520 p.a. for the first five years of the term of the tenancy and £4,276 p.a. for the next 15 years of the tenancy was worth "significantly less" than the ransom or surrender value it obtained, which I have assessed at £58,000. (I should explain that I have only added the £520 p.a. for the first five years, because the ordinary rent under the tenancy is then subject to review on an upwards or downwards basis to the market rent, and I assume that from the end of the fifth year of the term, the ordinary rent would indeed become the market rent).

99 In my judgment, the obligation of the Company, measured as at 27th April 1999, to pay the base rent (as adjusted by me as I have indicated) for the term of the tenancy, namely at the rate of £1,520 p.a. for five years and £4,276 p.a. for the next 15 years) had a value which was "significantly less" than the ransom or surrender value bestowed on the Company by the grant of the tenancy, measured at the same date, namely £58,000.

100 This can be demonstrated fairly easily. Assume that the £4,276 p.a. is payable in full from the commencement of the tenancy, rather than the lower figure being paid for the first five years; assume also that it is right to take the same deferment rate as for the rent, namely 8% p.a. This would mean that the value of the right to receive £4,276 p.a. for 20 years would be £39,250 (taking the multiplier, as before, as 9.8181). In my judgment, that is a figure "substantially less" than £58,000. However, the assumption which produced the figure of £39,250 is too generous to the defendants for three reasons. First, it ignores the important fact that, for the first five years (when each year is obviously worth more than any of the succeeding years in present value) the Company is only paying £1,520 p.a., and not £4,276

p.a. Secondly, it seems to me that yield of 8% p.a. is probably too low: given that 8% p.a. is an appropriate rate to take for the rent in light of the strength of the Company’s covenant, I would have thought that a higher rate would be appropriate for an annual payment which is not as secure as the rent. Where the rent payable by a tenant is in excess of the market rent, it is conventional to value that part of the rent which is in excess of the market rent on a more conservative basis (i.e. at a higher yield, therefore producing a lower present value) than that portion of the rent which is equivalent to the market rental value. Thirdly, the assessment of £39,250 ignores the fact that, while the Company can enjoy the ransom value for up to 20 years, it can choose to stop paying for it, and give it up, at the expiry of any year of the tenancy. The value of this option to the Company is reinforced by the fact that the base rent is stepped so that it is at a much lower rate for the first five years of the tenancy. That this is an added advantage can be shown by considering a very extreme case: if the base rent was payable at a nominal rate until the larger sum was due, the Company could have obtained the marriage value share for much of the 20 years, while having the right to avoid paying much for it by determining the tenancy near its end.

The sale agreement

101 The first question is the value of the farming assets sold under the sale agreement. This presents some difficulty, because it is unclear precisely what assets were included in the sale agreement. On the face of it, there is no reason to depart significantly from the value of those assets arrived at by Mr Sanders, namely £181,100. As I have mentioned, he struck me as a competent valuer. I have no reason to doubt that he carried out his role conscientiously. Given that Mr Taylor and Mr Williams were unclear as to what assets were included, and, therefore, cannot confidently give evidence as to the value of the farming assets as at 27th April 1999, I cannot see any good reason for departing from Mr Sanders’s figures, save to a small extent agreed by Mr Taylor and Mr Williams: the value they agreed for the farming assets is £172,500.

102 In the circumstances, the question which arises is whether the value of the Company’s unsecured obligation to pay £17,094 p.a. for 20 years beginning on 27th April 2000, is “significantly less” than the value of the assets, namely £172,500.

103 The figure of £17,094.39 p.a. payable under the sale agreement is based on a rate of 7% p.a. In my judgment, bearing in mind that the Company had no property (other than the tenancy, which was at a rent

higher than the market rate, and the farming assets themselves) and the defendants were provided with no security whatever for the repayment of the instalments over 20 years, I think that 7% p.a. was a rate which was too low to take into account the risk which the defendants were facing. In practice, what the defendants were doing under the sale agreement was making available to the Company a loan for £172,500, which was repayable by 20 equal annual instalments (rather like an endowment mortgage) without any security whatever. It appears to me fanciful to think that anyone would have made available a substantial loan to the Company in April 1999 on such a basis at anything like as low a rate as 7% p.a., particularly if repayment was to take place over 20 years.

104 It is fair to say that, particularly bearing in mind its identity, the evidence called on behalf of the Bank in connection with this issue was pretty feeble. Mr Williams’s evidence was that the appropriate rate would have been about 10% p.a.; I am bound to say that that struck me as a low rate. I believe that the explanation as to why he arrived at that rate was that he overlooked the fact that the Company provided no security whatever for the payment of the instalments. However, it is fair to say that that is based on something of a throw away remark from Mr Williams. Given that employees of the Bank were called to give evidence, it is surprising that nothing more satisfactory or authoritative was said on its behalf. One piece of evidence which did appear during the hearing was a document which showed the rate of interest which a sister company of UK Mortgages was charging the defendants in respect of fees for their services which remained outstanding. In respect of a much smaller amount for a much shorter period the rate of interest was over 13% p.a., which strikes me as a rather more likely rate than 10% p.a. Although I am sceptical as to whether 10% p.a. is a high enough rate of interest to take, I am persuaded by Mr Jourdan that it would be wrong for me to hold that a higher rate of interest was appropriate, bearing in mind that it should only have been too easy for the Bank, of all litigants, to establish a higher rate, that Mr Williams did give his mind to the point and arrived at 10% p.a., and that the arrangements between the defendants and the sister company of UK Mortgages were not examined in any great detail.

105 If a rate of 10% p.a. is taken on £172,500, then the instalments, instead of being £17,094 p.a., should have been £20,270 p.a.. I am of the view that £17,094 p.a. is “significantly less” than £20,270 p.a. The difference is over £3,175 p.a., and the amount by which the actual consideration falls short of market value in percentage terms is over 15.5%. In my view, whether in absolute terms or in relative terms,

£17,094 p.a. is “significantly less” than £20,270 p.a., at least in the context of the Bank’s case. (It may be that I should take the capital value of £17,094 p.a. and compare it with £172,500 but the outcome is the same: the Company obtained the farming assets worth £172,500 for less than £146,000.)

Conclusion

106 In these circumstances, despite Mr Jourdan’s well presented argument to the contrary, I am satisfied that, taking each on its own, the tenancy and the sale agreement were each entered into in circumstances which are caught by Section 423(1)(c). It may be appropriate to treat the two agreements as a single transaction for the purpose of Section 423(1)(c). If it is, then I would reach the same conclusion: there was no evidence to suggest that if each of the agreements was caught by Section 423 taken on its own, the combination of the two agreements should be caught if they were taken together. Indeed, it would be surprising if the evidence had supported such a contention.

107 This conclusion does not mean that I have to set the agreements aside, in light of the way in which Section 423(2) is expressed. However, in light of my findings, it appears to me that that is the appropriate course in the present case. Accepting that neither of the agreements was a sham, it remains the case that they were entered into for the purpose of improving the defendants’ position as against the Bank. The defendants, or at least their advisers, were well aware of the risks this involves, and in particular were well aware of Section 423 and the impact of the decision of the Court of Appeal of Woodward [1995] 1 BCLC 1. While anyone would have sympathy for Mr and Mrs Jones, who faced, and now face, eviction from their home and farm in which they have lived and worked for 25 years, it seems to me that the court should not go out of its way to assist people who have entered into artificial transactions to improve their position as against third parties. I emphasise that nothing that Mr and Mrs Jones did was improper or dishonest. They did what their advisors told them, and they were anxious to protect their home and their farming business. However, those who live by the sword die by the sword, and the fact that they lived by a sword which is conceived and manufactured by others does not alter the fact that it is the sword which they used against the Bank.

108 Even if I had thought it right to consider taking a course other than setting aside the agreements, I would have found it hard to think what that other course should be. The only obvious course would be to permit the defendants and the Company to amend the terms of the

agreements, so that the tenancy reserved a substantially higher base rent, and the instalments payable under the sale agreement were substantially increased. I very much doubt whether the defendants would be carrying out their duty as directors of the Company if they were prepared to agree to such a course. As I have mentioned, even under the tenancy in its present form, the property is significantly over-rented, and it is clear that, for whatever reason, the farming business has been carried on at a loss over the past year or more. Furthermore, even with the rosier prospects as they appeared in April 1999, those advising the defendants thought that it would not be prudent or sensible to impose a liability on the Company to pay more than £35,514 p.a. under the agreements for the first five years: hence the reduction of the base rent by the same £3,000 p.a. for that period. With the experience of the past year in the farming industry generally, it seems to me that to impose an even greater further liability than £3,000 p.a. (indeed, it would be more than £6,000 p.a.) on the Company would not be appropriate.

109 In these circumstances, I should set the agreements aside pursuant to Section 423(2).

ISSUES B8 AND B9: HAS THE BANK'S FLOATING CHARGE BECOME FIXED?

110 The Bank contends that its three agricultural charges crystallised, and became fixed charges binding on the Company, the moment that the sale agreement was completed, and the farming assets transferred to the Company. Miss Middleton contends that the charge crystallised at the moment that the sale agreement was entered into between the defendants and the Company for one or both of the following reasons:

1. At that moment, the partnership between the defendants was dissolved.

2. At that moment, the defendants ceased carrying on business.

111 So far as the first ground is concerned, there is no doubt that the effect of Clause 3 (iii) of the Charges, which reflects Section 7(1) of the 1928 Act, does provide for crystallisation upon the dissolution of the partnership. In this connection, it is right to refer to section 7(1) of the 1928 Act (and it appears that, somewhat oddly, there has never been any other sub-section). It provides as follows:

> " An agricultural charge creating a floating charge shall have the like effect as if the charge had been created by a duly registered debenture issued by a company:

> Provided that - (a) the charge shall become a fixed charge upon the property comprised in the charge as existing at the date of its becoming a fixed charge -
> ...
> (iii) upon the dissolution of partnership in the case where the property charged is partnership property;
> ..."

112 The Bank's contention is based on the proposition that the partnership between the defendants must have been dissolved when they transferred possession of the property, on which the farming business was carried out, to the Company (by virtue of the tenancy) and when they transferred all the assets of the farming business to the Company (through the sale agreement). I accept that the effect of the grant of the tenancy and the sale of the assets to the Company was that the defendants ceased to carry on the only business which they had, up till then, being carrying on, namely a farming business on the property. That must be right, simply because, in order to carry on the farming business, they needed to have the right of possession of farm land and of assets, including livestock and deadstock. They divested themselves of the right to possession and of any such assets, and it was not as if they had any intention of acquiring other farm land and other farming assets. The furthest they could go would be to say that, as I have mentioned, there was a real prospect of their taking possession of the property back from the Company and taking a transfer back of the assets from the Company, but that would have been no more than a contingent future possibility as at 27th April 1999.

113 At least on the face of it, however, I do not consider that that necessarily means that the partnership between the defendants must have been dissolved as at 27th April 1999. The mere fact that partners cease trading does not, as I see it, put an end to the partnership. After 27th April 1999, it is quite possible that the defendants would have been advised to dissolve their partnership for tax or other reasons. Equally, it is quite possible that they would have been advised to continue their partnership for the time being, on the basis that partnership accounts for the year ending 1st April 1999 still had to be prepared, that possible partnership drawings might still be available to them, and that, in light of the fact that the Company was due to pay rent under the tenancy and instalments under the sale agreement, it would be better, at least for the time being, that the partnership should continue for the purpose of receiving those sums. It might also have been sensible to continue the partnership bearing in mind the possibility that the tenancy might be surrendered and the

sale agreement reversed in the not too distant future.

114 Dissolution of a partnership can occur in any of the ways set out in Sections 32 to 35 of the Partnership Act 1890. Miss Middleton does not suggest that in any of those sections is there reference to dissolution merely by transfer of all the land and assets of the partnership (although it may be that an arguable case could be made for this under Section 32(b) of the 1890 Act). In light of the obiter observations of Lord Millett in Hurst -v- Bryk [2000] 2 All ER 193 at 201c, there must be a powerful argument for saying that the provisions of the 1890 Act are intended to be exclusive so far as the circumstances in which dissolution can occur. The current edition of Lindley & Banks on Partnership (1995 Edition, at paragraph 24.09), published before the decision in Hurst, suggests that if partners agree a permanent cessation of all forms of business, this takes effect as an agreement to dissolve. As Mr Jourdan says, I do not need to decide whether that is right or not: in the present case, there is no evidence that the defendants took any such positive decision as at 27th April 1999. Indeed, Mr Jones's evidence suggests the contrary.

115 I turn then to the second ground upon which the Bank relies. As mentioned, I accept that, as at 27th April 1999, as a result of entering into the agreements, and as a result of owning no agricultural assets and not having a right to possession of any agricultural land, the defendants ceased carrying on business. However, Mr Jourdan contends that this did not result in the charges crystallising, so as to become binding on the Company, for two reasons. The first reason is that cesser of the business of the chargor is not a circumstance giving rise to crystallisation of the charges either under Clause 3 of the charge or under Section 7 of the 1928 Act. The second argument is that, in any event, the crystallisation would have taken place, at the earliest, immediately after the sale agreement, and that this was therefore too late for the Bank's purposes, because such crystallisation would not enable the Bank to contend that the charges bound the Company.

116 The law relating to floating charges is, at any rate in this country concerned with charges granted by companies, rather than by individuals, because, in practice, floating charges are seldom, if ever, granted by individuals. Indeed, there is some question as to whether an individual can grant a floating charge, and, if he can, whether there is any point in his so doing (see the discussion in Gough on "Company Charges", 1996 Edition, Chapter 3).

117 In re Woodroffes (Musical Instruments) Limited [1986] Ch. 366, Nourse

J had to decide:

> "[T]he question whether the cessation of the Company's business causes an automatic crystallisation of a floating charge [which he described as] one of general importance upon which there appears to be no decision directly in point" (at 376G).

After considering a number of authorities, Nourse J said this at 377F to 378C:

> "Although the general body of informed opinion is of the view that automatic crystallisation is undesirable... I have not been referred to any case in which the assumption in favour of automatic crystallisation on cessation of business has been questioned. On that state of the authorities it would be very difficult for me to question it, even if I could see a good ground for doing so. On the contrary, it seems to me that it is in accordance with the essential nature of a floating charge. The thinking behind the creation of such charges has always been a recognition that a fixed charge on the whole undertaking and assets of the company would perilise it and prevent it from carrying on its business. ...A cessation of business necessarily puts an end to the company's dealings with its assets. That which kept the charge hovering has now been released and the force of gravity causes it to settle and fasten on the subject of the charge within its reach and grasp."

118 The question for me, therefore, is whether the omission of any express reference to the farmer ceasing to carry on business in Section 7(1)(a) of the 1928 Act (and, indeed, the omission of any such reference in Clause 3 of the Charges in the present case) means that the principle accepted and adopted by Nourse J does not apply to charges granted under the 1928 Act.

119 Mr Jourdan's contention is simple, namely that Section 7(1)(a) of the 1928 Act sets out the four circumstances in which a floating charge granted under that Act crystallises, and it is not open to the courts, or indeed to the parties who enter into a charge pursuant to that Act, to add to those grounds. I doubt that the four sub-paragraphs in Section 7(1)(a) of the 1928 Act are intended to be exclusive. The natural reading appears to me to indicate that, whatever circumstances the parties to a charge granted under that Act agree would convert it into a fixed charge, it must become fixed in the event of any of the four specified circumstances identified in Section 7(1)(a). However, it is not necessary for me to decide that issue.

120 It appears to me that the answer to Mr Jourdan’s submission is that a floating charge such as the charge in the present case is specifically provided by Section 7(1) to have “the like effect as if the charge had been created by a duly registered debenture issued by a company”. The consequence of the reasoning of Nourse J in Woodroffes, appears to me to be that one of the effects of a company granting a floating charge is that, irrespective of whether it is agreed as one of the terms of the charge itself, the charge will automatically become a fixed charge if the company chargor ceases carrying on its business. I think that Nourse J concluded that that is an inherent feature of a floating charge granted by a company. If that is so, then it seems to me that, in the opening part of Section 7(1) of the 1928 Act, the legislature has effectively provided that this is also an inherent characteristic of the charge granted under the 1928 Act.

121 As to Mr Jourdan’s second point, I am of the view that the sale agreement and the tenancy took effect at the same time. They were part and parcel of a single arrangement, although embodied in two agreements. Accordingly, at the moment they were entered into, the defendants ceased carrying on business. In my judgment, therefore, at the moment the assets were transferred from the defendants to the Company, the charge in favour of the Bank crystallised. While there is no authority directly on point, I take the view that it would be unrealistic to assume that there was a *scintilla temporis* between the sale of the assets to the Company and the crystallisation of the Bank’s Charge, so that, for a notional moment, the Company had the assets free of the Charge, which therefore did not become a fixed charge until a moment too late from the Bank’s point of view. In my judgment, the correct view is that the Charge crystallised at the moment that the sale took place, and that therefore the sale was subject to the Charge, because there was no moment, not even a notional moment, when the Company had ownership of the assets free of the fixed charge. I think that view is supported by two factors. The first is commercial common sense. The second is the rejection by the House of Lords of the concept of a scintilla temporis in not wholly dissimilar circumstances in Abbey National Building Society -v- Cann [1991] 1 AC 56 at 89F to 93C.

122 As Miss Middleton says, this view also receives support from observations of the Court of Appeal of New South Wales in Fire Nymph Products Limited -v- The Heating Centre Pty Limited (in liquidation) (1992) 10 ACLC 629. While that was a case concerned with the effect of a contractual provision for crystallisation, it is interesting to see what Gleeson CJ said at 636:

> "I cannot accept that there is a conceptual impossibility involved in making a charge become fixed, and attached to specific property, contemporaneously with the event that brings that about. I do not accept that it is in the nature of crystallisation of a charge that it can only occur after the happening of the event which, by contract, produces crystallisation. ...I do not accept that... the two things must occur in sequence or that the law necessarily perceives a relevant interval of time between the two."

Of course, as is clear from that short extract, the New South Wales Court was concerned with the effect of a contractual provision. However, it appears to me that, if it is of the nature of a floating charge that it crystallises when the chargor ceases business, and if the event which gives rise to the cesser of business is the transfer of assets, then, as it seems to me, the logic of the reasoning of Nourse J is that the crystallisation would occur at the moment of the transfer, and that the transferee would not have taken free of the fixed charge.

CONCLUSION

123 I should mention that there was originally an issue as to whether Rhostwpa had been properly charged to the Bank. In light of the fact that the confirmation had not been signed by the Bank, the defendants contended that there was no effective charge due to Section 2 of the Law of Property (Miscellaneous Provisions) Act 1989: see United Bank of Kuwait -v- Sahib [1997] Ch 107. At the beginning of the trial, Miss Middleton indicated that she wished to amend to plead estoppel. I indicated that it would be unfair on the defendants to have to argue the estoppel point now, without having had the benefit of disclosure and an opportunity to investigate evidence generally, but that the issue could be dealt with at a later date. After considering the question of the Bank's rights over Rhostwpa on the basis of estoppel, the defendants conceded that the Bank had an effective charge over Rhostwpa on that basis, even though Mr Jourdan contended, as I see it rightly, that, until the Bank raised the estoppel issue, the defendants would have succeeded in defeating the Bank's case on Rhostwpa in light of Section 2 of the 1989 Act and the decision in Sahib.

124 In these circumstances, I conclude as follows:

1. The tenancy is one which satisfies the requirements of

Section 99(13A) of the 1925 Act;

2. the tenancy and the sale agreement do not offend the rule against self dealing;

3. the tenancy and the sale agreement were each transactions at an undervalue pursuant to Section 423, and I consider that they should be set aside as against the Bank;

5. In any event, the Company acquired the farming assets subject to a fixed charge in favour of the Bank.