Neutral Citation Number: [2022] EWHC 2552 (Ch)

Case No: BL-2021-BHM-000005

IN THE HIGH COURT OF JUSTICE
BUSINESS AND PROPERTY COURTS IN BIRMINGHAM
BUSINESS LIST (ChD)

Birmingham Civil Justice Centre
33 Bull Street, Birmingham, B4 6DS

Date: 7th October 2022

Before:

HIS HONOUR JUDGE TINDAL
(sitting as a Judge of the High Court)

- -

Between:

MANOLETE PARTNERS PLC

Claimant

-and-

(1) PAUL ANTHONY RUTTER
(2) JOANNE THERESE RUTTER

Defendants

- -

(**Mr Ali Tabari**, instructed by **HCB Solicitors**) for the **Claimant**
The Defendants in person

Hearing dates: 13-16th and 29th -30th September 2022

- -

Approved Judgment

HIS HONOUR JUDGE TINDAL

HIS HONOUR JUDGE TINDAL:

Introduction

1. This case concerns Rut5 Limited (in Liquidation) ('the Company'), registered number 08413363. The Defendants (who are married) are the Company's only directors and shareholders and ran it from its incorporation on 21st February 2013 to the date it entered Administration on 1st November 2017. I will refer to the First Defendant as Mr Rutter and the Second Defendant as Mrs Rutter. The Administrator was Mr Gerald Irwin ('Mr Irwin'), who subsequently converted the Administration into a Creditors' Voluntary Liquidation ('CVL') from 5th November 2019 and became the Liquidator. On 13th March 2020, HHJ McCahill QC refused the First Defendant's application for a declaration that Mr Irwin's appointment as an Administrator was invalid. Shortly afterwards, on 1st May 2020, Mr Irwin assigned all liquidator claims against the Defendants to the Claimant, who issued these proceedings on 28th January 2021.

2. Following the Defendants' Defence on 25th March 2021, DDJ Stewart at a Case and Costs Management Hearing on 16th August 2021 gave directions through to trial. In February 2022, DJ Singh varied those directions and the matter was listed for trial on 13th-15th September 2022. On 23rd May 2022, DJ Rouine stayed the claim until 1st July 2022 to enable Mr and Mrs Rutter to bring an application to challenge Mr Irwin's appointment as Administrator and/or Liquidator. No application was made at that stage. That remained the position at Pre-Trial Review on 27th July 2022, when HHJ Williams gave relief from sanctions to both sides, permitting each to rely on their late witness statements, for the Claimant from Mr Irwin and for Mr and Mrs Rutter from each of themselves and an associate, Mr Smith. However, HHJ Williams refused permission to Mr and Mrs Rutter to call the Company's accountant Mr Langham, in large part because there was not even a witness statement from him at that stage.

3. All this remained the case until the week before trial starting on 13th September 2022. At that stage, Mr and Mrs Rutter made a flurry of applications which I heard on the first day of trial and on which I gave two oral judgments on that day. Their then-solicitors prepared and lodged those applications, including to stay the claim pending a challenge

to the validity of Mr Irwin's appointment as Administrator and Liquidator, but then came off record, so Mr and Mrs Rutter represented themselves at the trial.

4. A creditor of the Company Mr Hickey also applied to become a claimant in the case, effectively seeking to consolidate his existing claim against Mr Rutter for a guarantee. I refused his application to become a claimant as there was insufficient legal connection, although he does feature briefly in the story. I also refused Mr and Mrs Rutter's application to adjourn the trial for them to obtain legal representation, which they had until very recently, then dispensed with in circumstances on which they asserted privilege (as was their right). This would have caused months of delay in the trial through no fault of the Claimant. I was satisfied that, with assistance from myself pursuant to CPR 3.1A, Mr and Mrs Rutter could have fair hearings of the trial and their application to challenge Mr Irwin's appointments. I refused the latter partly on the merits and partly as cause of action estoppel given HHJ McCahill QC's decision in March 2020. However, I also granted Mr and Mrs Rutter relief from sanctions to call Mr Langham who had since prepared a statement (in a change in circumstances).

5. Another reason I was content that Mr and Mrs Rutter could fairly represent themselves even facing a claim for almost £1 million, was that many of the issues were primarily factual – and of course Mr and Mrs Rutter know better than anyone what they factually did and why at the time. The claim for Conversion was abandoned and the date of the Company's insolvency under s.123 Insolvency Act 1986 ('IA') and Mr and Mrs Rutter's duty to act in the interests of the Company's creditors under s.172(3) Companies Act 2006 ('CA') goes hand in hand with the main issue: whether a dividend of £560,000 was lawful. So, there remain three key issues I must resolve:

(i) When a dividend of £560,000 reducing Mr and Mrs Rutter's directors' loan amounted to a 'distribution' under s.829 CA: 31st July 2015, 29th July 2016 or 12th April 2017. That timing largely determines whether it was unlawful.

(ii) Whether Mr and Mrs Rutter owe £104,668.12 on their directors' loan and if so, whether they have in fact paid off and can off-set Company debt of £117,150.

(iii) Whether Mr and Mrs Rutter in fact spent the Company's money on their personal property without accounting for it, namely (1) up to £30,226.56 on their rental property, 4, Marsh Avenue ('Marsh Avenue'); and/or (2) up to £225,852.48 on their home, Launde Farm Lodge, Launde, Leicester ('Launde Farm').

Issues (ii) and (iii) are almost exclusively factual. Issue (i) has a number of legal complexities, but really comes down to when the 'distribution' of £560,000 was made.

6. At trial I have done my best to assist Mr and Mrs Rutter to have a fair hearing. This included not only assisting them to articulate their legal submissions on their preliminary applications and at the end of trial; raising legal points and cases in their favour with Mr Tabari, but also taking stock of the issues once I had determined the trial should proceed; and encouraging each to ask supplementary and any re-examination questions of the other, Mr Langham and Mr Smith. Under CPR 3.1A(5), I also asked my own questions of Mr Irwin first before Mr and Mrs Rutter asked him their questions. This is a practice I have adopted on many occasions in different judicial roles over the years with litigants-in-person: to ensure all relevant points were covered, that their questions stay relevant and the represented party can fully re-examine.

7. However, when a Judge assists a litigant-in-person, they must not lose sight of fairness to the represented party, even a large company like the Claimant, expertly represented by Mr Tabari (whose skill in advocacy and the law was only matched by his patience with Mr Rutter). After I admitted Mr Langham's late statement (but before I heard his evidence) and after Mr Irwin and Mrs Rutter's evidence, I felt one potential finding of fact was that the dividend of £560,000 was decided upon and entered in the 2014-15 accounts (which might support it and indeed mentioned it) in July 2016 to reduce Mr and Mrs Fuller's indebtedness; but was not recorded in a journal by Mr Langham until April 2017. That seemed broadly consistent with the documents, Mr and Mrs Rutter's pleaded case and Mr Langham's statement (even if they did not specify those dates). But it was inconsistent with the Claimant's pleaded case that the dividend was paid in July 2015 based on the 2013-14 accounts (which did not support that dividend).

8. In fairness to the Claimant and to ensure any findings I made were fully ventilated in evidence (c.f. *Satyam v Burton [2021] BCC 640 (CA)),* I raised this and offered the Claimant the chance to recall Mr Irwin or ask further questions of Mrs Rutter. Mr Tabari declined and suggested (as I anticipated he might) this would mean the dividend was still not in law 'distributed' until April 2017 by when the Company was nearly insolvent, so was unlawful. I permitted the Claimant to argue that alternative case without amendment. To be clear: I did so in fairness to the *Claimant* because I had admitted Mr Langham's late statement. It meant it could fully address (before Mr

Langham's evidence) a potential finding contrary to its pleaded case. It also meant that even if I made that finding, the Claimant had an alternative – if unpleaded - argument.

9. Moreover, as my first draft judgment was due to be handed down, Mr Tabari sought permission to re-open it, as he had overlooked in his closing submissions the alternative basis for the director's loan claim for £104,668.12: that even if Mr and Mrs Rutter were entitled to set off any payment against a *debt*, they could not do so for *breach of duty*. *AIC v FAAN [2022] 1 WLR 3223 (SC),* sets out the relevant principle in its headnote:

    "[T]he task of a judge faced with an application to reconsider a judgment and/or order before the order had been sealed was to do justice in accordance with the overriding objective… [T]he…principle of finality of litigation…cut in not merely when an order was sealed but when it was made…[So, a] judge….should not start from a position of neutrality or evenly-balanced scales…. especially in the case of a final order [which is] a weighty matter in the balance against making a different order. Accordingly, on an application for reconsideration the question is whether factors favouring reopening the order were, in combination, sufficient to overcome the deadweight of the finality principle on the other side of the scales, together with other factors pointing towards leaving the original order in place.."

10. On one hand, the 'deadweight of the finality principle' is heavy here as this was a draft final judgment after trial, the Claimant omitted to deal with the point in submissions and Mr and Mrs Rutter represent themselves. On the other, breach of duty was always the Claimant's pleaded alternative case which Mr and Mrs Rutter addressed in their statements. Moreover, Mr Tabari's trial Skeleton argued they were in breach of duty for failing to reduce the debt. But in my draft judgment, I found they had not just failed to reduce the debt but *actually run up the debt* of £104,688.12. So, on reflection, Mr Tabari was right to submit this was a pure issue of law and he did not need to re-open the evidence, only his submissions. Indeed, not re-opening might give Mr and Mrs Rutter an unfair windfall through that mistake, at the expense of the Company's unsecured creditors. So, applying the overriding objective to deal with cases justly and at proportionate cost having regard to the CPR 1 factors, on balance I found it just and proportionate to allow the Claimant to re-open, but to permit Mr and Mrs Rutter to give further evidence on this narrow point, but only if they wished to do so. I adjourned until the next day to give them time, as a longer delay would not improve their situation, just

increase costs. Having heard evidence, submissions and made my decision, I held back hand-down of my judgment to await *BTI v Sequana [2022] UKSC 22* on 5th October (which I discuss but does not change my decision). This is now my final judgment.

11. Mr Irwin in his evidence answered my questions to the best of his recollection. However, in addition to challenging his appointments, Mr and Mrs Rutter also criticised his conduct of the administration and liquidation. As I explained to them, many of these criticisms were not directly relevant to the issues I had to decide but might be relevant to his credibility. So, I permitted them to explore them and Mr Irwin accepted some of his recollection was wrong, for example his understanding of the purchase of the Company's factory in 2014. It is also true his drafting of the report in October 2019 (pgs.263-73) recommending transition from Administration to Liquidation could have been clearer (as I said in my preliminary judgment) and his own recoveries in the liquidation were limited, as mortgagee receivers sold the factory.

12. However, Mr Irwin is an insolvency practitioner of many years' experience. He has been immersed in the affairs of this company for almost five years and in his methodical way, I accept he has investigated it thoroughly, bearing in mind that Mr and Mrs Rutter did not engage fully with his investigations of the Company's finances, despite his requests (pgs.236-240). In terms of his evidence to the Court, all Mr Irwin can realistically do as an Administrator and Liquidator is to investigate the affairs of the Company, collate then present the evidence. That he has done, in the form of voluminous documentation. It is largely thanks to Mr Irwin that I had the benefit of a four lever-arch bundle ('MB'), supplemented by another application bundle ('AB') for the challenge to validity of his appointments on which I have also drawn. This all shows an often messy and incomplete picture. But I am satisfied that does not reflect shortcomings in his investigation, so much as in the Company's paperwork.

13. On that topic, as CICCJ Briggs said in *Re Glam & Tan [2022] EWHC 855* ps.29-31:

> *"It is well known and self-evident that a liquidator comes to an insolvent company as a stranger. His duty is to investigate its failings, collect-in and distribute its assets to the creditors of the Company according to the insolvency scheme. The courts acknowledge his absence of first-hand knowledge of the events that led to the insolvency by placing the burden of proof on a defendant director (who does or should have first-hand knowledge) to demonstrate why or how an event took place, if no minute exists, or where there is no other documentary evidence to support the position of a defendant director. In Murad v Saraj [2005] EWCA Civ 959, Arden LJ (as she was) [said] on the taking of an account, the court lays the burden on the defaulting fiduciary to show that the profit is not one for*

which he should account …The shifting of the onus of proof is consistent with the deterrent nature of the fiduciary's liability. The liability of the fiduciary becomes the default rule".....A few years later Arden LJ applied her reasoning in Re Mumtaz Properties [2011] EWCA Civ 610 at [16] "The approach of the judge….was to seek to test the evidence by reference to both the contemporary documentary evidence and its absence. In my judgment, this was an approach that he was entitled to take … persons who have conducted the affairs of limited companies with a high degree of informality ... cannot seek to avoid liability or to be judged by some lower standard than that which applies to other directors, simply because the necessary documentation is not available …"

14. Mrs Rutter’s evidence on the financial and administrative side of the Company was a curious mixture of occasionally implausible assertions interspersed with disarming honesty. For example, she initially and implausibly tried to explain away invoices clearly for building work at their home Launde Lodge Farm in 2015-2016 by saying the invoices merely stated it as a delivery address. But as soon as I asked her whether they had undertaken any work on their house in the period, she candidly accepted (even in the absence of other evidence at that stage) they had part-built an extension. She later accepted some invoices had charged the Company and should have been put through the loan account. Mrs Rutter also readily accepted that her and Mr Rutter paying £116,000 to one of the Company’s creditors under their personal guarantees also included payments to other creditors. She accepted the dividend of £560,000 had not been approved by formal shareholder resolution (although I return to this below). I initially thought Mrs Rutter’s assertion that Mr Langham may have made the entry on Sage in April 2017 reducing the directors’ loan balance by £560,000 without her agreement was an implausible assertion. However, considering Mr Langham’s evidence, I now understand what she meant. It was simply that she did not agree *in April 2017* to him making that entry – he does not say she (or Mr Rutter) did, but rather that he made the entry himself to ‘correct’ Sage as it was inconsistent with the 2014-15 company accounts which recorded a dividend of £560,000 being used to reduce the loan account balance. Those company accounts were discussed with Mr and Mrs Rutter and formally approved by her in July 2016 and so that was Mr Langham’s authority to make the ‘correction’ to Sage in April 2017. Mrs Rutter cannot remember much detail about those periods, but I am conscious she has had some serious health problems in the meantime and this may well have affected her memory. However, overall, I found Mrs Rutter an essentially honest and reliable witness, albeit with a tendency to speculate or not express herself clearly. I was particularly assisted by seeing the way she gave

evidence in Court (she gave brief but honest evidence remotely on the re-opened issue), especially given the absence of much contemporary documentation – but that itself matters to credibility: *Re Glam*.

15. However, Mr Rutter I am afraid, save on one issue, was a thoroughly unreliable witness. Ironically, the one issue was that he recalled the least: the dividend. He admitted he did not use Sage and took no interest in it, but left the inputting to his wife, son and Mr Langham, whilst he focussed on the order book and bank account. So, he accepted the dividend was probably entered on Sage on 12th April 2017 by Mr Langham. However, Mr Rutter maintained the dividend was decided on when discussing the 2014-15 accounts in July 2016, even though he could not recall the conversation. Indeed, he even admitted he may well have not declared the dividend in his tax return. However, this scanty recollection struck me as at least honest, unlike the rest of Mr Rutter's evidence, where he had no qualms about not only implausible assertions, but giving the distinct impression of making things up as he went along. For example, on the building invoices ostensibly related to their home at Launde Lodge Farm, clearly in the light of Mrs Rutter's candid admissions (and further evidence the Claimant had gathered overnight, including a planning application and photographs), Mr Rutter could not deny they had built an extension at their home (if not completely finished it) at the time. However, he not only stuck to his implausible explanation that various invoices to the Company explicitly referring to 'work at Launde Lodge Farm' or construction equipment delivered there (even in one case for the 'Launde Extension' - MB662) had been misaddressed because plant and materials were stored at their barn over the road. Not content with that, Mr Rutter also proffered entirely new explanations which he said he had 'remembered overnight': including that the Company had undertaken work for their next-door neighbours at 'The Stables'; and indeed, that an employee had bought 4 Marsh Avenue and put through invoices to the Company. I am afraid on this issue Mr Rutter was not telling me the truth, or at least was skewing the truth (e.g. that the Company had done work for their neighbours, which I accept given new documents he produced overnight) to explain away work billed to the Company but plainly done on their home and Marsh Avenue.

16. Mr Smith gave brief evidence (remotely from Spain, which I permitted) on that issue. He has a building company which worked with the Company on development projects

and often visited the barn at Launde Farm. However, his assertion that the invoices he saw related to legitimate development work did not go very far as he understandably could not really recall which invoices he was referring to. Therefore, while Mr Smith was honest and doing his best to assist me, his evidence in the end was peripheral.

17. However, by contrast Mr Langham's evidence was not peripheral but central (relevant to my decision to grant relief from sanction for it). Mr Langham was not only by some distance the most reliable witness (with respect to Mr Irwin, for the reasons given above). Mr Langham was on any view an impressive witness. The reasons for his late witness statement became clear as he gently observed that his family and Mr and Mrs Rutter's had known each other for years, yet he had been left with unpaid bills: 'the last in the queue' as he put it. Mr Langham's candour revealed his relationship with Mr and Mrs Rutter was strained. I accept he only reluctantly came to Court and he came to tell the truth, not just to support the Rutters' case. He accepted that Mrs Rutter spoke to him briefly about her evidence on one issue, but I accept it has not influenced his evidence. Mr Langham answered every question with clarity and force, emphasising that he was a professional, accountable to professional standards. So, I accept he would not have endorsed a decision to declare a dividend in April 2017 by which time the company was in financial trouble: as Mr Irwin said: a very strange thing for an accountant to do. Likewise, Mr Langham rejected any suggestion that he would have made entries on Sage in April 2017 without Mr and Mrs Rutter's permission. However, as he said he made that entry himself in April 2017 to 'correct' Sage by reference to the accounts approved in July 2016 and does not say Mr or Mrs Rutter asked him to make it *in April 2017*, his evidence is ultimately consistent with Mrs Rutter's. Mr Langham's evidence was also essentially consistent with my own reading of the contemporary documentation and I found it entirely credible. I shall return to Mr Langham's detailed account (that I accept) later, but the gist of it was that during the discussion of the completion of the 2014-15 accounts in July 2016 Mr and Mrs Rutter decided to declare a £560,000 'dividend' and offset it against their outstanding directors' loan account, but he did not input it onto Sage until April 2017.

Findings of Fact

18. I turn to my findings on the balance of probabilities. Mr and Mrs Rutter met in Leicestershire in the 1980s and later married. Mr Rutter ran a small business where Mrs

Rutter helped out with administrative and finance tasks in the evenings whilst working in a technical support analyst. She was then made redundant and by 1995 was working at a car dealership in purchase ledger accounts and moved to another company in 1999 dealing with its accounts with the assistance of an accountant. So she has experience of accounting, although I accept she has no formal training.

19. In 1999, Mr and Mrs Rutter incorporated Rutland Communications Ltd, which was a family company that grew sufficiently for Mrs Rutter to give up her employed role and she took on full office manager responsibilities. Indeed in 2012, their son Tommy Rutter began working for Rutland Communications Ltd. I have not heard evidence from him, but I understand he went on a part-time accounting technicians' course.

20. On 21st February 2013, the Company (i.e. Rut5 Ltd) was incorporated. It initially manufactured shopfitting units, at its rented factory units in Market Harborough. Mr and Mrs Rutter were equal shareholders and directors – with Mr Rutter responsible for the operational side of the business and Mrs Rutter responsible for the administrative and financial side. Tommy inputted data to produce the management accounts on 'Sage' to be reviewed by Mrs Rutter and their accountant, Mr Langham.

21. In August 2013, the Company set up a facility to factor their book debts with Redd Factors Ltd, who also took a floating charge debenture (AB109-129). This was the later foundation in November 2017 for the appointment of Mr Irwin as Administrator when the Company hit trouble. However, back in 2013-2015, I accept the relationship between Redd Factors and the Company was reasonably good and trusting.

22. Whilst the Company initially manufactured shop fittings, within a few months they had begun manufacturing digital media units ('POD's). These are those familiar 'digital hoardings', comprising a cabinet and a screen, advertising products in shops and shopping centres. These clearly 'took off' and the Company secured a steady contract to manufacture 100 PODs a month. This enabled the Company premises to be bought in June 2014 with a mortgage for £350,000 from Lloyds Bank and an additional £150,000 secured loan from Russell Cade Investments.

23. So, judging by the 2013-2014 accounts prepared by Mr Langham in December 2014 (MB1405-1418), the Company had a solid first 17 months (its financial year-end was 31st July). The Company's turnover from February 2013 to July 2014 was £1,742,220,

with gross profit of £581,151 and net profit after tax of £40,668. It had net assets of almost exactly the same - £40,670, with its main fixed asset the Company premises. Trade debtors totalled £152,501 and 'Other Debtors' totalled £478,888, which as Mr Irwin said would include the Directors' Loan Account ('DLA').

24. The DLA was recorded on a separate ledger account (MB249-254) on the Company's electronic bookkeeping system 'Sage', titled 'Directors' loan Account (P&J)' (i.e. 'Paul and Joanne' – Mr and Mrs Rutter). As Mr Rutter confirmed and (in this case) I accept as consistent with the ledger entries, there was only one loan account for them both and they appear to have used it rather like an overdraft facility: debiting it with expenses – including personal expenses (such as 'Range Rover'), 'Wages', 'Salary' and 'VTG Commission' (which Mr Rutter earned on POD sales), but then also regularly 'crediting' it. Mr Irwin has thoroughly investigated the Company's finances but has not suggested those 'credits' were not genuine, although he challenges the largest such 'credit': the 'net dividend' of £560,000 to which I return later.

25. Most of these entries were inputted by Tommy Rutter under Mrs Rutter's supervision. However, every few months (at least, as I will explain, until 2016) and especially around or after the financial year-end in July, one can see entries made by Mr Langham (marked 'DML'). As he and Mrs Rutter explained, he worked for the Company and others owned by Mr and Mrs Rutter, but would visit around year-end whilst preparing annual accounts and tax returns (in late 2014 for the 2013-14 accounts, in July 2016 for 2014-15 accounts and in March 2017 for 2015-16) He would then review the Sage entries against his own records used for the accounts to make sure both were correct and reconcile them, as one would expect. Therefore, one can see in the Sage account at such times entries which appear out of date order, such as several 'DML' entries dated 31st July 2014 but in between entries in November and December 2014 (MB250) – at the time Mr Langham did the 2013-14 accounts. Whilst Mrs Rutter disputes the accuracy of various entries from late-2016 onwards, insofar as they predate Mr Langham's last (and most significant) entries on 12th April 2017, I reject those criticisms and accept Mr Langham would have tied the loose ends. (I will also find Mrs Rutter's criticisms of entries later in 2017 appear simply to be quibbles about how they

were recorded - by her son under her own supervision – and I also reject them and find the debits and credits on the ledger for their loan is accurate).

26. However, what the Sage ledger (at least as printed out) does not do is record a running balance (as opposed to an end balance) of the loan, or at some points indebtedness of the Company to Mr and Mrs Rutter. But helpfully Mr Irwin later extracted the entries into a spreadsheet of debits and credits and running balance on the loan (MB269-276).

27. Nevertheless, there is one important 'health warning' with Mr Irwin's spreadsheet, as Mr Langham confirmed when I showed it to him. Because the spreadsheet not only gives a balance, but has also arranged the entries in chronological order, it can on occasion give a misleading indication of what the loan balance was at a particular time. For example, by arranging Mr Langham's '31st July 2014' entries on that date rather than when he entered them in November 2014, it suggests the balance on 31st July 2014 was different than anyone viewing the Sage system on that date would see. This is particularly important to remember with the £560,000 'net dividend' dated 31st July 2015, but effectively agreed as entered by Mr Langham as I shall explain on 12th April 2017. The *legal* effect of that entry is part of perhaps the most important issue I consider in detail later. However, its effect on the *spreadsheet* was to reduce the balance of Mr and Mrs Rutter's debt to the Company by £560,000 from the 31st July 2015. So, if anyone had looked at Sage between 31st July 2015 and 12th April 2017 to look at the running balance, the debt would have been £560,000 more than on the spreadsheet (and perhaps different again given other adjustments).

28. However, the dividend does not affect the accuracy of the balance on the spreadsheet before 31st July 2015. What is striking about that is that until February 2015, the Company owed Mr and Mrs Rutter money. It rather looks like a bank account with various debits and credits, with the balance owing to Mr and Mrs Rutter of £188,971.30 on 31st July 2014, although some higher balances (e.g. on 31st August 2014) are ephemeral stages in Mr Langham's year-end reconciliation. However, it is plain that between July 2014 and February 2015, the balance gradually lowered as Mr and Mrs Rutter drew on the account until it finally moved back from 'the black' into 'the red' on 28th February 2015 (MB270) and became a true 'loan account'.

29. This loosening of the purse strings reflected the health of the Company. At that same time, early 2015, fresh from its success diversifying into PODs, it diversified much more extravagantly (and as it turned out, unwisely) into financing residential property development in the South East. Mr Rutter approached Mr Smith, director of Redline Facilities Limited in Sheffield, to project-manage the building and refurbishment of residential property developments around Radlett in Hertfordshire. Mr Smith worked mainly with contacts from Yorkshire and they also sourced materials from there and I accept Mr Smith's evidence they stored them at the empty barn at Launde Farm.

30. However, as Mrs Rutter candidly admitted, at around this time, they were also building an extension at their home at Launde Lodge Farm. Following that admission, the Claimant obtained overnight three overhead photographs: one from September 2011, one from June 2018 and one from May 2021. The 2011 photograph shows Launde Lodge Farm as four buildings around a 'quad' with an opening to the road in front crossing the picture and another building on the other side of the road (which is the barn). However, on the 2018 photograph, there is plainly a new roof all the way round this square of buildings and to the bottom-right corner (there is no compass), one can see a darker roof jutting out. That is the extension Mr and Mrs Rutter had built (with Listed Building consent granted to them in November 2011), shown from the front outside on another undated photograph. It includes a new kitchen and indoor swimming pool, even if undated photographs from Mr and Mrs Rutter show the latter in an unfinished state (although as Mr Rutter did not deny, the property has since been since marketed for sale). The 2021 photograph is broadly similar.

31. When investigating the affairs of the Company from 2017, Mr Irwin found 2015 and 2016 Reserves Schedules (MB35-40/52-3) referring to £225,852.48 in costs on sub-contractors and materials relating to Launde Lodge Farm. This appears to have been prepared by Mr Langham but again probably with the assistance of Mrs and Tommy Rutter – certainly they did not correct it or dispose of it as based upon any misapprehension. So, the Company's own contemporary records between late 2014 and August 2016 clearly show a total of £225,852.48 was billed to the Company relating to Launde Lodge Farm. This is a considerable sum for an extension, but as the photographs show, this was a considerable extension and other work was clearly done at least on the

rooves of the other building by Mr and Mrs Rutter at the time. However, there is no evidence that any of that was ever put through the loan account.

32. The details of some of the invoices are revealing, for example the labour invoices for *'work at Launde Farm'* (as well as other places) from James Stapleford (pgs.282-300) and BB Builders (e.g. MB305) and skip hire (MB595), crane hire (MB603) and scaffolding (MB644) there. A building inspector visited *"Two storey pool extension at Launde Farm Lodge"* (MB489) and an invoice showed hire of an excavator for the *"Launde Extension"* (MB662). Whilst Mr Smith said he had been shown invoices definitely relating to Company work he was unclear whether they were these invoices.

33. Mr and Mrs Rutter's case in the Defence and Mr Rutter's evidence included the assertion that all these invoices relate to work done elsewhere but billed to Launde Farm, especially as it had been the registered office of the Company. However, that changed to the Company factory premises in March 2015, close to the start of the development project and it is not credible that so many contractors made that same mistake. Moreover, whilst I accept Mr Smith's evidence that the barn was used for storage for other development projects, this does not explain all the invoices Mr Irwin found plainly *relating to* Launde Lodge Farm, as opposed to simply *addressed* there. Indeed, whilst Mrs Rutter initially started off in evidence parroting their pleaded case, after candidly admitting they had built the extension, she also admitted that some of the invoices related to that extension and were paid through the Company, although she thought that they would be accounted for in the loan account. However, she accepted that this was the first time she had said this and did not in fact point to any entries in the loan account on this issue. I find none of them were accounted for.

34. These concessions prompted Mr Rutter to change tack overnight. As I have said, he started deploying entirely new arguments in cross-examination to try and explain away the evidence, in an increasingly strained and incredible way. This included that the work actually related to construction the Company and Redline had undertaken at a neighbouring property 'The Stables' (the first time he had mentioned this), producing an invoice. 'The Stables' is shown on the 2021 photograph (on the other side of a neighbouring property 'Launde Abbey' which seems largely unchanged) in the bottom-right hand corner, as an 'L-shaped' building with a fence round a yard. However, this fence is absent in the 2018 photograph and this building is absent in the 2011 one

(although there may have been old stables under the trees, hence the name). So, I accept there was building work at 'The Stables'. On the assumption (which the Claimant does not accept) this 2016 invoice from the Company to the owners of 'The Stables' is genuine and had not just been created by Mr Rutter overnight, it shows that the Company undertook construction work there. It does not prove that any of the invoices *Mr Irwin relies on* relate to work at 'The Stables' rather than 'Launde Lodge Farm'. It is the latter they refer to – and I note the Company's invoice to 'The Stables' is addressed to 'The Stables', Launde Road, Launde', not 'Launde Lodge Farm'. Whilst some workers using the barn may have referred to the barn as 'Launde Lodge Farm', they are unlikely to have referred to that for work relating to 'The Stables'.

35. Ultimately, if Mr and Mrs Rutter had been straightforward from the start that they spent Company money on developing their home, it is theoretically possible they may have been able to point to particular invoices which were legitimate Company expenditure, or which were properly accounted for as part of the directors' loan account. But I simply do not know, as that is not the course they took. Whilst I have assisted them with legal points and in questioning, it is not my role to trawl through invoices trying to look for a factual case they'd be aware of yet are not presenting.

36. I am therefore driven to conclude that the Claimant has proved on the balance of probabilities that all £225,852.48 of work invoiced from 2014 to August 2016 referring to Launde Lodge Farm all related to work done on Mr and Mrs Rutter's property and was billed to the Company but not properly accounted for through their loan account. I stress that conclusion does not rest on the burden of proof being on Mr and Mrs Rutter in any way, although in principle I consider it should be to the extent discussed by ICCJ Briggs in *Re Glam and Tan* and clearly the Defendants have failed to discharge that burden to the extent it is on them.

37. The Claimant makes a similar argument in relation to £30,226.56 in invoices relating to 4, Marsh Avenue in Kibworth. Again, there are many invoices referring to work at 'Marsh Avenue' (e.g. MB766-70). Mrs Rutter accepted that Marsh Avenue was their property and a considerable amount of work had been done there. Indeed, Mr Rutter put to Mr Irwin that it was far more than £30,000-worth of work, which he accepted. However, that is not inconsistent with the Claimant's pleaded case that £30,226.56 of *Company* money was used to (part-)fund the refurbishment of Marsh Avenue, since that

is what the invoices show, corroborated by Sage entries (see MB55-159). In the Defence, the only positive case is that invoices were made out to the Marsh Avenue address in error. But this makes no sense – the invoices relate to *work at Marsh Avenue*. Moreover, Mr and Mrs Rutter did not address this at all in their statements. Mr Rutter's entirely new assertion that the owner of Marsh Avenue worked for the Company and had 'put invoices through' is totally new, not evidenced and I reject it. Again, I am driven to conclude the effectively evidentially uncontradicted Company records show £30,226.56 of Company money was used to refurbish Marsh Avenue: neither Company expenditure, nor declared in the loan account.

38. However, whilst Mr Irwin tentatively floated in his statement that an additional £167,000 of expenditure could relate to Marsh Avenue, I am not in a position to make findings about that. It is not part of the Claimant's pleaded case which is limited to £30,226.56 and this is merely asserted in Mr Irwin's statement but not set out in any detail. If it is not my role to plough through invoices to build a case for the unrepresented Defendants to reduce their liability on Launde Farm, it is certainly not to do so for the represented Claimant to increase its recovery on Marsh Avenue. Indeed, whilst the Claimant initially sought an account, that was sensibly abandoned. So, I simply find on the balance of probabilities Mr and Mrs Rutter in total used £256,079.04 of Company money on their own two properties without declaring it.

39. In fairness, most of this personal expenditure funded by the Company was in 2015 when it was doing very well for most of the year. The POD contract was still proving very lucrative and it may well be the foray into property development prospered early on. Certainly, the accounts for the year-end 31st July 2015 (AB28-41) prepared by Mr Langham and signed off by Mrs Rutter on 29th July 2016 showed a spectacular year. Instead of the £1,742,220 turnover in 2013-14, turnover in 2014-15 increased almost ten-fold to £10,175,076, and net profit to £768,753 after allowance for tax of £204,970 (roughly the same as the £199,074.28 in Corporation Tax for the year declared to HMRC at the same time (but not paid, to which I return later). The reserve and net assets had also risen from £40,670 in 2014 to £809,423 in 2015 (before the £560,000 dividend). Moreover, in August 2015 Redd provided a loan of £250,000 secured on the 2013 debenture to pay off the £150,000 loan and interest to Russell Cade. However, the Company's rude health had encouraged Mr and Mrs Rutter's lavish

spending on their loan account. Their indebtedness had risen from credit on 28th February to owing £688,833.07 six months later, on 22nd July (MB271).

40. The next entry dated 31st July 2015 (MB272) is the 'net dividend' of £560,000, which on Mr Irwin's spreadsheet reduced the debt down to £128,833.07. However, as I explained, this is a reflection of the automatic chronological re-ordering of that spreadsheet, which was pulled through from the Sage account. Sage shows the 'net dividend' entry of £560,000 is dated 31st July 2015 but is sandwiched between two entries dated 12th April 2017 (MB254-5). That date is now agreed to be when Mr Langham inputted it. The Claimant no longer says this was on 31st July 2015.

41. Whilst I will come back to the circumstances in which Mr Langham made this entry on 12th April 2017 below, to understand why he did so, it is necessary first to set out my findings of fact in the intervening almost two-year period. However, I should first make clear it is also now common ground there was no actual movement of money at any stage. The 'net dividend' of £560,000 was a purely 'accounting transaction' having the effect of offsetting that 'dividend' to Mr and Mrs Rutter as shareholders against their directors' loan liability to the Company. The dispute is when that 'accounting transaction' was a 'distribution' under s.829 CA: 31st July 2015, 29th July 2016 or 12th April 2017. The different timings make a huge difference as to its legality because of the very different financial state of the Company on those three dates.

42. Indeed, the respective year-end accounts show dramatic decline from a £768,753 net profit in 2014-15 (AB31) to a £423,663 net loss in 2015-16 (MB24-5). This is explained by several factors. However, given a key issue is what and when Mr and Mrs Rutter should have known about the financial state of the Company, it is important not to roll those together in hindsight but rather take them in sequence:

42.1 The first problem was that in October 2015, the Company's biggest success – digital media 'POD's – came to an abrupt end. It appears that a dispute broke out with a lender over ownership of the PODs which the Company later resolved, but in the meantime, production stopped and sales dried up. This may well account for the fall in turnover from £10,175,076 in 2014-15 to £4,930,298 in 2015-16. Certainly, stocks rose from £196,882 in 2014-15 to £240,856 in 2015-16, suggesting more unsold stock. Sales may also have

started to suffer from the difficulties of a regular customer who later went into liquidation owing the Company £225,000.

42.2 The second problem, which would have become apparent as 2015-16 drew on, was that despite the sudden stop in POD production and fall in sales, business expenses were not markedly falling from £1,187,351 in 2014-15 to £1,080,023. Analysis of the 2016 accounts (MB33) shows most normal overheads were similar, but legal and professional fees shot up from £8,442 in 2014-15 to £101,237 in 2015-16 (doubtless partly due to the POD dispute). Consequently, as cash-flow tightened from falling sales, cash deposits dropped from £299,319 in 2014-15 to £54,992 in 2015-16 (MB25) Therefore, the Company was in a classic 'cash-flow crunch'.

42.3 The third problem is that by the end of the 2015-16 financial year, it would have also become apparent that the new property development and lending side of the Company was not prospering. I note even the work on Launde Lodge Farm stopped incomplete in August 2016. £600,000 appears to have been loaned to finance a property development in London where that company had gone into liquidation by December 2017 when Mr Irwin wrote his initial report for Rut5's Administration. It is unlikely this debt was all lost in 2015-16, not least as by 2016-17, the Company had made other unsuccessful loans of £156,000 and £300,000, some of which may have partly fallen into 2015-16. Certainly, loan interest from lending to other businesses also fell nearly £200,000 (MB33). However, I find all that partly explains the dramatic shift in the Company's debtors from 2014-15 where the Company was owed £1,086,349 (£840,622 trade debtors and £245,727 other debtors) to 2015-16 where the Company was only owed £669,129 in total (£111,248 trade debtors and £557,881 other debtors). I will come back to the significance of those 'other debtors' figures.

43. However, whilst it certainly would have been apparent to Mr and Mrs Rutter by July 2016 that 2015-16 had been a worse year than 2014-15, it is important not to place too much weight on the hindsight that comes from knowing the Company entered Administration in November 2017. Of course, Mr and Mrs Rutter had access to Sage, but they did not have Mr Langham's formal 2015-16 accounts (MB21-34) until March 2017. Indeed, even looking at those accounts, it is striking that not only had expenses not

changed much since 2014-15, but also that the asset and creditor position had not changed much either e.g. the short-term creditors had been £1,571,223 in 2014-15 and were £1,384,701 in 2015-16; the long-term unsecured creditors (both more than 1 year and more than 5 years) had been £667,745 in 2014-15 and were £669,325 in 2015-16; whilst the secured creditors had been £387,880 in 2014-15 and were £319,281 in 2015-16 after the re-financing with Redd in July 2015. Therefore, all in all, the Company was still servicing its debts, even if it was effectively treading water with them rather than making real headway. Yet, that is scarcely surprising given the catastrophic fall in turnover – and lesser but still significant fall in debts owed – noted above. So, by 31st July 2016, the Company had had a very bad year, but it was not yet in real financial trouble, even on its own later accounts for 2015-16.

44. Moreover, that bad trading year in 2015-16 had come after a stellar trading year in 2014-15. Small companies often hit a large bump in the road but recover and keep on going. Mr and Mrs Rutter had long experience of such small businesses since the late 1980s and I accept that it was not simply mindless optimism or 'Micawberism' which led them to consider that 2014-15 proved they were on to a good thing with the PODs and they could turn it round again and/or the property development would come good. Mrs Rutter, with evident fondness, described in evidence her faith based on experience that Mr Rutter would find a solution, as he had with their other businesses before.

45. Nevertheless, as Mr and Mrs Rutter got to July 2016, whilst it would be 8 months before they had the concerning 2015-16 accounts, they must have already known it had been a bad year and they needed to tighten their belts. As Mr Langham prepared the 2014-15 accounts reflecting easier times, it became apparent to him the net profit for 2014-15 would be nearly £770,000 and tax liability about £200,000. In fact, the Corporation Tax Return Mr Langham prepared for 2014-15 also dated 29th July 2016 shows liability of £199,274.28 (MB1074-8), whilst the accounts a slightly higher figure of £204,970. Therefore, the net profit after tax was £768,753, which with accumulated profit reserves from 2013-14 of £40,668 gave distributable profits of over £800,000.

46. It does not appear Mr Langham made any Sage entries in July 2016 (MB253) (it would be much a simpler case if he had). But he said and I accept that he would have looked at the loan account. I took him to the running balance in July 2016 in Mr Irwin's spreadsheet and he agreed that one would need to add on £560,000 to see what the balance would

have appeared as at that time, since it was not adjusted until April 2017. Therefore, as at the entry on 28th July 2016 (which was made on that date – see MB253), the apparent balance of £181,218.31 (MB273) may well have then appeared as £741,218.31. Therefore, by around that date three important factors would have been clear to Mr Langham analysing the internal records. Firstly, on one hand for 2014-15 there was a substantial fund of undistributed profits which could be declared as a dividend. Secondly, on the other, by July 2016, there was a substantial debt on the directors' loan account which could be reduced dramatically by the 'accounting offset' of such a 'dividend'. Thirdly, whilst work on the 2015-16 accounts lay 8 months ahead, the year just finishing had plainly been much worse than 2014-15 had been.

47. Neither Mr Langham, Mrs Rutter nor Mr Rutter could remember exactly how the dividend arose in their discussion of the 2014-15 draft accounts in late July 2016. However, I accept Mr Langham's account (not inconsistent with Mr and Mrs Rutter's evidence, although neither could remember much detail). I find on the balance of probabilities that Mr Langham explained the combination of high undistributed profits in 2014-15 and high loan balance by July 2016 to Mr and Mrs Rutter who recognised a chance to reduce their indebtedness by using a dividend to reduce the loan. They probably also have realised they needed to do so then, given 2015-16 had been worse.

48. I pointed Mr Langham to the corrected balance on Mr Irwin's spreadsheet on 1st August 2016 of £43,343.07 (MB273), suggesting a pre-adjusted balance of c.£600,000 - Mr Langham thought it may have been £560,000 so the dividend reduced it to nil. However, the Sage entry of 1st August 2016 reducing the balance by £137,875.24 to £43,373 was actually made in late October 2017, just before Administration (MB254). So, the better inference from the documents on the balance of probabilities is that a dividend of £560,000 was chosen in July 2016 to reduce the *undistributed profits* in the 2014-15 accounts down to £249,421 (MB38). That was over six times higher than the figure in the 2013-14 accounts: £40,668. A reserve cushion of just under £250,000 for losses in 2015-16 was a wise provision at the end of a worse year in 2015-16 than in 2014-15, although hindsight now shows that year turned out worse even than feared.

49. Be that as it may, whatever the reason £560,000 was chosen, I accept Mr Langham's evidence that Mr and Mrs Rutter decided to use it as a dividend back-dated to 31st July 2015 to reduce the directors' loan. Mr Langham did not decide that off his own bat – he

says and I accept Mr and Mrs Rutter decided to do that following discussion of the draft accounts in July 2016 and he recorded that they had done this in the 2014-15 accounts which Mrs Rutter then approved on 29th July 2016. This recorded not only the dividend and reserves but that the 'other debtors' balance (which as Mr Irwin said, would record the directors' loan account) at 31st July 2015 was £245,727. The last unaffected directors' loan account balance before the £560,000 adjustment was on 22nd July 2015: £688,833.07 (MB271). It follows that Mr Langham's 2014-15 accounts also plainly recorded the reduction of £560,000 in the directors' loan account balance as at 31st July 2015 under 'other debtors', because otherwise that balance in the accounts would have been far higher than £245,727. Both dividend and reduction were recorded.

50. Therefore, in short, I find as facts on the balance of probabilities that in July 2016, as Mr Langham prepared and discussed the 2014-15 draft accounts, Mr and Mrs Rutter decided (i) to take a dividend of £560,000, leaving profit reserves of c.£250,000 and (ii) to offset that £560,000 against their directors' loan debt, then almost £700,000. Mr Langham then prepared the final accounts on that basis, backdating the transaction to the year-end 31st July 2015; and explicitly recording both aspects of it in the accounts which Mrs Rutter then formally approved on 29th July 2016. This ensured the accounts gave a true and fair view of the Company's finances as at 2014-15 (s.393 CA to which I return). However, no entry was made on Sage reducing the directors' loan balance then.

51. Another point emerges when one studies the detail of the accounts. Mrs Rutter accepted that she and Mr Rutter had not declared the dividend by shareholder ordinary resolution under Art.54.1 of the Company's Articles. However, Art.54.1 states: "*The company may by ordinary resolution declare dividends and the directors may decide to pay interim dividends.*" (my underline). Whilst I and Mr Tabari both missed it at the time, actually if one looks at the relevant 'line' of the 2014-15 accounts, the £560,000 is declared as an *interim* dividend (AB35). So, Mr and Mrs Rutter's decision (as directors) to award themselves as shareholders an *interim dividend* appears consistent with Art.54 (though it was not explored in evidence, I also consider its lawfulness later). Moreover, as the loan account was in their joint names and as there was no explicit apportionment, it follows the credit of £560,000 just reduced their joint indebtedness on their loan.

52. Mr Tabari also pressed Mr and Mrs Rutter whether they had declared that dividend in their personal 2014-15 income tax returns, which they have pointedly failed to disclose

despite repeated requests. Whilst Mrs Rutter speculated that she had asked for them from Mr Langham, he denied having prepared them (which I accept). Tellingly, amid all his tall tales about Launde Lodge Farm in evidence, Mr Rutter, having started out with the same line as his wife, when pressed on this by Mr Tabari, rather sheepishly accepted that he probably did fail to declare it in his tax return. I find this was the case for both of them and sadly also echoes their failure to pay the Company's Corporation Tax of just under £200,000 and various other tax liabilities which finally led to the winding-up petition. This reflects no credit whatsoever on them. However, the irony is if Mr Tabari is right that the £560,000 'dividend' had no legal effect until April 2017, Mr and Mrs Rutter did not break the law in not declaring it for tax in the year 2014-15.

53. This is not the only respect in which, as I said above, it would have been a much simpler case if Mr Langham had on or about 29th July 2016 entered on Sage the net dividend of £560,000 dated 31st July 2015 as reducing the loan account, as he did on 12th April 2017. Had he done so, the one remaining but (according to Mr Tabari's and my own researches) apparently novel and complex legal issue I have to resolve later of whether the 'distribution' under s.829 CA happened on 31st July 2015, 29th July 2016 or 12th April 2017 would not have arisen. Mr Tabari (as I will explain, fairly and in my view correctly) does not argue that if the 'distribution' under s.829 was in July 2016 that it was unlawful. Indeed, I have foreshadowed the basic reason in this judgment above: by 29th July 2016 it would have been clear to Mr and Mrs Rutter that 2015-16 had been worse than 2014-15, but they did not yet have the detail of that in the 2015-16 accounts which did not come until March 2017. Moreover, unlike at that stage, as at July 2016, the Company ended a bad year but was not yet in real financial trouble. Indeed, using a dividend of £560,000 to reduce what they owed the Company, rather than taking it out of the Company as cash, benefitted the Company as well as them.

54. Yet Mr Langham did not complete that Sage entry recording the net dividend of £560,000 at the end of July 2016. In fact, he did not do so until 12th April 2017 just after he had finished preparing the 2015-16 accounts signed off on 30th March 2017, because he did not do further work for the Company for those 8 months. Mr Tabari argued that Mr or Mrs Rutter therefore could and should have made the Sage entry back in July 2016 or soon afterwards. However, Mr Langham said it would have been more appropriate for him to have done that as a year-end adjustment. Mrs Rutter also said that such a year-end

journal entry would have been made by Mr Langham. As she said, she was not a trained accountant. However much she and Mr Rutter merit criticism for failing to declare to HMRC the dividend, it would have been bold of them to have changed their Company's ledger themselves to reflect their own decision to reduce their own joint indebtedness by £560,000. It is not unrealistic to anticipate official questions about the legitimacy of doing that. I can understand why she would prefer it be done by Mr Langham. After all, here we are six years later and her joint liability for £560,000 hangs on the legal status of that entry and the July 2016 decision and accounts. Of course, I do not find that Mrs Rutter would have anticipated that. However, I do accept that she preferred – reasonably – for Mr Langham to make that Sage entry – indeed he said himself in evidence it would be more appropriate. I accept that it was.

55. However, what Mrs Rutter could have done in Autumn 2016 is just to *ask* Mr Langham to make that Sage entry of £560,000. There were several reasons why she did not:

55.1 Firstly, because the Company was now in straitened times for cashflow, Mr Langham was not getting paid – he was 'last in the queue' as he put it. I strongly suspect any goodwill from their previous friendship was close to exhausted now as Mr and Mrs Rutter cut costs, including Mr Langham's fees.

55.2 Secondly, whilst I have accepted Mr and Mrs Rutter were disappointed but determinedly optimistic in July 2016 to return to a better year in 2016-17, I accept by early 2017, the situation was plainly going from bad to worse. As Mr Irwin later observed in his December 2017 report (AB211), there was no improvement in the POD sales and the property ventures had fallen flat leaving only debt and litigation. An individual owed the Company c.£156,000, another company owed it £300,000 (guaranteed up to £250,000) and yet another company owing it £600,000 had gone into liquidation. Moreover, even though Mr Langham had carefully made provision for c.£200,000 2014-15 Corporation Tax in the accounts, Mr and Mrs Rutter had not paid it – hoping in discussions with Mr Langham in March 2017 to offset the 2015-16 losses (MB257). As I will discuss, by September 2017, HMRC had lodged a winding-up petition for £326,438.29, including the £199,074.28 in Corporation Tax. It is striking that the dates of the tax due are (save for a few minor sums) from mid-2016 onwards. This illustrates that from about late 2016, the cashflow problems had got so bad that the Company was not meeting its tax liabilities as it had previously done.

55.3 Thirdly, rather than calling on the accounting expertise of Mr Langham, I accept Mrs Rutter's evidence that by 2017, their main need was advice to try to save the business. Indeed, their bank (Lloyds, the mortgagee of the factory) had sent in an insolvency adviser to try to help the Company trade through the crisis.

It is perhaps unsurprising that amidst all these difficulties, calling in Mr Langham to make a formal amendment to Sage to reflect the dividend they had formally recorded and used on the loan account in Summer 2016 was not a high priority, if Mr and Mrs Rutter even gave it a thought at all. In this context, whatever one may think about their failure to pay and declare tax for 2014-15 personally and for the Company, so far as the issue of not ensuring the £560,000 dividend was entered on Sage is concerned (which in fairness to them, Mr Langham could have done back in July when finishing the accounts), this can legitimately be seen as a genuine and understandable oversight.

56. This brings me at last to Mr Langham making that entry for £560,000 net dividend on Sage. It was plainly done on 12th April 2017, because it is sandwiched between two other entries on that date, the second of which was also done by Mr Langham. He had already finished the 2015-16 accounts, which Mrs Rutter had signed off on 30th March 2017, following discussion of the tax position (MB257-258). The gap in time between lodging the abbreviated accounts at Companies House was almost a month – to 25th April, much longer than the previous year and straddling this date of 12th April. However, whilst suggesting in cross-examination to Mrs Rutter that this was in some way sinister (which prompted her to warn Mr Langham overnight before his evidence), Mr Tabari did not really pursue that point in submissions. He recognised that given the dividend (and indeed its offset on the loan account in 'other debtors') had been recorded in the 2014-15 accounts in July 2016, it was not sensible to argue the dividend had only been decided upon in April 2017 in some way to steal a march on the by-now looming insolvency. Instead, Mr Tabari has pursued the much better legal point that the 'distribution' under s.829 CA was only complete when entered on Sage on 12th April 2017 and by then, the risk of insolvency was so high that it was unlawful.

57. However, Mr Langham rejected that interpretation of his actions in cross-examination really for two reasons. Firstly, he said that far from the Sage entry in April 2017 constituting the 'transaction' itself, it was correcting and backdating Sage to reflect what was in the 2014-15 accounts, which is what year-end Sage adjustments were for and as

he had done many times before. Secondly, it was plain from his evidence that Mr Langham would never have considered facilitating a dividend of £560,000 for a company whose accounts he was just about to lodge at Companies House showing a loss of over £400,000. Mr Irwin had said it would be 'surprising' for a qualified accountant to have done so. I would say it would have been reckless and indeed unlawful as Mr Tabari argues. Moreover, as I have noted, Mr Langham does not say he was reminded or instructed by Mr or Mrs Rutter on 12th April to make that Sage entry, yet I entirely accept he would not have made it completely off his own bat (and properly understood, I do not consider that was what Mrs Rutter was suggesting). I find on the balance of probabilities that Mr Langham made this entry thinking he was simply 'tidying up Sage' as a year-end correction. His authority to do so derived from Mr and Mrs Rutter's decision in July 2016 and his and their expectation he would enter it on Sage, which he accepted it would be more appropriate for him to do than them.

58. I can take the rest of my findings of fact relatively quickly. Leaving to one side the dividend issue, from Mr Irwin's spreadsheet of the directors' loan account, it might appear that it was again in credit for much of the second half of 2016 and first half of 2017 until July 2017. However, that would not be how it would have appeared at the time, because it would have shown Mr and Mrs Rutter substantially in debt to the Company throughout, were it not for the last credit to Sage of £13,875.24 dated 1st August 2016 entered by Tommy Rutter apparently on or after 26th October 2017 – just before the Administration started on 1st November 2017 (MB254). I spotted this point in my draft judgment and it was briefly explored with Mrs Rutter in her evidence on the re-opened issue. I accept Tommy made this entry in late October 2017 and backdated it to August 2016 on Mr Langham's instructions and that it was legitimate.

59. However, in my draft judgment, I also found that due to that retrospective correction, in mid-July 2017 the directors' loan account had strictly been in credit. Therefore, the debt of £104,688.12 which the Claimant claims had been run up between July and October 2017 – despite the difficult financial circumstances of the Company. As I explained above, this finding was enough of a factual foundation for the Claimant's re-opened legal point, which Mr Tabari omitted to deal with in closing submissions, that this was not just a debt (which could be set-off) but a breach of duty (which legally cannot be). This was one of the main reasons why I both allowed the Claimant to re-open the point (that it had

pleaded and established in evidence but simply omitted in submissions) but also for Mr and Mrs Rutter to give further evidence if they wished to address it and indeed ordered repeat disclosure of Company bank statements as they had requested. Mrs Rutter gave evidence and was cross-examined. Mr Rutter added observations that Mr Tabari did not challenge and which I shall treat as evidence. I accept their evidence on this issue as genuine and honest (although as I will explain, that does not help them on the legal issue) and I will make the following additional findings of fact on the point.

60. As I have said, in March 2017, Mrs Rutter signed off the 2015-16 accounts (that Mr Rutter also saw) which showed that 2015-16 had been much worse than they had feared in July 2016 when I have found they decided on the £560,000 dividend. Moreover, as I have explained, by Spring 2017 the actual situation had deteriorated: there was a cash-flow crisis. Judging by those re-disclosed bank statements, by late March the Company bank account had entered its £50,000 overdraft and rarely left it.

61. Indeed, by early June 2017, the Company had been near or even above its £50,000 overdraft limit for a couple of months. This briefly changed on 7th June when Redd Factors leant it £133,000, but that same day it was all paid out and the account when back into overdraft and a fortnight later was back at its over-draft limit. This is where Mr Hickey briefly enters the story, as on 14th July he leant the Company £300,000 (which he maintains was guaranteed by Mr Rutter: the subject of Mr Hickey's claim). Whatever the position about that guarantee (which I need make no findings about), I accept that money was soon spent on PODs and three days later on 17th July, the Company was back in its overdraft yet again and then remained there.

62. It was also on 17th July that the director's loan account (as retrospectively corrected by Tommy Rutter's 2016 entry in October) moved from credit to debit (pg.276). In the following three months until the last entries (including Tommy Rutter's retrospective one) on 26th October 2017, just over £220,000 of debt was accumulated, offset with about £70,000 of repayments. However, making undisputed adjustments, the figure the Claimant seeks as non-Company expenditure by Mr and Mrs Rutter which they are said to owe in debt and in breach of duty in that period is £104,688.12 (MB276). In fact, I accept Mrs Rutter's re-opened evidence that £10,000 to 'Exodus Financial' was genuine Company expenditure, reducing that total debt to £94,688.12.

63. Nevertheless, I see no other reason to adjust my finding in my draft judgment that all the rest of that £94,688.12 was personal expenditure by Mr and Mrs Rutter. Indeed, the vast majority of the entries in the Sage ledger say 'P & J Rutter'. There were no fewer than 24 payments to themselves, including of £18,597.96 (apparently according to the bank statement the finance on their BMW car), £10,000 and £15,000, as well as £7,143.20 apparently to a travel agent. Mrs Rutter did not seem too sure if that related to a holiday or business travel, but as Mr Tabari says, if the latter, there would be no need to claim it through the loan account. Whilst Mrs Rutter challenged some of the other payments, for the most part these seem to be quibbles about accounting or wording, which is particularly ironic given the ledger throughout would have shown a substantial debt until 'corrected' by the credit of c.£137,875.24. I find on the balance of probabilities all withdrawals were properly included, related to personal not Company expenditure. So, in just over 3 months to 31st October 2017, aside from the dividend, credit of £137,875.24 and £10,000 to Exodus Finance, the debt run up was £94,688.12.

64. Indeed, Mrs Rutter accepted that they had continued to use the directors' loan account as they had always used it – to pay themselves 'wages' (strictly 'drawings', but it does not matter) and other personal expenses. I find they did to the sum of £94,688.12. Indeed, unlike the dividend, this can be seen in the 'real world' expenditure of the bank account (which of course may only have covered part of their journaled spending). This shows a number of the items on the ledger (including the £18,597.96 for the BMW finance and £7143.20 for the travel agent which I accept related to a holiday especially given the time of year in July). By the end of July, the bank account was back up to its £50,000 overdraft limit. Whilst this occasionally and very briefly reduced, the account was near its limit both before and after 18th September 2017 when HMRC presented its winding-up petition for £326,438.29 (MB228), including £200,000 Corporation Tax.

65. Mr and Mrs Rutter freely admit continuing to use the loan account as they always had - even despite this line of financial shocks: the disastrous 2015-16 accounts approved in March 2017, the massive unpaid Corporation Tax bill of £200,000 which came back to roost in that petition and the intervention of a bank insolvency adviser. They maintained their determined optimism because the Company was owed a total of £1.3 million from various sources and they were advised they could trade through the storm. I accept that this was their genuine view. However, to use an analogy I floated at

the time, they did not 'batten down the hatches' despite that storm, they just kept on sailing as usual because they could see daylight on the horizon. I will have to consider below if that was a breach of duty to the Company and creditors. For now, I can return to my findings of fact as they were in the draft judgment.

66. Mr Rutter repeated what he said in the course of the earlier challenges to Mr Irwin's appointments: that even after that winding-up petition, the Company could have kept on trading with its full order book. They had an offer of finance to pay off the tax bill from another corporate lender and Mr Rutter plainly feels 'tricked' by Mr Sullivan from Redd Factors into agreeing to Administration on 31st October 2017, when presented with an inflated demand for over £800,000. I have some sympathy with Mr Rutter's concern this level of indebtedness was inaccurate – Mr Sullivan appears to have acknowledged as such a few months later. But be that as it may, as HHJ McCahill QC found on 13th March 2020, it did not invalidate Redd's appointment of Mr Irwin as Administrator and as I found his transfer to liquidation was also valid.

67. Much of Mr and Mrs Rutter's challenge to Mr Irwin in questioning him was to the conduct of the administration and liquidation. This is not only irrelevant, it is unfair. Mr Irwin was diligent – and if his job was complicated, that was because of the poor and confusing record-keeping at the Company – perhaps typified by that 18-month delayed 'correction' to the Sage account on 28th October 2017 of over £130,000. Whilst Mrs Rutter says that she and her son were untrained, this does not explain why she and Mr Rutter failed to engage with Mr Irwin's investigation and his draft statement of affairs dated 1st November 2017, suggesting a total deficiency of £1,246,127 (MB241). Whilst Mr and Mrs Rutter said they provided an annotated response at the time (MB1131), as I will find, the 'County Asset Finance' and 'Lead Asset Finance' debts were not paid off until 2020 and 2021. I find they did not co-operate with that investigation (not least because Mr Irwin chased them for a response in 2019 (MB240).

68. So, even if Redd Factors' debt was much lower than £840,000 and they did pay off vehicle finance prior to the Administration so the deficiency was much lower, the Company was still plainly insolvent at the point of Administration and I am afraid that Mr Rutter's contention that they could have traded out of it is close to self-delusion. Moreover, Mr Irwin could not prevent Lloyds appointing the LPA Receivers for the factory and they did in fact recover over £400,000 even after the mortgage. However, the

Claimant has accepted that the claim for conversion cannot be pursued as there is no evidence property was taken by Mr and Mrs Rutter after receivers entered.

69. Yet, in fairness to Mrs Rutter, I was struck by her candour in her evidence that their payment of £116,000 to County Asset Finance to stave off their bankruptcy in December 2020 included not only their debt which they had guaranteed on behalf of the Company, but also debts owed to other creditors. I accept Mrs Rutter's evidence, corroborated by an email of 21st December 2020 (MB1079) that County Asset Finance were paid £116,000, but that Mr Irwin received £5,000 and Rate Setter £10,000, so I find County Asset Finance were paid £101,000 by Mr and Mrs Rutter under a guarantee (which I have not seen), which extinguished the Company's debt to them. Likewise, I accept that on 13th December 2021, Mr and Mrs Rutter paid off £16,150 of the Company's debt to Lead Asset Finance under a guarantee as well. That is accepted to extinguish the directors' loan claim in debt, but I will have to consider breach of duty. However, first I will deal with in much more detail the more complex dividend claim.

The Dividend Claim

Summary

70. This claim is at first sight legally complex – and there appears to be no reported case on the 'date of distribution' point, according to the research of both myself and Mr Tabari. However, as I said above, he (rightly) does not say that if the dividend of £560,000 was a 'distribution' made in July 2016, it was unlawful, whereas I accept if the 'distribution' only came with the Sage entry on 12th April 2017, by then it was unlawful. So, this complex issue – and £560,000 riding on it – comes down to timing.

71. I have set out my findings of fact already on this issue. I can summarise them by saying that I have found on the balance of probabilities that in the course of preparing the 2014-15 accounts in July 2016, Mr Langham had a discussion with Mr and Mrs Rutter about the level of net profits of £768,753, creating with that accumulated from 2013-14, reserves of £809,423. At the same time, the directors' loan account indebtedness was £688,833.07. However it came up, I have found Mr and Mrs Rutter decided to pay a dividend from the distributable profits and use it to reduce the loan account debt. A dividend of £560,000 was settled upon, leaving a little under £250,000 distributable reserves. Given Mr and Mrs Rutter knew in July 2016 that 2015-16 was much worse than

2014-15, that was a reasonable figure to leave in reserves, but they did not yet know that by the time the accounts for 2015-16 were prepared, they were much worse. Both sides of this purely 'accounting transaction' were recorded in the accounts dated 29th July 2016: the director-declared valid interim dividend of £560,000 and reduction in 'other debtors' reflecting the £560,000 reduction in the loan debt with effect from 31st July 2015. Mr Langham could have also recorded that on Sage at the time, but he left it to do later. Perhaps neither he nor Mr and Mrs Rutter thought it would be 8 months later, but it was reasonable for them to leave it to him and with the growing crisis in Autumn 2016 that they did not remind him was an understandable oversight (although the failure to pay tax on the dividend or the 2014-15 Corporation Tax was not). When Mr Langham did return in March 2017 to complete the 2015-16 accounts, it became apparent the 2015-16 loss was much more substantial than the 2014-15 reserves. However, Mr Langham did not think that prevented him on 12th April 2017, without even checking with Mr and Mrs Rutter, from making what he thought was simply an accounting correction to Sage to bring it into line with the 2014-15 accounts.

72. It may be the lawyers will be interested in my detailed legal reasons for my conclusion based upon my full findings of fact (of course not simply that brief summary). But Mr and Mrs Rutter – and Mr Irwin and his colleagues – simply want to know my decision. For reasons I will explain, my decision on the dividend claim is that the 'distribution' in law happened in July 2016 and so was lawful. Therefore, I dismiss the claim for £560,000. Before launching into a complex legal analysis, I will summarise it.

73. Mr Tabari's basic argument in his extremely helpful closing submissions is this:

> *"The definition of 'distribution' at s.829(1) CA requires, on a proper construction, a positive action which affects the Company's finances in some definite way. In this case, that is the date on which the entry was made into the Company's records, i.e. 12th April 2017."*

Even assuming Mr Tabari's first sentence is correct, I still disagree with his second. In this case, the *'positive action which affects the Company's finances in some definite way'* was the decision in July 2016 not just to declare a dividend of £560,000, but to allocate it to reduce the balance of the directors' loan account, then almost £700,000. That immediately *in July 2016* affected the respective legal positions of the Company – acting through its directors Mr and Mrs Rutter – and themselves in their capacities both

as directors and shareholders. It was an agreement between all relevant legal parties, just like two companies setting off mutual debts. Of course, the position is more legally complex within companies to avoid abuse under the CA. However, as I shall explain, these duties were not breached in this case. A dividend was legally declared and due and lawfully used to reduce the directors' indebtedness by £560,000. That completed transaction was recorded in the 2014-15 accounts by Mr Langham, approved by Mrs Rutter on 29th July 2016 as a true and accurate picture of the 2014-15 financial year. Sage then needed adjustment to reflect that existing legal position, which is all Mr Langham did on 12th April 2017 – just as he thought he was doing. Finally, the fact Mr and Mrs Rutter had a liability to pay personal tax on the dividend they failed to declare does not change that, although they may well owe HMRC more tax.

74. In any event, even if Mr Tabari is right that the 'distribution' legally did not happen until 12th April 2017, it follows that Mr and Mrs Rutter were not dishonest in failing to declare it to HMRC and I find they were reasonable to leave the inputting to Mr Langham and it would be fair overall to relieve them of their liability for breach.

The Legal Principles

75. Save for a couple of paragraphs later, this is the only part of my judgment which is amended to reflect the Supreme Court decision in *BTI v Sequana [2022] UKSC 22*. I did not call for further argument on it, as the Supreme Court upheld the decision of the Court of Appeal in *BAT v Sequana [2019] Bus LR 2178 (CA).* Indeed, my decisions on the couple of minor points where *Sequana* directly applies to this case are clearer. However, as the reasoning of the Supreme Court differs in some respects from the Court of Appeal, it seems to me preferable for me to focus on the former, not the latter.

76. Having said that, I start with a helpful explanation of 'dividends' in the Court of Appeal by Richards LJ (now Lord Richards, as he has become in the same week his decision in *Sequana* was upheld by his new colleagues in the Supreme Court). The classic example of a 'dividend' is a sum declared by a company to be payable (and then paid) to shareholders in relation to their shares. Richards LJ said in the CA judgment at p.41:

> *"…[R]ights are conferred on shareholders as regards dividends by the terms of issue of the shares or by the articles, and it is pursuant to those rights that shareholders receive dividends. Those rights are attached to the shares for which*

consideration was provided by the original holders. Dividends are both commercially and legally a return on the investment."

Sequana concerned the payment of a large dividend to a corporate shareholder by a company which partially set-off a debt owed to the company by the corporate shareholder. At the time, the company was solvent but had a large potential liability which risked future insolvency, which eventually happened a decade later. The Court of Appeal held this could amount to a 'transaction at an undervalue' under s.423 Insolvency Act 1986, even though a dividend is not (for the reason quoted above) a 'gift', because it is given for no consideration by the shareholder (p.50) and can amount to a 'transaction' even though it is typically a unilateral act by the company (ps.58-60). That decision was not appealed and does not arise in this case either. Therefore, from now on when referring to *Sequana,* I will refer to the Supreme Court decision unless I say otherwise. Further, whilst the Supreme Court was unanimous as to the result, the judgment of Lord Briggs commanded the support of Lords Kitchin and Lord Hodge but there are differences in nuance between his judgment and those of Lord Reed and Lady Arden. Therefore, I will respectfully focus only on the judgment of Lord Briggs.

77. The issue before the Supreme Court in *Sequana* was whether the dividend paid was not only a 'transaction at undervalue' enforceable against the recipient (and now insolvent) shareholder, but also a breach of duty by the company's directors enforceable against them. Upholding the decision in the Court of Appeal, the Supreme Court in summary agreed that at common law (as recognised by s.172(3) Companies Act 2006 ('CA')), directors owed duties to their own company to take into account the interests of its creditors when the directors knew or ought to have known that the company would be imminently insolvent, or that its insolvent administration or liquidation was probable; (including in relation to the distribution of an otherwise lawful dividend). However, since in *Sequana* that trigger was not met at the time the dividend was paid, there was no breach of what Lord Briggs called this 'creditor duty' (although he agreed with Lord Reed it was not a duty owed *to* creditors, but to the company itself *about* its creditors).

78. This is not the main way in which the Claimant puts the dividend claim here. It primarily relies on Part 23 CA, although this was also briefly discussed in *Sequana*. For example, in deciding the creditor duty applied to otherwise lawful dividends, Lord Briggs summarised the statutory and common law rules on paying dividends at p.158:

> *"United Kingdom company law regulates the payment of dividends by a combination of very old common law rules and a modern statutory code. The common law rules are those which (apart from statutory authority) restrain a company from reducing its capital: Trevor v Whitworth (1887) 12 App Cas 409. The modern statutory code is to be found in Part 23 of the 2006 Act. It provides that dividends may only be paid out of distributable profits, and then prescribes detailed rules for ascertaining what those are, at any given time, usually by reference to the company's last annual accounts…."*

However, those common law duties (not only the creditor's duty but also the 'reduction of capital' rule) and Part 23 CA sit alongside one another, as Lord Briggs said at p.160:

> *"…[S]ubject to two irrelevant exceptions, the whole of Part 23, and the authority which it provides to pay dividends, is subject to any rule of law to the contrary: s.851(1). If as I have concluded the creditor duty is part of the common law, then it cannot be treated as ousted by Part 23. In that context the respondents expressly concede that the general duty of directors in section 172(1) is not excluded by Part 23. There is no sensible reason why the creditor duty recognised by s.172(3) should be either…."* Lord Briggs then added this at p.161:
>
> *"Part 23 identifies profits available for distribution on a balance sheet basis. A company may well have a balance sheet surplus while being commercially (i.e. cash flow) insolvent. It cannot be the case that directors of a company already unable to pay its debts as they fall due could distribute a dividend, or do so if the consequence of the payment was to bring about cash flow insolvency. To do so in those circumstances would be to take a foolhardy risk as to the long-term success of the company, by exposing it to the real risk (or at least a gravely increased risk) of being wound up."*

Against that background, I will first set out two separate statutory frameworks within the CA itself: (1) relevant provisions in Part 15 CA on preparation of Company accounts, that are important to (2) the scheme of lawful distributions in Part 23 CA.

79. As to annual accounts, the requirements for the Company as a 'Small Company' being exempt from audited accounts are set out at ss.393-6 CA (the accounts must be circulated to the Company's shareholders – here Mr and Mrs Rutter - under s.423 CA):

> *"**393**(1) The directors of a company must not approve accounts for the purposes of this Chapter unless they are satisfied that they give a true and fair view of the*

assets, liabilities, financial position and profit or loss– (a) in the case of the company's individual accounts, of the company…

***394** The directors of every company must prepare accounts for the company for each of its financial years…[i.e.] "individual accounts".*

***396**….(1) Companies Act individual accounts must comprise– (a) a balance sheet as at the last day of the financial year, and (b) a profit and loss account.*

(2) The accounts must– (a) in the case of the balance sheet, give a true and fair view of the state of affairs of the company as at the end of the financial year, and (b) in the case of the profit and loss account, give a true and fair view of the profit or loss of the company for the financial year…..

(5) If in special circumstances compliance with any of those provisions is inconsistent with the requirement to give a true and fair view, the directors must depart from that provision to the extent necessary to give a true and fair view. Particulars of any such departure, the reasons for it and its effect must be given in a note to the accounts."

80. The complicated statutory framework in Part 23 CA 2006 summarised in *Sequana*, so far as material actually provides as follows:

*"**829**(1) In this Part "distribution" means every description of distribution of a company's assets to its members, whether in cash or otherwise, subject to the following exceptions.*

(2) The following are not distributions for the purposes of this Part– (a) an issue of shares as fully or partly paid bonus shares; (b) the reduction of share capital– (i) by extinguishing or reducing the liability of any of the members on any of the company's shares in respect of share capital not paid up, or (ii) by repaying paid-up share capital; (c) the redemption or purchase of any of the company's own shares out of capital (including the proceeds of any fresh issue of shares) or out of unrealised profits in accordance with….Part 18; (d) a distribution of assets to members of the company on its winding up.

***830** (1) A company may only make a distribution out of profits available for the purpose.*

(2) A company's profits available for distribution are its accumulated, realised profits, so far as not previously utilised by distribution or capitalisation, less its

accumulated, realised losses, so far as not previously written off in a reduction or reorganisation of capital duly made….

***836** (1) Whether a distribution may be made by a company without contravening this Part is determined by reference to the following items as stated in the relevant accounts: (a) profits, losses, assets and liabilities; (b) provisions of the following kinds (i) where the relevant accounts are Companies Act accounts, provisions of a kind specified for the purposes of this subsection by regulations under s.396; (c) share capital and reserves (including undistributable reserves).*

(2) The relevant accounts are the company's last annual accounts, except.. where the distribution would be found to contravene this Part by reference to th[ose]… last annual accounts, it may be justified by reference to interim accounts.

(3) The requirements of– section 837 (as regards the company's last annual accounts), section 838 (as regards interim accounts)….must be complied with, as and where applicable.

(4) If any applicable requirement of those sections is not complied with, the accounts may not be relied on for the purposes of this Part and the distribution is accordingly treated as contravening this Part….

***837**(1) The company's last annual accounts means the company's individual accounts– (a) that were last circulated to members in accordance with s.423 (duty to circulate copies of annual accounts and reports)*

(2) The accounts must have been properly prepared in accordance with this Act, or have been so prepared subject only to matters that are not material for determining…whether the distribution would contravene this Part….

***838** (1) Interim accounts must be accounts that enable a reasonable judgment to be made as to the amounts of the items mentioned in section 836(1)….".*

81. Therefore, as Zacaroli J summarised in SSF v Loch Fyne *[2021] BCC 354* at ps.88-9:

"*(1) A company may only make a distribution out of profits available for the purpose, being its accumulated, realised profits, so far as not previously utilised by distribution or capitalisation, less its accumulated, realised losses: s.830.*

(2) Whether a distribution can be made by a company without contravening Pt 23 is determined by reference to (1) the profits, losses, assets and liabilities, (2) provisions of certain specified kinds and (3) share capital and reserves (including undistributable reserves) as stated in the relevant accounts: s.836(1).

(3) The relevant accounts are the company's last annual accounts, except that (so far as relevant for this case) where the distribution would be found to contravene Pt 23 by reference to the company's last annual accounts, it may be justified by reference to interim accounts: s.836(2).

(4) For the company's last annual accounts (being those last circulated to members) to be relied on, they must have been properly prepared in accordance with the 2006 Act (or have been so prepared subject only to matters not material for determining whether the distribution would contravene Pt 23): s.837

(5) For interim accounts to be relied on, they must…enable a reasonable judgment to be made as to the amounts of the items in s.836(1): see s.838(1).

(6) If any applicable requirement of s.837 (in relation to the last annual accounts) or s.838 (in relation to interim accounts) is not complied with, then "the accounts may not be relied on for the purposes of this Part and the distribution is accordingly treated as contravening this Part": s.836(4). The question whether a distribution contravenes Pt 23 (as opposed to the question of the directors' or shareholders' liability in respect of an unlawful distribution) is answered objectively by reference to relevant accounts as defined by s.836(2): See, for example, It's a Wrap (UK) Ltd v Gula [2006] B.C.C. 626 at [43], where Chadwick LJ noted that the question whether there has been a contravention of Pt 23 does not turn on whether the company making the distribution knew the facts or knew the legal rules."

82. By contrast, the personal liability of 'members' (i.e. shareholders) is dependent on what they knew or ought to have known, as provided by s.847 CA, which states:

"1) This section applies where a distribution, or part of one, made by a company to one of its members is made in contravention of this Part.

(2) If at the time of the distribution the member knows or has reasonable grounds for believing that it is so made, he is liable– (a) to repay it (or that part of it, as the case may be) to the company, or (b) in the case of a distribution made otherwise than in cash, to pay the company a sum equal to the value of the distribution (or part) at that time.

(3) This is without prejudice to any obligation imposed apart from this section on a member of a company to repay a distribution unlawfully made to him."

In *SSF*, Zacaroli J summarised personal liability for shareholders in *SSF* at ps.97-103:

"97. Section 847… applies where a distribution, or part of one, made by a company to one of its members is made in contravention of Pt 23. If at the time of the distribution the member "knows or has reasonable grounds for believing that it is so made", he is liable (a) to repay it (or that part of it, as the case may be) to the company, or (b) in the case of a distribution made otherwise than in cash, to pay the company a sum equal to the value of the distribution (or part) at that time: s.847(2). This is without prejudice to any obligation imposed apart from s.847 on a member of a company to repay a distribution unlawfully made to him.

98. In It's a Wrap (UK) Ltd v Gula (above), the Court of Appeal held that it is enough, in order to establish that a shareholder knew or had reasonable grounds for believing that the distribution was made in contravention of the Companies Act 1985 that it had the relevant knowledge of facts which, if they existed, led to the conclusion that the distribution contravened the statute. It was not necessary that the shareholder had knowledge of the legal rules and the consequences of those rules when applied to the facts.

99. It was unnecessary for the Court of Appeal in that case to determine the precise meaning of "had reasonable grounds for believing", but Arden LJ and Chadwick LJ went on to give (obiter) consideration to that question….

100. Arden LJ, at [24] considered that the concluding words of Article 16 (and thus the words "has reasonable grounds for believing" in the UK statute) "must be directed to a situation where the shareholders ought reasonably to have been aware of the factual situation that the distribution contravened the Act." Chadwick LJ, on the other hand, at [52], considered that it was by no means self-evident that the words "has reasonable grounds for believing" were to be equated with constructive knowledge, "if by that expression is meant knowledge which a person would have but for his negligence". He cited Swain v Natui Ram Puri [1996] P.I.Q.R. P442 (a case concerned with liability under the Occupiers Liability Act 1984) for the proposition that the phrase "has reasonable grounds to believe" was not equivalent to "ought to have known". While it would not permit an occupier to turn a blind eye, it was not sufficient (in the words of Evans LJ at P488) to prove that the occupier ought to have known particular facts. The occupier must be proved "either to have actual knowledge of the relevant fact or to have known facts which gave reasonable grounds for the relevant fact." Chadwick LJ's provisional view, therefore, was that: "The knowledge which the legislature has sought to

describe in s.277(1) of the 1985 Act is, I think, knowledge which the member has and knowledge which the member 'must be taken to have' or, perhaps, 'may reasonably be taken to have'."

101. The statutory remedy is without prejudice to any relief available at common law: s.847(3) of the 2006 Act. At common law, a distribution of a company's assets to a shareholder, except in accordance with specific statutory provisions, is unlawful and ultra vires the company: Progress Property Co Ltd v Moorgath Group Ltd [2011] 1 W.L.R. 1; per Lord Walker JSC at [15].

102. In Precision Dippings Ltd v Precision Dippings Marketing Ltd [1986] Ch. 447; (1985) 1 B.C.C. 99539, Dillon LJ, at 457H–458A; 99544 held that because the shareholder, who received a dividend pursuant to an ultra vires act on the part of the company, "had notice of the facts and was a volunteer in the sense that it did not give valuable consideration for the money", it was a constructive trustee for the company, citing Rolled Steel v British Steel Corp [1986] Ch. 246;

103. The parties were in agreement the liability of LFO under s.847 as recipient of the distribution is limited to that part of the distribution which LFO knew or had reasonable grounds for believing was made in contravention of Pt 23. No argument was advanced the measure of relief at common law would be different"

83. In *SSF*, Zacaroli J then summarised at ps.104-113 the legal liability of directors, which arises not under s.847 CA but under their statutory directors' duties in s.171-5 CA:

"104. The parties were also in agreement that the relevant legal principles as to the liability of a director for causing the company to pay an unlawful dividend were as recently summarised in Burnden v Fielding [2019] EWHC 1566 (Ch):

> *"First, directors, although not trustees, were to be treated as if they were trustees in relation to the company's funds. Second, if they knew the facts which constituted an unlawful dividend, then they would be liable as if for breach of trust irrespective of whether they knew that the dividend was unlawful. Third, however, if they were unaware of the facts which rendered the dividend unlawful then provided they had taken reasonable care to secure the preparation of accounts so as to establish the availability of sufficient profits to render the dividend lawful, they would not be personally liable if it turned out that there were in fact insufficient profits for that purpose. Fourth, they were entitled to rely in this respect upon the opinion of others, in*

particular auditors, as to the accuracy of statements appearing in the company's accounts."

105. The parties disagreed as to the extent of a director's liability in respect of a dividend which was partially made out of profits and partially out of capital.

106. The claimant relied on Re Paycheck Services 3 Ltd [2010] 1 W.L.R. 2793; for the proposition that a director is liable for the whole of the dividend, not merely the difference between the unlawful distribution and the distribution which could lawfully have been paid. At [49], Lord Hope said: "Where dividends have been paid unlawfully, the directors' obligation is to account to the company for the full amount of those dividends: see Bairstow v Queens Moat House [2002] B.C.C. 91 [54], per Robert Walker LJ."

107. [Lord Hope] *went on however to conclude it was open to the court to limit the amount the director should pay to what the only creditor in the liquidation of the company had lost (relying upon a discretion in s.212 Insolvency Act 1986).*

108. In Bairstow, it was contended that directors were liable to the extent that their actions caused the company loss, in accordance with the decision of the House of Lords in Target Holdings Ltd v Redferns [1996] A.C. 421 and, on that test, it was apparent that there was no actionable loss occasioned by the unlawful dividends since they could have been declared and paid by the company in a lawful manner, if the company's subsidiary had first paid up its distributable profits to the company (see at [52]). Robert Walker LJ rejected that argument (at [53]–[54]), noting that the case was very different from Target Holdings: the directors in Bairstow had deliberately and (at least in relation to one of the relevant years of account) dishonestly paid unlawful dividends.

109. In Paycheck in the Court of Appeal ([2009] EWCA Civ 625; [2010] B.C.C. 104), a similar argument based on Target Holdings was advanced. Rimer LJ rejected it at [96], concluding that the basic remedy was one of restitution because directors, if not trustees in the strict sense, owe a duty as a trustee not to misapply the company's assets, and referring among other things to the judgment of Robert Walker LJ in Bairstow (above). In the Supreme Court, Lord Walker (at [124]–[125]) and Lord Clarke (at [146]) agreed on this issue with Rimer LJ.

110. The first, second and fifth defendants in this case advance a different argument to that run in Bairstow and Paycheck. Mr Hinks submitted, not that the directors' liability was limited to loss caused to the company, but that they were liable

> *(subject to any defence based on s.1157) for the distribution to the extent that it was unlawful, that is to the extent that the October management accounts …. did not reveal sufficient distributable reserves.*
>
> *111. In my judgment, the defendants' approach is to be preferred both as a matter of principle and on authority. So far as authority is concerned, that was the conclusion reached by HH Judge Richard Seymour in Re Marini Ltd [2003] EWHC 334 (Ch). As a matter of principle, there is a difference between (1) seeking to justify an unlawful dividend on the basis that the company could have done something different which would have enabled it to make a distribution in the relevant amount and (2) a dividend which, on the basis of what the company in fact did (and the accounts which it in fact had in front of it) was only out of capital as to part of the payment.*
>
> *112. Accordingly, the liability of the directors to compensate the company in respect of the distribution is limited in amount by reference to that part of the distribution which was made out of capital and thus in contravention of Part 23.*
>
> *113. It was common ground that the directors also owed the statutory duties set out in ss.171, 172 and 174 CA: (1) to act in accordance with the company's constitution and not to make dispositions which are ultra vires the company; (2) to exercise powers only for the purposes for which they were conferred; (3) to act in ways which they considered, in good faith, would be most likely to promote to the success of the company, including the duty to act in the interests of creditors where the company is, or is likely to become, insolvent; and (4) to exercise reasonable care, skill and diligence."*

84. Zacaroli J's reference in that last paragraph in *SSF* to *'the duty to act in the interests of creditors where the company is, or is likely to become, insolvent'* refers to the directors' 'creditors duty' to the company noted in s.172(3) CA and explained in *Sequana*, which I summarised above. This arises in this case both in relation to the dividend claim (depending on when I find the 'distribution' under s.829 CA happened) and the directors' loan breach of duty claim, so I need to explain both the content and the trigger point of that duty. Lord Briggs stated its content at p.176 and its trigger at p.203:

> *"Prior to the time when liquidation becomes inevitable and s.214* [Insolvency Act 1986 i.e. 'wrongful trading'] *becomes engaged, the creditor duty is a duty to consider creditors' interests, to give them appropriate weight, and to balance them*

against shareholders' interests where they may conflict. Circumstances may require the directors to treat shareholders' interests as subordinate to those of the creditors. This is implicit both in the recognition in s.172(3) that the general duty in s.172(1) is "subject to" the creditor duty, and in the recognition that, in some circumstances, the directors must "act in the interests of creditors". This is likely to be a fact sensitive question. Much will depend upon the brightness or otherwise of the light at the end of the tunnel; i.e. upon what the directors reasonably regard as the degree of likelihood that a proposed course of action will lead the company away from threatened insolvency, or back out of actual insolvency. It may well depend upon a realistic appreciation of who, as between creditors and shareholders, then have the most skin in the game: i.e. who risks the greatest damage if the proposed course of action does not succeed…..

..[The creditor duty arises with] *either imminent insolvency (i.e. insolvency which directors know or ought to know is just round the corner and going to happen) or the probability of an insolvent liquidation (or administration) about which the directors know or ought to know, are sufficient triggers for the engagement of the creditor duty. It will not be in every or even most cases when directors know or ought to know of a probability of an insolvent liquidation, earlier than when the company is already insolvent. But that additional probability-based trigger may be needed in cases where the probabilities about what lies at the end of the tunnel are there for directors to see even before the tunnel of insolvency is entered."*

Lord Briggs also helpfully summarised the meaning of 'insolvency' itself at p.120:

"Insolvency takes two forms. Either may exist without the other. The first is usually called balance sheet insolvency, where the value of the company's assets is exceeded by the value of its liabilities: s.123(2) [Insolvency] Act 1986. The second is what is generally known as commercial insolvency, where the company is unable to pay its debts as they fall due: s.123(1)(e)…[N]either will necessarily be permanent, nor fatal to the long-term success of the company, although of course either may be, and commercial insolvency often is. A company may experience short-term commercial insolvency due to a temporary adverse balance between the liquidity of its assets and the maturity of its debts. Many start-up companies are balance sheet insolvent before a new invention or business product is sufficiently developed to be brought to market so as to generate revenue or goodwill value, and yet the company later becomes spectacularly successful, and its shareholders

become millionaires. In both cases the directors may perceive that there is a reasonable prospect that the company will be able to trade out of insolvency, for the benefit of both creditors and shareholders, a perception often labelled as seeing light at the end of the tunnel."

85. Lord Briggs' reference to s.172(1) CA points towards the other statutory duties on directors to the company in Part 10 CA which Zacaroli J mentioned in paragraph 113 of *SSF*. In this case, it is helpful to cite ss.171-174 CA as is relevant with headnotes (omitting e.g. s.172(2) as it is irrelevant and also s.172(3) as I have just addressed it):

"171 Duty to act within powers

A director of a company must–(a) act in accordance with the company's constitution, and (b) only exercise powers for the purposes for which they are conferred.

172 Duty to promote the success of the company

(1) A director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole, and in doing so have regard (amongst other matters) to– (a) the likely consequences of any decision in the long term, (b) the interests of the company's employees, (c) the need to foster the company's business relationships with suppliers, customers and others, (d) the impact of the company's operations on the community and the environment, (e) the desirability of the company maintaining a reputation for high standards of business conduct, and (f) the need to act fairly as between members of the company…..

173 Duty to exercise independent judgment

(1) A director of a company must exercise independent judgment.

(2) This duty is not infringed by his acting– (a) in accordance with an agreement duly entered into by the company that restricts the future exercise of discretion by its directors, or (b) in a way authorised by the company's constitution.

174 Duty to exercise reasonable care, skill and diligence

(1) A director of a company must exercise reasonable care, skill and diligence.

(2) This means the care, skill and diligence that would be exercised by a reasonably diligent person with– (a) the general knowledge, skill and experience that may reasonably be expected of a person carrying out the functions carried out by the director in relation to the company, and (b) the general knowledge, skill and experience that the director has."

As s.170 and 178 CA explain, these duties codify common law and equitable principles and are to be interpreted and applied in the same way, with the same remedies (see Lord Reed in *Sequana* p.63). s.171 CA codifies the requirement on directors to act within their powers, not *'ultra vires'*. s.174 CA codifies a director's duty of care to the company. ss.173 and s.172 CA codify aspects of a director's fiduciary duties to the company. In particular, as Lord Briggs noted in *Sequana* at ps.139-140, s.172(1) CA:

> *"…recognises that, as a separate entity to its shareholders, a company has responsibilities of a legal, societal, environmental and in a loose sense, moral or ethical nature, compliance with which is likely to secure rather than undermine its success. Those responsibilities are not those of its shareholders, even viewed as a whole. But compliance with them is a matter for the directors, as custodians of what* [has been] *memorably called the 'conscience of the company'…."*

86. This reinforces Mr Tabari's submission that sole director-shareholders cannot simply treat the interests of the company as the same as their own personal interests. Indeed, there can be a conflict between their interests as shareholders and interests as directors. Whilst Mr Tabari relied on s.175 CA (duty on directors to avoid conflicts of interest), s.175(3) states: "*This duty does not apply to a conflict of interest arising in relation to a transaction or arrangement with the company."* However, his submission is supported by a combination s.172(1), s.173 and s.175 CA given they can overlap: s.179. (However, Mr Tabari did not rely on s.177 - duty to declare interests in transactions - presumably as Mr and Mrs Rutter obviously knew of each other's interests: s.177(6)(b); or s.197 CA – the requirement of ordinary resolution for directors' loans - because the Claimant relies on not impugns the directors' loan). However, Mr Tabari also argues the dividend was outside Mr and Mrs Rutters' powers as directors (s.171) as in breach of the Company Articles (incorporating the CA 2006 Model Articles 2008 for private companies limited by shares), especially Art.54 (and I add Arts.56 and 60) which state:

> *"DIVIDENDS AND OTHER DISTRIBUTIONS*
>
> ***54 Procedure for declaring dividends***
>
> *54.1 The company may by ordinary resolution declare dividends and the directors may decide to pay interim dividends.*
>
> *54.2 A dividend must not be declared unless the directors have made a recommendation as to its amount. Such a dividend must not exceed the amount recommended by the directors.*

> *54.3 No dividend may be declared or paid unless it is in accordance with members' respective rights.*
>
> *54.4 Unless the members' resolution to declare or directors' decision to pay a dividend, or the terms on which shares are issued, specify otherwise, it must be paid by reference to each member's holding of shares on the date of the resolution or decision to declare or pay it…..*
>
> ***56 Payment of dividends and other distributions***
>
> *56.1 Where a dividend or other sum which is a distribution is payable in respect of a share, it must be paid by one or more of the following means ….Transfer to a bank…account specified by the distribution recipient… or…Any other means of payment as the directors agree with the distribution recipient either in writing or by such other means as the directors decide.."*

Art.60 also empowered the Company to make 'non-cash distributions'.

87. Indeed, it is relatively common for directors to be empowered as Mr and Mrs Rutter were here to pay an interim dividend, as Richards LJ observed in *Sequana* (CA) at p.48:

> *"While the right to receive a dividend does not arise until the conditions laid down in the company's articles…are satisfied, which will normally involve a resolution of the directors either to pay a dividend or to fix the maximum to be declared by the company in general meeting* [he quoted] *'directors effectively release funds due to members from their power to retain them in the business."*

The distinction is said to be the difference between a 'final dividend' which requires ordinary resolution or an 'interim dividend' which the directors may decide to pay – a distinction noted in *Palmer's Company Law (2022)* at 9.711-12:

> *"In modern practice, a distinction is drawn between the final dividend and an interim dividend, i.e. a dividend paid between two annual meetings. The articles usually provide that: final dividends may be declared by the company in general meeting, but no dividend shall exceed the amount recommended by the directors …and interim dividends may be paid by the directors from time to time…. …Before declaring an interim dividend, the directors must satisfy themselves that the financial position of the company warrants the payment of such a dividend out of profits available for distribution, but, as Lord Alverstone C.J. observed in Lucas v Fitzgerald (1903) 20 T.L.R. 16 at 18 "The declaration of interim dividend depends much more upon estimates and opinions than the declaration of a final dividend, which is made upon the information contained in a formal balance sheet." The*

payment of an interim dividend is not conditional upon the subsequent declaration of such a dividend by a general meeting. But if the articles empower the directors to pay interim dividends, if justified, a declaration by the directors of an intended dividend to be paid at some future date may be rescinded by a resolution of the directors before that date arrives: Lagunas Nitrate Co v Schroeder (1901) 85 L.T. 22."

Moreover, as *Palmer* goes on say at p.9.715:

"Where a dividend is declared and becomes payable, it is a debt and each shareholder is entitled to sue the company for his proportion. Until the dividend is declared and payable, the shareholder has no right to sue. Once a dividend has been declared, it is ultra vires to resolve that payment should be postponed."

As authority for that last proposition, *Palmer* cites the Scottish case of Doherty v Jaymarke *(2001) SLT (Sh Ct) 75* where Sheriff Nicholson said at pg.78B-C:

"I accept, of course, that a date for payment of an interim dividend can be set down, and that nothing will be due until that date arrives. I also accept that.... a decision to pay an interim dividend can be rescinded at any time before the date for payment arrives. In the present case, however, it seems to me that the argument advanced on behalf of the defenders totally ignores the fact that the appropriate share of the interim dividend was in fact paid to [the main shareholder] *Mr Shaw on 28 April 1998. It may be that, as was submitted on behalf of the defenders, the sheriff was technically wrong to conclude that the resolution of that date postponing payment* [to the pursuer – i.e. claimant shareholder] *until 31 December 1999 was ultra vires of the company. In my view, however, that resolution was at least of no effect given that payment was simultaneously being made to one of the* [other] *shareholders....a company can[not] discriminate between shareholders of the same class."*

88. I recognise the significance of this legal distinction between 'interim' and 'final' dividends only occurred to me in writing this judgment and was not explored in evidence or submissions. I offered the Claimant the opportunity to make submissions about it, but Mr Tabari declined, contending it would require re-opening of evidence, but stressed the Claimant does not accept this point. It seems to me more a point of law than of contested evidence, but I accept I must not decide a case on a basis not neither pleaded nor canvassed at trial (*Satyam* p.36). However, this is not the *basis upon which I decide* the

case, merely an *alternative basis*. The basis upon which I decide the case (which I did expressly raise to ensure it was canvassed at trial) was the potential finding of fact I have now made. That is: Mr and Mrs Rutter decided in July 2016, in the course of discussing with Mr Langham the 2014-15 accounts, both to declare the dividend of £560,000 back-dated to 31st July 2015 and use it to reduce their directors' loan account, but Mr Langham did not input it onto Sage until 12th April 2017. That is why I offered Mr Tabari the opportunity to recall Mr Irwin on that point and to ask further questions of Mrs Rutter, both of whom had already given evidence. Mr Tabari, perfectly sensibly and on instructions, preferred to deal with the point with Mr Langham and Mr Rutter, yet to give evidence. On all the evidence – particularly that of Mr Langham – I have now made those findings of fact and indeed relied upon the Claimant to argue the 'distribution' was not until April 2017. That is the 'basis' on which I will decide in law whether the 'distribution' under s.329(1) CA was in July 2016 or April 2017.

89. Be that as it may, another reason I referred Mr Tabari to *Satyam* was what is sometimes called the '*Duomatic* principle' after the case that articulated it, but which in *Sequana* was called - and which I shall call - the 'ratification principle' (see the discussion in Lord Reed's judgment ps.23-4, and 37-42), as summarised by Lord Briggs at p.125:

> *"[S]hareholders of a company may, acting unanimously, procure the company to do anything within its corporate capacity, and may also ratify (by making it the company's own act) any decision of the directors to the same effect, so as to preclude any claim by the company against the directors for breach of duty. I will call it the ratification principle, although that is only one aspect of it…. [However], the two common law principles could not both apply at the same moment in a company's existence….[T]he creditor duty [is] engaged by insolvency…the ratification principle…[is] disapplied by insolvency…."*

90. For the ratification principle to apply, *all* shareholders must agree to the action: *Dickinson v NAL [2020] 1 WLR 1122 (CA)* and positively manifest such agreement: *Satyam* p.45; and the transaction must not involve dishonesty or bad faith towards the company: *Satyam* ps.56-9. None of these limitations appears to be an issue on my findings of fact. I have found that in July 2016 Mr and Mrs Rutter decided to declare a dividend of £560,000, used it to reduce the directors' loan account and recorded that in the 2014-15 accounts they approved. So, *if* the ratification principle applies, this decision can be

treated as being authorised by the shareholders by ordinary resolution. This would fully answer the Claimant's challenge that Mr and Mrs Rutter had no power to make this decision under the Articles and so violated s.171 CA. (Indeed, it would also appear to avoid any complex questions of quorum of directors at a meeting voting on an interim dividend which may arise under the Articles and the provisions of s.175 and 177 CA on directors' duties: see s.180(4) CA: not relied on here by the Claimant).

91. However, Mr Tabari argues the ratification principle is excluded here for two reasons:

91.1 Firstly, as noted above and discussed in *Sequana*, the ratification principle is consistent with the creditor duty because the former is displaced by the latter where the company is or would be insolvent. As Lord Briggs said at p.149:

> *"The ratification principle does not apply to a decision by shareholders which is either (i) made at a time when the company is already insolvent or (ii) the implementation of which would render the company insolvent."*

91.2 Secondly, the ratification (or '*Duomatic*') principle cannot apply to unlawful distributions or returns of capital, as Nugee LJ explained in *Satyam* at ps.47/9:

> *"If an impugned transaction is an unlawful return of capital, the Duomatic principle cannot be relied on because the transaction would be ultra vires the company, and the corporators cannot do informally what they have no power to do formally: see Ultraframe (UK) Ltd v Fielding [2003] EWCA Civ 1805 at [40] per Waller LJ: "The Duomatic principle accepts that all shareholders may formally or informally assent to or approve an arrangement or a transaction so that it is binding on the company. But that principle only applies to acts or transactions which are intra vires the company ... Thus ... if a director of a company 100% owned by himself decided simply to take the assets of the company for himself, he would not be able to rely on the Duomatic principle, because such conduct could not be considered a bona fide distribution of profits and would be a reduction of capital and ultra vires the company without the sanction from the court."*

In *Satyam*, the question was whether a sale at an undervalue was an unlawful distribution of capital which disabled the application of the ratification principle to regularise the directors' decision to make the sale. The Court of Appeal found that because the judge had gone off on a frolic of his own with a basis of decision that

had not been canvassed at trial, he had failed to make sufficient findings of fact to determine whether the sale at an undervalue was an unlawful distribution.

92. As noted in *Satyam*, 'unlawful distribution' at common law now is governed by the approach in *Progress Property v Moore [2011] 1 WLR 1 (SC).* In *Moore*, PPC Ltd sold to M Ltd shares in YMS Ltd when all three were controlled by one common shareholder. The director procuring sale for £60,000 genuinely believed it was at market value, but it turned out to be a huge undervalue. The Court held it was not an unlawful disguised distribution of capital but a genuine (if disastrous) commercial sale. Lord Walker explained the common law principles of 'unlawful distribution':

"1 A limited company not in liquidation cannot lawfully return capital to its shareholders except by way of a reduction of capital approved by the court. Profits may be distributed to shareholders (normally by way of dividend) but only out of distributable profits computed in accordance with the..Companies Act 2006

Whether a transaction amounts to an unlawful distribution of capital is not simply a matter of form. As Hoffmann J said in Aveling Barford Ltd v Perion Ltd [1989] BCLC 626, 631: "Whether or not the transaction is a distribution to shareholders does not depend exclusively on what the parties choose to call it. The court looks at the substance rather than the outward appearance. Similarly, Pennycuick J observed in Ridge Securities Ltd v Inland Revenue [1964] 1 WLR 479, 495:

"A company can only lawfully deal with its assets in furtherance of its objects. The corporators may take assets out of the company by way of dividend, or, with the leave of the court, by way of reduction of capital, or in a winding up. They may, of course, acquire them for full consideration. They cannot take assets out of the company by way of voluntary distribution, however described, and, if they attempt to do so, the distribution is ultra vires the company"….

15….The rule is essentially a judge-made rule, almost as old as company law itself, derived from the fundamental principles embodied in the statutes by which Parliament has permitted companies to be incorporated with limited liability…..

16 Whether a transaction infringes the common law rule is a matter of substance, not form. The label attached to the transaction by the parties is not decisive. That is a theme running through the authorities, including Ridge and Aveling….

24 The essential issue then, is how the sale…is to be characterised….The deputy judge did not ask himself (or answer) that precise question. But he did…roundly

reject the submission made on behalf of PPC that there is an unlawful return of capital: 'whenever the company has entered into a transaction with a shareholder which results in a transfer of value not covered by distributable profits, and regardless of the purpose of the transaction'. A relentlessly objective rule of that sort would be oppressive and unworkable. It would tend to cast doubt on any transaction between a company and a shareholder, even if negotiated at arm's length and in perfect good faith, whenever the company proved, with hindsight, to have got significantly the worse of the transaction……

27 If there were a stark choice between a subjective and an objective approach, the least unsatisfactory choice would be to opt for the latter. But in cases of this sort the court's real task is to inquire into the true purpose and substance of the impugned transaction. That calls for an investigation of all the relevant facts, which sometimes include the state of mind of the human beings who are orchestrating the corporate activity.

28 Sometimes their states of mind are totally irrelevant. A distribution described as a dividend but actually paid out of capital is unlawful, however technical the error and however well-meaning the directors who paid it. The same is true of a payment which is on analysis the equivalent of a dividend. Where there is a challenge to the propriety of a director's remuneration the test is objective….but probably subject in practice to what has been called a 'margin of appreciation'. If a controlling shareholder simply treats a company as his own property….his state of mind (and fellow directors) is irrelevant. It does not matter whether they were consciously in breach of duty, or just woefully ignorant of their duties. What they do is enough by itself to establish the unlawful character of the transaction.

29 The participants' subjective intentions are however sometimes relevant, and a distribution disguised as an arm's length commercial transaction is the paradigm example. If a company sells to a shareholder at a low-value assets which are difficult to value precisely, but which are potentially very valuable, the transaction may call for close scrutiny, and the company's financial position, and the actual motives and intentions of the directors, will be highly relevant. There may be questions to be asked as to whether the company was under financial pressure compelling it to sell at an inopportune time, as to what advice was taken, how the market was tested, and how the terms of the deal were negotiated. If the conclusion is that it was a genuine arm's length transaction then it will stand, even if it may,

> *with hindsight, appear to have been a bad bargain. If it was an improper attempt to extract value by the pretence of an arm's length sale, it will be held unlawful. But either conclusion will depend on a realistic assessment of all the relevant facts, not simply a retrospective valuation exercise in isolation from all other inquiries. Pretence is often a badge of a bad conscience."*

Lord Walker approved at p.32 of *Moore* this observation by Lord Hamilton in the Scottish case of *Clydebank FC v Steedman (2002) SLT 109* at p.79:

> *"[D]irectors are liable only if it is established that in effecting the unlawful distribution they were in breach of their fiduciary duties (or possibly of contractual obligations, though that does not arise in the present case). Whether or not they were so in breach will involve consideration not only of whether or not the directors knew at the time that what they were doing was unlawful but also of their state of knowledge at that time of the material facts. In reviewing the then authorities Vaughan Williams J in Re Kingston Ltd [1896] 1 Ch 331, 347: "In no [case cited] can I find directors were held liable unless the payments were made with actual knowledge the funds of the company were being misappropriated or with knowledge of the facts establishing misappropriation."*

As noted in *Sequana*, s.851 CA preserves common law unlawful distribution.

93. However, the question of 'unlawful distributions' at common law under the principle in *Moore* (so potentially disabling reliance on the ratification principle to avoid breach of s.171 CA following *Satyam*) is closely related to whether there is unlawful distribution under Part 23 CA at least on the meaning of 'distribution' in s.829 CA, which I repeat:

> *"(1) In this Part "distribution" means every description of distribution of a company's assets to its members, whether in cash or otherwise, subject to the following exceptions.*
>
> *(2) The following are not distributions for the purposes of this Part– (a) an issue of shares as fully or partly paid bonus shares; (b) the reduction of share capital– (i) by extinguishing or reducing the liability of any of the members on any of the company's shares in respect of share capital not paid up, or (ii) by repaying paid-up share capital; (c) the redemption or purchase of any of the company's own shares out of capital (including the proceeds of any fresh issue of shares) or out of unrealised profits in accordance with….Part 18; (d) a distribution of assets to members of the company on its winding up."*

In *SSF*, Zacaroli J at p.55 quoted p.1 of *Moore* as relevant to the definition of 'distribution' under s.829 CA. This is consistent with *Buckley on the Companies Acts (2022)* notes 18-20) to s.829 CA (citations omitted, but including *Moore and SSF)*:

> *"18 [s.829](1) ensures that a wide meaning is given to 'distribution' by referring to 'every description of distribution' and 'whether in cash or otherwise'. The express limits are that it must be a distribution of the company's assets and it must be made to the company's members.*
>
> "*19. There is no definition of the word 'distribution'. What constitutes a distribution for the purposes of the common law rules has been considered in a number of authorities and there seems no reason why they should not also apply to Part 23. It is not simply a matter of form; the court looks at the substance rather than the outward appearance. If a transaction is in truth a distribution, it does not matter that it is given another description, but it is not necessary to find that the parties' description of the transaction or its terms was a deliberate sham.*
>
> *The payment of interest at a grossly inflated rate on a debt due to a shareholder, the payment of remuneration to directors who were also shareholders to the extent that it was unjustifiably high, and the sale of an asset at what was known and intended to be an undervalue have been held to be distributions. A payment to members in their capacity as such under a company voluntary arrangement made outside a winding up is a distribution to which the requirements of Part 23 apply. The creation of a liability, described as a management charge, by a subsidiary in favour of its holding company in respect of past services provided without any agreement (express or implied) that there would be any charge, has been held to be a distribution… It was irrelevant the directors of the subsidiary believed they were entitled to create a liability in respect of such past services. 20. Where a distribution takes the form of a monetary payment or a transfer of non-cash assets to members for which no separate consideration is provided, there will usually be no difficulty in identifying it as a distribution. There may be real difficulty where consideration is provided to the payment or transfer. The proper approach to determining whether a transaction is to be characterised as a distribution was considered by the Supreme Court in Moore."*

I respectfully agree with *Buckley*'s analysis. I add it is unlikely that Parliament intended the same word to mean different things in statute and common law, even if the test for

'unlawfulness' differs. 'Unlawfulness' at common law is governed by the principles in case-law such as *Moore*. 'Unlawfulness' under Part 23 is governed by the complex provisions of Part 23 CA as quoted above, with their summaries in *Sequana* and *SSF*.

94. Speaking of 'parliamentary intention', the general principles of statutory interpretation were recently considered by Lord Hodge DPSC in *R(O) v SSHD [2022] 2 WLR 343*:

> *"29 The courts in conducting statutory interpretation are 'seeking the meaning of the words which Parliament used': Black-Clawson International Ltd v Papierwerke Waldhof-Aschaenburg AG [1975] AC 591, 613 per Lord Reid. More recently, Lord Nicholls of Birkenhead stated: 'Statutory interpretation is an exercise which requires the court to identify the meaning borne by the words in question in the particular context'. (R v Secretary of State for the Environment, Transport and the Regions, Ex p Spath Holme Ltd [2001] AC 349, 396.) Words and passages in a statute derive their meaning from their context.*
> *A phrase or passage must be read in the context of the section as a whole and in the wider context of a relevant group of sections. Other provisions in a statute and the statute as a whole may provide the relevant context. They are the words which Parliament has chosen to enact as an expression of the purpose of the legislation and are therefore the primary source by which meaning is ascertained. There is an important constitutional reason for having regard primarily to the statutory context as Lord Nicholls explained in Spath p 397: 'Citizens, with the assistance of... advisers, are intended to be able to understand parliamentary enactments so they can regulate their conduct accordingly. They should be able to rely upon what they read in an Act of Parliament'. _*
> *30 External aids to interpretation therefore must play a secondary role. Explanatory Notes, prepared under the authority of Parliament, may cast light on the meaning of particular statutory provisions. Other sources, such as Law Commission reports, reports of Royal Commissions and advisory committees, and Government White Papers may disclose the background to a statute and assist the court to identify not only the mischief which it addresses but also the purpose of the legislation, thereby assisting a purposive interpretation of a particular statutory provision. The context disclosed by such materials is relevant to assist the court to ascertain the meaning of the statute, whether or not there is ambiguity and uncertainty, and indeed may reveal ambiguity or uncertainty: Bennion, Bailey and*

Norbury on Statutory Interpretation, 8th ed (2020), para 11.2. But none of these external aids displace the meanings conveyed by the words of a statute that, after consideration of that context, are clear and unambiguous and which do not produce absurdity…

31 Statutory interpretation involves an objective assessment of the meaning which a reasonable legislature as a body would be seeking to convey in using the statutory words which are being considered. Lord Nicholls, again in Spath Holme at 396, in an important passage stated:

> *"The task of the court is often said to be to ascertain the intention of Parliament expressed in the language under consideration. This is correct and may be helpful, so long as it is remembered that the 'intention of Parliament' is an objective concept, not subjective. The phrase is a shorthand reference to the intention which the court reasonably imputes to Parliament in respect of the language used. It is not the subjective intention of the minister or other persons who promoted the legislation. Nor is it the subjective intention of the draftsman, or of individual members or even of a majority of members of either House . [W]hen courts say such-and-such a meaning 'cannot be what Parliament intended', they are saying only that the words under consideration cannot reasonably be taken as used by Parliament with that meaning."*

I will use the expression 'parliamentary intention' in that sense Lord Nicholls described (respectfully, entirely consistently with Lord Reid in *Black-Clawson*).

95. Finally, directors can be relieved of liability for breach of duty under s.1157(1) CA:

"If in proceedings for negligence, default, breach of duty or breach of trust against– (a) an officer of a company….it appears to the court hearing the case …the officer.. is or may be liable but that he acted honestly and reasonably, and that having regard to all the circumstances of the case (including those connected with his appointment) he ought fairly to be excused, the court may relieve him either wholly or in part, from his liability on such terms as it thinks fit."

In *Dickinson* at p.44, Newey LJ held s.1157 applies to proprietary and personal claims:

"Section 1157 applies to 'proceedings for negligence, default, breach of duty or breach of trust'. Here, Judge Cooke found Mr Dickinson to have caused company property to be transferred to himself without authority. The words 'negligence,

default, breach of duty or breach of trust' are, as it seems to me, apt to describe that conduct. The fact that all applications of a company's money ultra vires the company can be said to represent breaches of trust on the part of the directors lends support to that conclusion.....section 1157 is not stated to be limited to personal claims. It empowers the court to grant relief from 'liability' without distinguishing between different species. Moreover, construing section 1157 as limited to personal claims could produce arbitrary and unattractive results. Take a case such as Ratification where remuneration has been paid without due authorisation. Relief would be available in respect of a personal claim but not, presumably, in so far as it remained possible to identify the money in the director's hands. The fact that a claim might be proprietary rather than personal will very often, I think, be a weighty factor to put into the balance. After all, the grant may, in effect, transfer ownership. However, I do not consider there to be any absolute bar on the grant of relief as regards a proprietary claim."

96. However, Newey LJ went on to agree with HHJ Cooke's[1] refusal to grant relief where the director-shareholder had sold company property to himself at an undervalue and leased it back, as he was not acting in the company's best interests at the time. The discretion under what is now s.1157 also arose – and in the context of an unlawful dividend - In *Re Marini Ltd [2004] BCC 172*. As well as Mr Richard Seymour QC (sitting as a Deputy High Court Judge) deciding that liability for unlawful distributions under Part 23 and common law is limited to the extent that it is unlawful – as noted by Zacaroli J in *SSF (*and if not he'd have granted relief under the forerunner of s.1157 for the 'lawful part ') Mr Seymour refused relief for the 'unlawful part' at p.57:

" I am persuaded on the evidence that the respondents did seek the advice of [their accountant] in relation to the dividend before it was paid and did act honestly and reasonably upon that advice in making the distribution. The trigger conditions for the exercise of the discretion conferred by s.727 of the 1985 Act [now ss.1157 CA] *are thus met. However…I have the greatest difficulty in seeing that it is ever likely that 'in all the circumstances of the case' it is going to be right that a defaulting director 'ought fairly to be excused for the negligence, default, breach of duty or breach of trust', if the consequence of so doing will be to leave the director, at the expense of creditors, in enjoyment of benefits which he would never have received*

[1] My greatly-admired predecessor as Specialist Civil Circuit Judge in Birmingham Business and Property Court

but for the default. However honestly the director acted, however much it may have appeared at the time of the act complained of that the only person who might be harmed by the act would be the director himself, it just is not fair, as it seems to me, that if it all goes wrong the guilty director benefits and the innocent creditors suffer. For this reason, I decline to exercise my discretion under s.727 in favour of any of the respondents in relation to their respective liabilities for breach of s.263 in relation to the dividend."

Was the 'distribution' in July 2016 or April 2017 ?

97. At last, I turn to the central issue in the case: whether the 'distribution' under s.829 CA and common law (as in *SSF* not suggested to be different) was in July 2016 or April 2017. Mr Tabari argued *Moore*, *Satyam* and *SSF* were concerned with whether a given 'transaction' was or was not a 'distribution', not with its date. But another way of putting the question here is precisely that: whether what I have found happened in July 2016 was by itself a 'distribution' in law or whether that was only in April 2017.

98. I will set out Mr Tabari's written submission that the 'distribution' was in April 2017 in full (although will add points he elaborated on in oral submissions below):

> *"11. The Court raised the question of whether the distribution comprises the Sage entry in April 2017 or the entry of the dividend in the Company's year-end 2015 accounts, signed off in July 2016. The definition within the Companies Act is the same as that applied to the common law principles…*
>
> *12. The definition of 'distribution' at s.829(1) CA requires, on a proper construction, a positive action which affects the Company's finances in some definite way. In this case, that is the date on which the entry was made into the Company's records, i.e. 12th April 2017.*
>
> *13. Buckley on the Companies Act at note [18] within the commentary to s.829 sets out that it must be a "distribution of the company's assets and it must be made to the company's members". Accordingly, to be a distribution, it must be "made" – again, denoting a positive act of some sort.*
>
> *i. When the Sage entry was made on 12th April 2017, it affected the running balance of the DLA– that was a tangible effect on the Company's finances, and the point at which the distribution was made.*

ii. By contrast, had the objective observer looked at the balance of the DLA…between 30th July 2016 and 11th April 2017, they would not have seen that the dividend listed in the 2015 accounts had taken effect.

iii. The fact that the dividend appears in the year-end 2015 accounts is irrelevant. An entry in the accounts is not definitive of reality – the Court has to examine what ***actually*** *took place, not what was presented to the outside world (consistent with the quote from Hoffman J quoted in Moore [at 1] and Moore itself at [16]). This is even more important when, as admitted by Mr Rutter in his evidence, he did not act with HMRC as if he had received a dividend for that year, because he has not paid any tax on it or, it seems, revealed its existence to HMRC.*

14. It is correct that, according to the authorities, the word 'distribution' is to be construed widely, but the vast majority of the reported cases to that effect were concerned with counteracting the mischief whereby a director or company seeks to argue that a transaction was not, in fact, a 'distribution' (in order to avoid it being caught by Chapter 23 Companies Act), for example in SSF and Satyam (and see also the notes in <u>*Buckley*</u> *at note [19] to s.829).*

That is the opposite to the present case. That wide definition is ***not*** *designed to allow a transaction such as the dividend in this case to be found to taken place on 31st July 2015 when, in fact, it was not put into effect until 12th April 2017.*

15. The definition of 'distribution' does not relate to the date on which a decision is made by the directors to cause, at some point in the future, a distribution to be made – that date is irrelevant. Any decision to make a distribution in the future must be reviewed in light of supervening events, such as a material deterioration in the Company's finances. In any event:

a. There is no documentary evidence of any decision to make a distribution from which the Court can gain assistance, and it appears clear that the Company's Articles were not even considered, let alone circumvented;

b. Mrs Rutter was unable to assist with the date of such a decision, as was Mr Rutter (his answer was no more than a guess);

c. The evidence of Mr Langham appears to have been that there were discussions about the dividend in or around the end of July 2016, but there appears to have been nothing to effect the outcome of those discussions until much later.

d. *Mr Langham's off-hand suggestion that he was simply posting corrections on Sage appears to ignore the fact that, as a matter of fact, there had been no trace of the dividend in the Company's books and records at any point before 12th April 2017."*

Mr Tabari orally submitted that to amount to a 'distribution' in s.829 CA and common law, a 'positive action' must not just affect a company's finances in some definite way, but also must change the legal and the tax position between company and shareholders.

99. Mr Tabari's argument, in writing and orally, was of the highest quality. Nevertheless, on reflection I have come to the conclusion that I respectfully disagree. I summarised my reasons above that the *'positive action which affects the Company's finances in some definite way'* was the decision in July 2016 not just to declare a dividend of £560,000, but to allocate it to reduce the balance of the directors' loan account, at that stage almost £700,000, and record that in the 2014-15 accounts, I shall call by the neutral word 'transaction' (which a dividend can be: *Sequana CA*). In my judgment, in July 2016, even before the entry was made on Sage in April 2017, that transaction was a 'distribution' both under s.829 CA and in common law, for five alternative reasons:

100. Firstly, I will assume Mr Tabari is right to submit that a 'distribution' under s.829 CA must be a positive action not only affecting a company's finances in some definite way, but also changing the legal position and tax liability of its shareholders. In my view, that perfectly describes Mr and Mrs Rutter's decision in July 2016 to declare themselves a dividend, 'pay' it immediately into their directors' loan account reducing it, both of which were recorded in the 2014-15 accounts: declaring the dividend and reducing the 'other debtors' figure. Those statutory accounts did not *predict* or even *constitute* that whole transaction, they *recorded it as having already happened*: indeed, backdated it to the 2014-15 year. In my judgment, this is a clear and straightforward 'distribution' within s.829(1) CA as a question of fact. But if necessary to analyse it in legal terms, Mr and Mrs Rutter used their dividend to part-pay their debt to the company, in a straightforward 'set-off'.[2] The parties were Mr and Mrs Rutter, each with their two different 'hats': as directors (on behalf of the Company) and as shareholders. Wearing their director 'hats' on behalf of the Company, they declared the interim dividend, as it is recorded in the

[1] See, merely by way of example, the discussion at p.4-026 of Vol.6 'Set-Off and Netting' in '*Wood on Law and Practice of International Finance* (2019).

accounts, then 'agreed with themselves' wearing their 'shareholder' hats that 'dividend' would be 'paid' into their directors' loan account. It was either an 'agreed means of payment' under Art.56 or a 'non-cash distribution' under Art.60, but even if it was neither, the 'set-off' of the dividend against the directors' loan account was a 'distribution' of Company non-cash assets to its members (Mrs and Mrs Rutter, who used it to reduce their debt as directors) under s.829 CA. Of course, putting it like this sounds strange. But it follows from the legal fiction of separate corporate personality in *Salomon v Salomon [1897] AC 22* (*Sequana* p.136) applied to a case where the only directors are also the only shareholders, as is common. Moreover, this is precisely what their accountant Mr Langham understood they had *done* (not just *decided*), which is why he recorded it as he did in the 2014-15 accounts. Those showed the £560,000 stayed in the company, which benefitted by being 'repaid' rather than 'paying out'. The 'distribution' also raised a personal tax liability, which if not paid does not change what in law was done: it just means Mr and Mrs Rutter may well (subject to tax law) owe HMRC more tax. Of course, not only that tax, but the 'split personality' distribution itself, raise the question of whether that distribution was *lawful*, which I consider later. However, it is the very fact there was a 'distribution' under s.829 CA (and at common law) that raises this question of its legality.

101. Secondly, even if I am wrong, I do not in any event accept Mr Tabari's oral submission (not argued in his written submissions) that a 'distribution' under s.829 CA must change the legal position and the tax liability of the shareholders. s.829(1) CA states that 'distribution' '*means every description of distribution of a company's assets to its members, whether in cash or otherwise'*. There are three observations I would make:

101.1 As to tax, there is no hint in s.829 that a 'distribution' must be a transaction with tax effects (under a completely different statute not even referred to in s.829). That would not just contort the wording of s.829, but subordinate it to an external meaning hidden to the ordinary reader (c.f. *R(O)*). If Parliament had intended to limit 'distributions' to 'taxable transactions', it would have explicitly said so.

101.2 As to legally-effective transactions, again this would go against the ordinary meaning of the words Parliament has used in s.829. As *Buckley* observes, s.829 gives a wide meaning of 'distribution' including *'every description of distribution ….whether in cash or otherwise'* which is a 'distribution' of the company's assets to its members. The statutory phrase 'every description of distribution' contradicts

any limitation to 'only legally-effective distributions'. Nor does the word 'distribution' carry any requirement of being itself 'legally-effective'. It is a 'factual word', not a legal term of art like 'sale', 'disposition' of 'gift'. Of course, 'distributions' can consist of or include legal transactions (see e.g. s.845 CA), but there is no suggestion in the wording of s.829 (or for that matter, s.845 CA) that they must do so. Indeed, as discussed in *Sequana*, in law a dividend is given for no consideration (although not a 'gift') and may be unilateral. Yet surely a 'dividend' is the paradigm example of a 'distribution' in s.829 CA. It is also difficult to understand why Parliament would have intended to include within s.829 CA legally-effective transactions such as undervalue sales of company assets to shareholders and require them to be 'lawful' under the detailed rules of Part 23, but to exempt legally-ineffective factual transfers or payments. It would undermine the purpose of the actual provisions to regulate all 'distributions' and indeed be inconsistent with the words of s.829: *'every description of distribution'*.

101.3 In any event, as *Buckley* also observes, there is no reason to believe Parliament intended 'distribution' in s.829 CA to have a different meaning than 'distribution' in common law, as discussed in *Moore*. The approach in *Moore* does not include any requirement that a transaction must be legally-effective to amount to a 'distribution': quite the contrary, the focus is on substance not just (legal) form.

102. Therefore, I will interpret 'distribution' in s.829 CA in the light of the approach in *Moore*, where Lord Walker focussed not just on form but substance. He said at p.27:

"In cases of this sort the court's real task is to inquire into the true purpose and substance of the impugned transaction. That calls for an investigation of all the relevant facts, which sometimes include the state of mind of the human beings who are orchestrating the corporate activity."

This chimes with his quote in *Moore* from Lord Hoffmann at p.1 and comment at p.16:

"As Hoffmann J said in Aveling Barford Ltd v Perion Ltd [1989] BCLC 626, 631: "Whether or not the transaction is a distribution to shareholders does not depend exclusively on what the parties choose to call it. The court looks at the substance rather than the outward appearance'.....Whether a transaction infringes the common law rule is a matter of substance, not form. The label attached to the transaction by the parties is not decisive....."

Of course, in some cases, such as *Aveling* (see *Moore* p.30) and *SSF* 'looking at substance not form' focusses on seeing through the pretence of a transaction. However, in others, as in *Moore* itself, 'looking at substance not form' involves not just looking at *what* the parties did but *why* they did it. As Lord Walker said at p.30 of *Moore*:

> *"If… it was a genuine arm's length transaction then it will stand, even if it may, with hindsight, appear to have been a bad bargain. If it was an improper attempt to extract value by the pretence of an arm's length sale, it will be held unlawful. But either conclusion will depend on a realistic assessment of all relevant facts, not simply a retrospective valuation exercise in isolation from all other inquiries"*

103. I have endeavoured to follow that approach here and have set out my findings of fact. Without repeating them, I am satisfied in July 2016, while they discussed the draft 2014-15 accounts, Mr Langham showed Mr and Mrs Rutter there were net profits after tax of £768,753, which with those from 2013-14 created a reserve of £809,423, but at the same time, the directors' loan account indebtedness was £688,833.07. Mr and Mrs Rutter decided to declare a dividend of £560,000 and to off-set it against their directors' loan account not in the future but retrospectively. Mr Langham recorded both aspects in the 2014-15 accounts which Mrs Rutter then formally approved on 29th July 2016 on the basis – as was her duty under s.393 CA – that they gave a 'true and fair view' of the Company's financial position in 2014-15. Of course, as Mr Tabari says, an entry in the accounts is not *definitive* of reality. But it can *evidence* reality, as I find it does here.

104. That transaction in July 2016 was not a 'pretence' or a 'sham', but a genuine transaction and indeed *'a positive action which affected the Company's finances in some definite way'*, even if it did not legally reduce the level of Mr and Mrs Rutter's debt (which I found above that it did). It reduced the distributable profits and also the reserves for future years, which had implications for future potential dividends, for example. Indeed, Mr Langham thought it also reduced the indebtedness to the Company of Mr and Mrs Rutter (who did not disagree with this) and this is why he made his entry on Sage in April 2017. He rejected the suggestion this itself was a payment of the dividend and said (and I accept) that it was just a correction to bring Sage into line with the real financial position recorded in the accounts in July 2016. At that time, Mr Langham had not understood Mr and Mrs Rutter to be simply 'deciding to make a distribution in the future', as Mr Tabari characterises it. Mr Langham understood them in July 2016 to be

making a retrospective transaction, which is how he recorded it in the accounts. It was his task to reflect this July 2016 transaction on Sage, but there was delay in doing so. I consider on all the relevant facts that in *substance*, just as Mr Langham thought, the 'distribution' had taken place in July 2016, even if (contrary to what I have found above) in *form*, the dividend in July 2016 was not 'paid' until April 2017 nor indeed changed the legal or tax position until then.

105. Thirdly, even if it is one of those cases which Lord Walker mentioned in *Moore* at p.28 where the states of mind of the individuals involved are irrelevant, in my judgment the transaction in July 2016 which Mr Langham recorded in the 2014-15 accounts to use a dividend of £560,000 to reduce the loan account (under 'other debtors') was objectively a 'distribution' under s.829 CA in substance not just form following *Moore.* The dividend of £560,000 was not just an informal 'decision', or a 'plan' to declare and pay a dividend eventually to reduce the loan. It was a decision in July 2016 to make an 'accounting distribution' recorded in the Company's 2014-15 accounts (even if it was not a legally-effective transaction, which I have found it was). By contrast, the Sage entry in April 2017 was objectively in substance not form merely a correction to align Sage with the 2014-15 accounts, not least as it was backdated to 31st July 2015 – the last day of the accounting period in the 2014-15 accounts. Of course, if those accounts had been inaccurate (whether or not a deliberate 'sham') or simply the 'form' of the transaction not reflecting its true 'substance', that would be different. But even just on the objective facts, the 2014-15 accounts reflected the substance of the 'distribution'.

106. Indeed, the Claimant is pushed into the strange position of arguing that one accounting transaction where no assets actually changed hands - the Sage entry in April 2017- was a 'distribution'; whereas an earlier accounting transaction – recorded in the Company's statutory accounts - was not. If so, a purely administrative exercise of adjusting a ledger that no-one outside the Company sees would be a 'distribution'. But a transaction recorded in statutory accounts accessible to others outside the Company and affecting its tax position and indeed its distributable profits and reserves would not be. An internal journal entry would 'trump' the statutory accounts. Indeed, it would *falsify* them because it would over-ride the recording in the 2014-15 accounts (and Sage itself) that the dividend arose and was offset against the loan in July 2015. What apparently would matter is the date on which such a back-dated Sage entry happened to be made, here 12th April 2017. Indeed, it would not apparently matter who made the Sage entry, nor even if

it was actually made without authority or even by mistake (unlike here). This could accidentally (or deliberately) skew the date of the 'distribution' outside of the control of the directors (who at least do approve the statutory accounts), let alone the shareholders, especially in larger companies. Parliament cannot have intended that result from the words it chose in s.829 that 'distribution' '*means every description of distribution of a company's assets to its members, whether in cash or otherwise'.* Mr Tabari did not suggest any statutory purpose for such an interpretation – his premise was simply that there was no 'distribution' until the Sage entry because that was akin to 'payment'. But that elevates an entry on an internal accounting record to the status of a payment into a bank account and indeed above the company's statutory accounts. It assumes what it needs – and I find, at least here, fails – to prove.

107. Ultimately, a 'distribution' by actual transfer of assets (e.g. a bank transfer from a company's bank account to a shareholder's bank account) happens on a particular day. Likewise, where a 'distribution' is by 'accounting transaction', it should happen on the date that happens. If there is a choice of date between earlier statutory accounts where the 'distribution' of dividend and offset on liability are recorded as happening (indeed as having happened retrospectively); and a later internal journal entry where only one side is recorded, objectively and rationally, the date of the formal accounts must be the date of 'distribution'. This is especially as s.829(1) CA applies to *'every description of distribution of a company's assets to its members, whether in cash or otherwise'*. Therefore, objectively, in substance, the date of 'distribution' here was 29th July 2016.

108. Fourthly and more fundamentally, even aside from the detail of my findings of fact, in my judgment it is consistent with the statutory wording, context and purpose of s.829 CA that if a dividend is genuinely allocated by shareholder-directors to reduce their directors' loan and that is recorded in the company accounts, that is a 'distribution' in s.829 CA without any further action and irrespective of the legal effect of their actions.

    108.1 In s.829 CA itself, the key word Parliament chose was not 'payment', 'sale', 'transfer' or 'disposition', but rather 'distribution', which as I have said is a word with factual connotations rather than legal ones. Moreover, as *Buckley* observes, Parliament chose a wide meaning of the word 'distribution'. This conclusion is borne out by the exceptions in s.829(2), especially the *"reduction of share capital— (i) by extinguishing or reducing the liability of any… members on any of the*

company's shares in respect of share capital not paid up'. By excluding that transaction, Parliament plainly intended a meaning of 'distribution' in s.829(1) wide enough to cover reduction of shareholder liability to the company on unpaid share capital, otherwise the exception would have been otiose. Yet Parliament did not choose to exclude in s.829(2) reduction of liability to the company by using a dividend to a shareholder for a loan in their capacity as director. s.829 CA read as a whole is plainly wide enough to cover such an 'accounting transaction', without the need for money or assets to change hands. Indeed, in *SSF*, the 'management charge' from parent to subsidiary not reflecting a legal obligation was considered a 'distribution', as was an interim dividend (to which I will return). However, there is no reference in *SSF* to any money changing hands: this was apparently also an 'accounting transaction' between parent and subsidiary (see p.10 *SSF*). Of course, if the statutory accounts take the form of a 'distribution' but that does not reflect the genuine substance of the transaction, then it would not be a 'distribution' (*Moore*). However, where director-shareholders genuinely allocate a dividend from company assets (distributable profits) to reduce their directors' loan and record it in the company accounts, that amounts to a 'distribution' in s.829 CA in substance <u>and</u> form. Mr Tabari did not argue that a 'distribution' requires money to change hands - his submission was rather that such a 'distribution' does not occur under s.829 CA until recorded in the company's internal management accounts. However, for the reasons above, that submission appears to me inconsistent with the wide scope of s.829 CA, which specifically covers *'every description of distribution…whether in cash or otherwise'*.

108.2 Moreover, this conclusion is also consistent with s.829 CA read in its statutory context in the Companies Act 2006. Such a 'contextual reading' reflects the guidance in *R(O)* that the meaning of a statutory expression must be understood in its statutory context: firstly, the rest of the section and later, the rest of the Act. This is a surer guide than external aids like background material (or indeed, dictionaries, to which I was not referred). As I have noted, Part 23 CA explicitly links the lawfulness of a 'distribution' to the level of distributable profit in its 'relevant accounts' – i.e. the last statutory accounts, or if distribution would be unlawful based on those, 'interim accounts' defined in s.838 which '*enable a reasonable judgment to be made as to the amounts of the items mentioned in s. 836(1)'* (i.e. distributable profit). So, where a dividend is genuinely allocated by shareholder-

directors to reduce their directors' loan liability and that is recorded in the company's statutory accounts, that will in turn govern the extent of remaining 'distributable profit' and so the lawful extent of future dividends based upon those accounts. That reinforces the interpretation that this transaction is a 'distribution' within s.829 CA without any further action and irrespective of the legal effect. Otherwise, it would undermine the statutory priority to 'the relevant accounts', as it might be argued it does not matter whether a further dividend is 'covered' by the distributable profit in the 'relevant accounts', because an earlier dividend they record was never 'factually distributed'. This would destabilise the certainty and reliability of the statutory scheme. This is true whether the 'distribution' is made part-way through a financial year on the old 'relevant accounts' and then recorded in what become the new 'relevant accounts'; or where the 'distribution' is made based on draft accounts (amounting to 'interim accounts' under s.838) and then recorded in the final statutory accounts, which then become the new 'relevant accounts'. This conclusion is also supported by other parts of the Companies Act – in particular the obligation for the statutory accounts to give a true and fair view of the company's finances (s.393), which actually trumps some of the statutory technical specifications for statutory accounts (s.396(5) CA). I recognise there are duties of accuracy for 'accounting records' (s.386), but to interpret 'distribution' as prioritising their accuracy over that of the statutory accounts would be inconsistent with other provisions of the CA. (Indeed, ensuring accounting records are accurate under s.386 CA is what Mr Langham did when he corrected Sage in April 2017 to reflect the accounts).

108.3 This interpretation of s.329 CA both in isolation and in context is also consistent with the statutory purpose of Part 23 CA in general and of the wide scope of 'distribution' in s.329 in particular. The reason Parliament intended a wide meaning to 'distribution' is obvious: it is to ensure the net is cast wide over 'distributions' so that more transactions are regulated by Part 23 and to reduce the scope for avoidance of it. As the cases suggest, many transactions may practically 'distribute' company assets to members but be structured in a way to disguise that, such as the 'management charge' on the subsidiary which otherwise had no liability to pay its parent in *SSF*, or the suspicious sale at an undervalue in *Satyam* (if not the unwise but genuine one in *Moore*). This is the reason why, as emphasised in *Moore*, the focus must be on the substance rather than just the form of transaction. However,

that does not mean that the form of the transaction is irrelevant. If it takes the form of a dividend allocated by shareholder-directors to reduce their directors' loan and that is recorded in the company accounts, unless it is not genuine in substance, that is a 'distribution' even without further action, even if no money changes hands and it has no legal effect. After all, it still has practical implications: directors' understanding of their debt and further borrowing; and the company's distributable reserves, solvency, liquidation etc. It is also consistent with the statutory purpose if this is a 'distribution' in s.829 CA. Director-shareholders wishing to reduce loan liability to the company have an incentive to use dividends to do so. Indeed, it is more likely now after s.197 Companies Act 2006 made directors' loans lawful if authorised by ordinary resolution. To allow director-shareholders to argue that the use of a dividend to reduce their loan liability as recorded in the statutory accounts did not amount to a 'distribution' because it was not recorded in management accounts would create a lacuna in the coverage of Part 23 CA. It would undermine the protection it offers to the company and indeed to creditors; and create confusion on how much the directors actually still owe to the company. Indeed, a wide approach to 'distribution' is consistent with Part 23's statutory purpose and indeed fair. Just because a transaction amounts to a 'distribution' does not mean it is unlawful. Lawfulness is assessed by reference to 'relevant accounts' under ss.836-8 and individuals' knowledge under s.847 CA. If I may be permitted a florid metaphor, Parliament was obviously content to cast the net wide over 'distributions' in the knowledge that the holes in it are big enough to let the little fish swim free.

109. Fifthly, even if I am wrong on all four grounds discussed above, there is a simpler route to a conclusion in this case that there was a 'distribution' in July 2016, albeit as I have said, it was not explored in evidence or submissions, and is merely a (fallback) alternative finding. The point is simply that an 'interim dividend' recorded in statutory accounts in itself amounts to a 'distribution' in s.829 CA, even if not 'paid' (or allocated to a directors' loan account). Indeed – it did in *SSF* itself (the dispute was limited to the 'management charge'). This is because the dividend is a debt owed to the shareholders. This is not only a positive action with a definite effect on a company's finances, it also changes the legal position (if not also the tax position, even if there may be an issue about in which year it is taxable). That distinction between a 'dividend' and its 'payment' is not artificial: it is included in this Company's articles (Art.56.1):

> *"Where a dividend or other sum which is a distribution is payable in respect of a share, it must be paid by one or more of the following means ....Any other means of payment as the directors agree with the distribution recipient either in writing or by such other means as the directors decide...."* (my underline).

Of course, not all decisions to pay a dividend create a debt, as they could be reversed, but a *declared and immediately payable* dividend is a debt as said in *Palmer* at p.9.715:

> *"Where a dividend is declared and becomes payable, it is a debt and each shareholder is entitled to sue the company for his proportion. Until the dividend is declared and payable, the shareholder has no right to sue. Once a dividend has been declared, it is ultra vires to resolve that payment should be postponed."*

That last proposition comes from *Doherty* - itself an interim dividend case, where a later date for payment of the dividend had been set. Here, there was not only no later date for payment, the dividend was recorded in the statutory accounts. Indeed, it was recorded as a 'interim dividend' and so was a valid act of directors under Art.54.1:

> *"The company may by ordinary resolution declare dividends and the directors may decide to pay interim dividends."*

In any event, since those directors Mr and Mrs Rutter were also the only shareholders, they could potentially rely (subject, to the more general legality of the transaction) on the ratification principle – effectively rendering the 'interim dividend' a final one. Either way, their decision to pay a dividend – and indeed to formally record it in the statutory accounts as already paid in 2014-15 - created a debt to them amounting to a 'distribution'. It distributed the company's assets to them as members through a debt within s.829 CA even if it was not formally 'paid' at that time (as I have found it was).

Was the July 2016 distribution lawful ?

110. For those five alternative reasons, there was a 'distribution' under s.829 CA in July 2016, in the circumstances of this case. The question is then whether it was lawful. I can deal with this issue much more briefly because in closing submissions Mr Tabari accepted the Claimant had not argued that if the 'distribution' under s.829 CA was in July 2016, as I have found that it was, that it was unlawful. I consider that the Claimant was right not to do so for the following reasons, which I can set out relatively briefly.

111. As I have found the 'distribution' was in July 2016, under Part 23 CA, as discussed in *SSF*, whilst s.830 CA provides that a company can only make a distribution out of profits

available for the purpose, that is determined by reference to the 'relevant accounts': s.836 CA. Those are the last annual accounts, except where the distribution would be found to contravene Pt 23 by reference to the company's last annual accounts, it may be justified by reference to 'interim accounts'. Since the 2014-15 accounts Mrs Rutter signed off on 29th July 2016 had been circulated to all shareholders – namely her and Mr Rutter, I consider that if the 'distribution' simply took effect through those accounts (i.e. my fifth reason above), they were 'the relevant accounts' under ss.836 and 837 CA and so the distribution plainly lawful. However, if (consistent with my first to fourth reasons) the 'distribution' took effect in the July discussions and was simply recorded in those accounts signed off on 29th July 2016, then the last official accounts were those for 2013-14, which cannot justify the distribution of £560,000 (a similar point to the Claimant's original case). However, since that is the case, then under s.836 CA the distribution can be justified by 'interim accounts', which under s.838 must '*be accounts that enable a reasonable judgment to be made'* as to distributable profit etc. The draft accounts for 2014-15 enabled a much more 'reasonable judgment' to be made than those for 2013-14, especially for an 'accounting transaction' backdated to 2014-15. Moreover, the draft accounts enabled the assessment of a provisional reserve for distributable profits of just under £250,000 even after the dividend, which was reasonable on the information Mr and Mrs Rutter had, even allowing for their knowledge that 2015-16 was much worse than 2014-15. So, I am entirely satisfied that the draft accounts Mr Langham prepared which led to the discussion about the dividend qualify as 'interim accounts' under s.838 CA and legitimise the dividend of £560,000, especially as backdated to the 2014-15 accounts.

112. It follows there was no violation of Part 23 CA for which Mr and Mrs Rutter could be liable, whether as directors or shareholders. Even if there was a technical breach, since the 2014-15 draft accounts showed a distributable reserve of nearly £250,000 left, Mr and Mrs Rutter neither knew nor had reasonable grounds to believe there was any breach so would not be liable as shareholders in s.847 CA. The same is true as directors for breach of Part 23 being unlawful under s.171 CA, as they were entitled to rely upon Mr Langham's opinion (*SSF*). Even if technically liable as they did not wait a few days until the 2014-15 accounts were lodged, I relieve them from liability under s.1157 CA.

113. Turning to Mr and Mrs Rutter's wider liability as directors, I have found that they were entitled as directors to declare and pay an interim dividend and could (subject to unlawful

distribution at common law discussed below) rely on the ratification principle to treat the dividend as being authorised by general resolution in any event, so they did not act in excess of their powers and so there is no breach of s.171 CA. Likewise, I consider that they did exercise independent judgment under s.173 CA and were not in conflict of interest under s.175 CA because they reasonably considered the distributable profits enabled a dividend not to be removed from the Company for their own consumption, but to reduce a debt to it, that was in the Company's best interests (so there was no violation of ss.172(1) either) and reasonable exercise of functions (so s.174 is not breached). I have also found that as at July 2016, the Company had a worse year but was not yet in real financial trouble and was still paying debts and meeting liabilities as they fell due. It was neither insolvent nor was that 'imminent', so there was no breach of the common law duty preserved by s.172(3) CA discussed in *Sequana*. In any event, since in my judgment Mr and Mrs Rutter acted honestly and reasonably in relying on Mr Langham's reassurance that a dividend of £560,000 could be used to offset the directors' loan, in the absence of a finding of unlawful distribution as in *Re Marini*, I would grant them relief from liability for breaching ss.171-5 under s.1157.

114. Moreover, unlawful distribution at common law, is not an entirely objective question of whether 'distribution' was made out of capital, as Lord Walker said in *Moore* at p.26:

> *"A relentlessly objective rule of that sort would be oppressive and unworkable. It would…cast doubt on any transaction between a company and a shareholder, even if negotiated at arm's length and in perfect good faith, whenever the company proved, with hindsight, to have got significantly the worse of [it]…"*

115. Instead, Lord Walker in *Moore* at p.32 approved this approach in *Steadman*:

> *"[D]irectors are liable only if it is established that in effecting the unlawful distribution they were in breach of their fiduciary duties (or possibly of contractual obligations, though that does not arise in the present case). Whether or not they were so in breach will involve consideration not only of whether or not the directors knew at the time that what they were doing was unlawful but also of their state of knowledge at that time of the material facts."*

116. Indeed, if the common law took a purely objective approach looking purely at the company's objective financial condition and distributable reserves in hindsight at the time of 'distribution', that would completely circumvent the careful checks and balances

in Part 23 CA of 'relevant accounts' and 'knowledge' and indeed render the statutory scheme almost completely otiose. There should be harmony between statute and common law (*Sequana* p.235) Here, for the reasons already given, I accept Mr and Mrs Rutter's state of mind at the material time (i.e. July 2016) was such that they were reassured by their trusted professional accountant that this course was open to them. I would find no breach of the common law principle of unlawful distributions (and so no exception from their ability to rely on the ratification principle discussed in *Satyam*). Even if I were wrong about that, I would relieve them from liability under s.1157 CA. In any event, it follows I find the £560,000 dividend was lawful and dismiss that claim.

If the 'distribution' was in April 2017, was it unlawful ?

117. Just as Mr Tabari accepted he was not arguing if the distribution had been in July 2016 (as I have found) that it was unlawful (with which I agree, as I have just explained), I did not call on him to elaborate why he argued that if the distribution had been in April 2017 (which I have rejected), it would have been unlawful. It plainly would have been. As Mr Tabari submitted, by 12th April 2017, the 'last relevant accounts' under s.836 CA were those for 2015-16 which showed a huge loss and negative distributable reserves that could not support any dividend being paid at all. Moreover, since Mr and Mrs Rutter would have been aware of those accounts, they plainly would have been aware that a distribution would have been unlawful, both in statute and at common law. This would have disabled them from relying on ratification (*Satyam*). Indeed, by April 2017, insolvency was 'imminent' (if the Company was not already 'balance sheet insolvent') so they owed a duty to creditors: *Sequana*. Any dividend would be unlawful

118. Therefore, the question would come down to whether I could properly relieve Mr and Mrs Rutter of liability under s.1157 CA. This was not pleaded by them, but I raised it as an issue at trial and the Claimant had the opportunity to address it in evidence. In any event, it is another alternative finding. It is perhaps unrealistic to decide how I would have exercised a discretion on a very different legal conclusion than my own. However, my factual findings would be the same. (I have not found, as the Claimant at one stage argued I should, that the decision to pay the dividend was *made* in April 2017 despite those 2015-16 accounts. If I had done, relief would have been out of the question).

119. So, in this context, I would be exercising the discretion on the basis that Mr and Mrs Rutter made the decision to make the distribution in July 2016 and recorded it; and on the draft accounts and other information they had at the time this was reasonable. Indeed, I would have found – as I have found above – that this decision was taken not to remove profits from the company, but to reduce their indebtedness to it, improving its financial position, at a time when the business had a bad year, but insolvency was not yet 'probable'. However, I would have found the 'distribution' was in April 2017 –because of Mr Langham's 8-month delay in entering the net dividend on Sage which he and Mrs Rutter reasonably considered was a matter for him not her and Mr Rutter. I would have found this delay was explained by their focus on improving, then eventually just trying to save the business rather than paying for Mr Langham to come in to make an entry whose legal significance not even he appreciated. When he did so in April 2017, the Company was plainly in deep trouble. There is no evidence – and I have not found – that Mr Langham was *asked at that stage* to make the entry by Mr and Mrs Rutter. But that does not mean he did it completely off his own bat as Mr and Mrs Rutter speculated. I have found he made that entry under the authority to do so he was given in July 2016 and thinking (legally incorrectly on this hypothesis) that he was not making a 'distribution'; and that had he realised he was, he would not have made because by then, a distribution of any size, let alone £560,000 was unlawful.

120. On that basis, not only were Mr and Mrs Rutter honest (as Mr Tabari accepts – their failure to declare tax being irrelevant, and on this hypothesis lawful, as I have said), contrary to his submissions, I would have found they also behaved 'reasonably', especially since their decision to distribute was in July 2016, not April 2017. That was also so in *Re Marini*, yet Mr Seymour QC still declined to order relief at p.57:

> *"I have the greatest difficulty in seeing that it is ever likely that 'in all the circumstances of the case' it is going to be right that a defaulting director 'ought fairly to be excused for the negligence, default, breach of duty or breach of trust', if the consequence of so doing will be to leave the director, at the expense of creditors, in enjoyment of benefits which he would never have received but for the default. However honestly the director acted, however much it may have appeared at the time of the act complained of that the only person who might be harmed by the act would be the director himself, it just is not fair that if it all goes wrong the guilty director benefits and the innocent creditors suffer."*

121. However, concern about leaving a director who was never entitled to dividend to keep it at the expense of creditors does not address a situation, as here, where the director's decision to distribute was intended to keep the profits in the company as well as reduce indebtedness, so *improving* the solvency of the company at a time when insolvency was not probable. Nor does it address the situation that the entry would have been lawful had an accountant made the entry reasonably delegated to him to make at the time, but was rendered unlawful by an accountant doing so several months later. In my judgment, Mr Seymour QC in *Re Marini* was not intending to articulate a 'bright line rule' that an unlawful distribution can never be relieved and if he was, I respectfully disagree.

122. Moreover, since *Re Marini*, in *Dickinson* at p.47, Newey LJ suggested that relief would be 'improbable' for directors who breached duties by wrongly taking company property at an undervalue, there was no 'absolute bar' to doing so. If that is the case for proprietary claims in breach of trust, I consider it should also be the case for unlawful distributions: relief is 'improbable' but there is no 'absolute bar'. In the extremely unusual even exceptional circumstances which I have described here, I would have been satisfied that relief should have been granted to Mr and Mrs Rutter. However, in the light of my finding the 'distribution' was in 2016 not 2017, that is academic.

Directors' Loan Claim

123. I can deal with this issue more briefly. I have found as a fact above in this judgment that between July and October 2017, Mr and Mrs Rutter ran up a debt on the directors' loan account of £94,688.12 (quite aside from the final credit of over £130,000 entered by Tommy Rutter on Mr Langham's instructions in October 2017). I found this was a series of payments to themselves which they made, were not legitimate company expenditure and so which were owed to the Company. However, I went on to find above that I accepted on the balance of probabilities that in December 2020, they paid under a

guarantee to County Asset Finance £116,000 (of which £101,000 discharged the Company's debt to it) and in December 2021, they paid off £16,150 of the Company's debt to Lead Asset Finance under a guarantee as well. Mr Tabari accepted that if I made those findings of fact, as I have, that Mr and Mrs Rutter were entitled to set off those payments to cancel out the balance on the directors' loan owed in debt even though they were made after liquidation: *DTI v Frid [2004] 2 WLR 1279 (HL).*

124. However, as I have explained, Mr Tabari had also pleaded and argued the position was different if running-up of this debt of £94,688.12 was also a breach of directors' duty. Whilst he omitted to address this in his closing submissions, I have explained why I permitted the Claimant to re-open this issue after my draft judgment. Mr Tabari is right to submit that liability for breach of director's duty cannot be offset by a director paying a guarantee for the Company's debt. In *Manson v Smith [1997] 2 BCLC 161*, Millett LJ (as he was) said in refusing permission to appeal against a decision refusing set-off of a debt owed by a company to a director against a liability for a wrongful director's loan (approved in *Smith v Bridgend CC [2001] 3 WLR 1347 (HL)* at p.35):

> *"Rule 4.90* [in materially the same terms as the current Insolvency Rule 14.25] *…require[s] there to be mutual debts or mutual dealings. When Mr Manson improperly withdrew money from the Company this did not constitute a dealing between him and the Company. A misappropriation of assets is not a dealing…. [T]he thief who steals my watch does not deal with me. Similarly, the man who steals money from a company does not obtain the money by a dealing within Rule 4.90 Accordingly, his liability to repay money he has misappropriated cannot be set-off against any debt owing to him by the Company."*

The issue is whether running-up of debt of £94,688.12 was a breach of directors' duty.

125. By way of context for the running up of that debt in July-October 2017, I noted that the 2015-16 accounts were signed off by Mrs Rutter in March 2017. They showed *'a dramatic decline from a £768,753 net profit in 2014-15 to a £423,663 net loss in 2015-16'*. I found this was explained by three factors. Firstly, there was the fall in POD sales (with turnover falling from £10,175,076 in 2014-15 to £4,930,298 in 2015-16 and stock rising from £196,882 in 2014-15 to £240,856 in 2015-16, suggesting more unsold stock). Sales may also have started to suffer from the difficulties of a regular customer who later went into liquidation owing the Company £225,000. Secondly, business expenses had not markedly fallen from £1,187,351 in 2014-15 to £1,080,023 and the Company was in

a classic 'cash-flow crunch'. Thirdly, the new property development and lending side of the Company was not prospering. There was a dramatic shift in the Company's debtors from 2014-15 where the Company was owed £1,086,349 (£840,622 trade debtors and £245,727 other debtors – of course as reduced by the dividend) to 2015-16 where the Company was only owed £669,129 in total (£111,248 trade debtors and £557,881 other debtors). However, the asset and creditor position had not changed much e.g. the short-term creditors had been £1,571,223 in 2014-15 and were £1,384,701 in 2015-16; the long-term unsecured creditors (both more than 1 year and more than 5 years) had been £667,745 in 2014-15 and were £669,325 in 2015-16; whilst secured creditors had been £387,880 in 2014-15 and were £319,281 in 2015-16.

126. However, whilst I explained why there was cause for optimism for Mr and Mrs Rutter when the dividend was decided on in July 2016 (when not all these figures would have been available), by March 2017, that situation had deteriorated. For convenience, I will repeat my key findings for mid-to-late 2017:

> *"…[B]y early 2017, the situation was plainly going from bad to worse. As Mr Irwin later observed in his December 2017 report (AB211), there was no improvement in the POD sales and the property ventures had fallen flat leaving only debt and litigation. An individual owed the Company c.£156,000, another company owed it £300,000 (guaranteed up to £250,000) and yet another company owing it £600,000 had gone into liquidation. Moreover, even though Mr Langham had carefully made provision for c.£200,000 2014-15 Corporation Tax in the accounts, Mr and Mrs Rutter had not paid it – hoping in discussions with Mr Langham in March 2017 to offset the 2015-16 losses (MB257)…..*
>
> *By early June 2017, the Company had been near or even above its £50,000 overdraft limit for a couple of months…. This briefly changed on 7th June when Redd Factors leant it £133,000, but that same day it was all paid out and the account when back into overdraft and a fortnight later was back at its over-draft limit. This is where Mr Hickey briefly enters the story, as on 14th July he leant the Company £300,000…..[T]hat money was soon spent on PODs and three days later on 17th July, the Company was back in its overdraft yet again and then remained there. It was also on 17th July that the director's loan account (even as retrospectively corrected by Tommy Rutter's 2016 c.£130,000 entry in October)*

moved from credit to debit (pg.276). In the following three months until the last entries (including Tommy Rutter's retrospective one) on 26th October 2017, just over £220,000 of debt was accumulated, offset with about £70,000 of repayments…..I find on the balance of probabilities all withdrawals were properly included, related to personal not Company expenditure….[S]o in just over 3 months to 31st October 2017, quite aside from the dividend, credit of £137,875.24 and £10,000 to Exodus Finance, the debt run up was £94,688.12…..Mr and Mrs Rutter admit continuing to use the loan account as they always had - even despite….a line of financial shocks: despiter the disastrous 2015-16 accounts approved in March 2017, despite the massive unpaid Corporation Tax bill of £200,000 which came back to roost in the petition [on 18th September 2017 when HMRC presented its winding-up petition for £326,438.29] and despite the intervention of a bank insolvency adviser. They maintained their determined optimism because the Company was owed a total of £1.3 million from various sources and they were advised they could trade through the storm. I accept this was their genuine view. However, to use an analogy I floated at the time, they did not 'batten down the hatches' despite that storm, they just kept on sailing as usual because they could see daylight on the horizon. Mr Rutter repeated….that the Company could have kept on trading with its full order book. They had an offer of finance to pay off the tax bill from another corporate lender and Mr Rutter plainly feels 'tricked' by Mr Sullivan from Redd Factors into agreeing to Administration on 31st October 2017, when presented with an inflated demand for over £800,000. I have some sympathy with Mr Rutter's concern this level of indebtedness was inaccurate… [But] HHJ McCahill found….it did not invalidate the appointment of Mr Irwin..."

127. Against the background of those findings of fact (expanded given the re-opened evidence of Mr and Mrs Rutter), Mr Tabari sensibly does not rely on s.171 (excess of powers), as s.197 CA states directors' loans may be authorised by ordinary resolution and here the ratification principle would apply. However, he puts his case in three other ways, which in my judgment do establish individual and alternative breaches:

127.1 Firstly, I agree that the running-up of £94,688.12 of debt to the Company in a little over three months was negligent and in breach of Mr and Mrs Rutter's duty to the Company of reasonable care, skill and diligence under s.174 CA.

This is before and after the presentation of the winding-up petition in September 2017 (which cannot reasonably have been unexpected). I accept they continued to use the directors' loan account as they always had, but seemingly ignoring that the financial situation of the Company had dramatically deteriorated. They ran up almost £100,000 of debt against the background of the bad 2015-16 accounts, the cash-flow crisis, living deep in the overdraft and with a huge unpaid tax bill that eventually came home to roost with the September petition. I accept they genuinely believed they could see daylight on the horizon with a full order book and over £1 million owed to the Company. However, there is no sign whatsoever that they curtailed personal spending. Gone was the prudence of June 2016 of keeping the dividend in the Company, so reducing the debt. They just kept on sailing through the storm without battening down the hatches until eventually the ship was hit with a massive wave and just sank.

127.2 Secondly, even if I am wrong about the breach of s.174 CA, I accept Mr Tabari's alternative submission that in steering this course, Mr and Mrs Rutter breached other statutory fiduciary duties to the Company under ss.172(1), 173 and 175 CA. As I noted, there is overlap between those sections: the common thread in this case is the clear conflict of interest: between their interests in continuing to use the director's loan account to finance their personal spending through Company bank accounts; and the Company's interests in restraining its spending to what was necessary in such financially difficult and uncertain times – again, both before and after the petition. Of course, sole director-shareholders may struggle to conceive of the Company to have different interests. But it can and here it did: though Mr and Mrs Rutter ignored that conflict of interest.

127.3 Finally, I accept that this expenditure of £94,688.12 on the director's loan account was also a breach of Mr and Mrs Rutters' creditor duty – including relating to HMRC – under s.172(3) CA. Whilst that duty's 'trigger' has just been pushed back from 'probable' to 'imminent' by the Supreme Court in *Sequana*, that is academic as I find by July 2017, the Company was *actually insolvent*. Mr and Mrs Rutter's ability to raise yet further lending to pay off the HMRC winding-up petition of over £325,000 does not mean they were

> not insolvent. The test is whether it had insufficient assets to be able to meet all of its liabilities, including prospective and contingent liabilities, in the sense discussed in *Sequana* and *Re Casa Estates [2014] EWCA Civ 383*. Here, the Company was plainly 'balance-sheet' and 'cash-flow' insolvent. Therefore, I find on the balance of probabilities the Company was actually insolvent by July 2017 and even if I am wrong about that, insolvency was 'imminent' or administration 'probable' on the test set out in *Sequana*. By prioritising their own borrowing from the Company over the creditors' duty (which they ignored) Mr and Mrs Rutter were in breach of that duty as well.

It follows that Mr and Mrs Rutter cannot in law set-off their discharge of guarantees on behalf of the Company against their debt to it and are liable for the £94,688.12 as well. However, after I pointed out that set-off was highly relevant to the issue of an account on the properties claims to which I now turn, that issue was abandoned by the Claimant.

The Properties Claims

128. I repeat my findings of fact above, starting with those relating to Marsh Avenue:

> *"The Claimant makes a similar argument in relation to £30,226.56 in invoices relating to 4, Marsh Avenue in Kibworth. Again, there are voluminous invoices (although they appear to cover the period from mid-2015 to October 2015, not 2014-15 as pleaded) referring to work at Marsh Avenue (e.g. MB766-70). Again, Mrs Rutter accepted that Marsh Avenue was their property and a considerable amount of work had been done there. Indeed, Mr Rutter put to Mr Irwin than far more than £30,000-worth of work, which he accepted. However, that is not inconsistent with the Claimant's pleaded case that £30,226.56 of Company money was used to (part-)fund the refurbishment of Marsh Avenue, since that is what the invoices show, corroborated by Sage entries (see MB55-159).*
>
> *In the Defence, the only positive case is that invoices were made out to the Marsh Avenue address in error. But this makes no sense – the invoices relate to work at Marsh Avenue. Moreover, Mr and Mrs Rutter did not address this at all in their statements. Mr Rutter's entirely new assertion that the owner of Marsh Avenue worked for the Company and had 'put invoices through' is totally new, not evidenced and I reject it. Again I am driven to conclude the effectively evidentially uncontradicted Company records show £30,226.56 of its money was used to*

refurbish Marsh Avenue: not Company expenditure and not declared in the loan account."

129. I added that it was not my role to plough through invoices to try and increase the Claimant's recovery up to the asserted but not evidenced further c.£160,000 Mr Irwin claims. However, in fairness the Claimant does not ask me to do so, but to order an equitable account. But there are potential arguments against that in relation to a situation where Mr Irwin has had several years to do so and not evidenced that breach. So, I will hear further submissions on this point when I hand down judgment. However, I have found Mr and Mrs Rutter spent £30,226.56 of Company money on their own (non-home) property at Marsh Avenue, which was a plain breach of trust and fiduciary duty, as well as a breach of the duty to act in the Company's interests under s.172 CA. As the property has been sold, they are certainly liable to account personally at least £30,226.56, subject to further submissions on hand-down of judgment.

130. On Launde Lodge Farm, I will also repeat my key findings of fact above:

"When investigating the affairs of the Company from 2017, Mr Irwin found 2015 and 2016 Reserves Schedules referring to £225,852.48 in costs on sub-contractors and materials relating to Launde Lodge Farm. This appears to have been prepared by Mr Langham but again probably with the assistance of Mrs and Tommy Rutter…So, the Company's own contemporary records between late 2014 and August 2016 clearly show a total of £225,852.48 was billed to the Company relating to Launde Lodge Farm. This is a considerable sum for an extension, but as the photographs show, this was a considerable extension and other work was clearly done at least on the rooves of the other building by Mr and Mrs Rutter.

However, there is no evidence that any of that was ever put through the loan account….The details of some of the invoices are revealing, for example the labour invoices for 'work at Launde Farm' (as well as other places) from James Stapleford and BB Builders and skip hire, crane hire and scaffolding there. A building inspector charged to visit a "Two storey pool extension at Launde Farm Lodge" and an excavator for "Launde Extension". Whilst Mr Smith's statement suggested 'invoices' he was shown by related to other work, he did not really appear to recognise any of these….Mr and Mrs Rutter's case in the Defence and Mr Rutter's

evidence included the assertion that all these invoices relate to work done elsewhere but billed to Launde Farm, especially as it had been the registered office of the Company. However, that changed to the Company factory premises in March 2015, close to the start of the development project and it is simply not credible that so many contractors made that mistake. Moreover, whilst I accept Mr Smith's evidence that the barn was used for storage for other development projects, this does not explain all the invoices Mr Irwin found plainly relating to Launde Lodge Farm, as opposed to simply addressed there. Indeed, whilst Mrs Rutter initially started off in evidence parroting their pleaded case, after candidly admitting they had built the extension, she also admitted that some of the invoices related to that extension and were paid through the Company, although she thought that they would be accounted for in the loan account. However, she accepted that this was the first time she had said this and did not in fact point to any entries in the loan account on this issue. I find none of them were accounted for… These concessions prompted Mr Rutter to change tack overnight. As I have said, he started deploying entirely new arguments in cross-examination to try and explain away the evidence, in an increasingly strained and incredible way. This included that the work actually related to construction the Company and Redline had undertaken at a neighbouring property 'The Stables' (the first time he had mentioned this), producing an invoice. 'The Stables' is shown on the 2021 photograph (on the other side of a neighbouring property 'Launde Abbey' which seems largely unchanged) in the bottom-right hand corner, as an 'L-shaped' building with a fence round a yard. However, this fence is absent in the 2018 photograph and this building is absent in the 2011 one (although there may have been old stables under the trees, hence the name). So, I accept there was building work at 'The Stables'.

On the assumption (which the Claimant does not accept) this 2016 invoice from the Company to the owners of 'The Stables' is genuine and had not just been created by Mr Rutter overnight, it shows that the Company undertook construction work there. It does not prove that any of the invoices Mr Irwin relies on relate to work at 'The Stables' rather than 'Launde Lodge Farm'.

It is the latter they refer to – and I note the Company's invoice to 'The Stables' is addressed to 'The Stables', Launde Road, Launde', not 'Launde Lodge Farm'. Whilst some workers using the barn may have referred to that as 'Launde Lodge Farm', they are unlikely to have referred to it for work relating to 'The Stables'.

Ultimately, if Mr and Mrs Rutter had been straightforward from the start that they spent Company money on developing their home, it is theoretically possible they may have been able to point to particular invoices which were legitimate Company expenditure, or which were properly accounted for as part of the directors' loan account. But I simply do not know, as that is not the course they took. Whilst I have assisted them with legal points and in questioning, it is not my role to trawl through invoices trying to look for a factual case they'd be aware of yet are not presenting. I am therefore driven to conclude that the Claimant has proved on the balance of probabilities that all £225,852.48 of work invoiced from 2014 to August 2016 referring to Launde Farm all related to work done on Mr and Mrs Rutter's property and billed to the Company but not properly accounted for through their loan account….."

131. However, in respect of Mr and Mrs Rutter's home, the Claimant has not only personal claims for breach of s.172(1) CA and fiduciary duty, but also a proprietary claim for breach of trust, as in *Dickinson*, where a director took Company property in breach of duty (by buying it at an undervalue then leasing it back). Whilst s.1157 CA is theoretically available, as confirmed in *Dickinson* itself, it is 'improbable'. In this instance of funding the extension through the Company without declaring it through the loan account, I have found Mr and Mrs Rutter did not act honestly and reasonably and so, no relief would be appropriate under s.1157 CA. It follows that they must pay the Claimant a further £225,852.48 to reimburse the Company what they wrongly used.

132. However, Mr and Mrs Rutter still own Launde Lodge Farm and they told me that it has been valued at between £1.8 million and up to £5 million (but probably nearer £2.5 million), with a mortgage of about £1.5 million. Therefore, given the extent of the extension the Company at least in part funded with the £225,852.48 they used in breach of trust, the Claimant seeks not just a personal remedy (a judgment debt Mr and Mrs Rutter must pay) but a 'proprietary remedy' (i.e. an interest in the house). The Claimant's choice of remedies is explained in *Snell's Equity*, 34th ed:

*"**30-050….**Against the defaulting trustee, a proprietary claim may be enforced by an equitable lien or beneficial interest under a constructive trust.*

> ***30-054*** *To rely on the equitable rules of identification the claimant must have some distinct equitable title to the original asset* [that is, the money that was spent]… *The requirement that the claimant have a distinct equitable title is commonly satisfied by the original asset having been held subject to a fiduciary relationship before it was misapplied…*
>
> ***30-055….****Against an asset in the hands of the trustee, the claimant has an election between two proprietary remedies. He may enforce an equitable lien against it for the value of the original asset which was applied to acquire it. The lien is for this fixed amount, and does not change in value even if the substituted asset rises or falls in value. Alternatively, he may claim the entire beneficial ownership of the substituted asset under a constructive trust. The value of this proprietary security will vary as the value of the substituted asset fluctuates. The claimant has an unrestricted election between whichever of the remedies is more advantageous to him….*
>
> ***36-007*** *An equitable lien is very different from a common law lien, and indeed far more like an equitable charge [or mortgage]. Unlike a lien that arises at common law, an equitable lien is not dependant on possession. Like a charge, an equitable lien gives the lienee rights in the nature of a charge upon property until certain claims are satisfied. The equitable lien differs from an equitable charge only in that it arises by operation of equity, from the relationship between the parties, rather than by any act of theirs. Similarly to a charge, an equitable lien is enforceable by means of an order for sale…*
>
> ***44-004*** *Equitable liens are thus similar to mortgages in the sense that they provide security without possession. However, they differ from mortgages in that they arise by operation of law rather than because the parties have consented…"*

133. As Mr Tabari says, this is not a case where there is a question about the Company's money being paid into a mixed fund and thereby becoming unidentifiable. There has been no evidence to support an equitable defence of 'change of position'. However, he rightly recognised the difficulty in valuing any beneficial interest in the absence of 'before and after' valuations. Given the level of the existing equity, the claimant sought an 'equitable lien' which works more like a second mortgage in the sum of £225,852.48, which does not rise or fall in value with the house, but reduces as it is paid off, like a mortgage. When I explained this to Mr Rutter, he accepted it seemed 'fair'. I entirely agree with that fair concession and I will order it.

Conclusion

134. Therefore, I dismiss the dividend claim, but uphold the claim in respect of the director's loan account in the sum of £94,688.12 and the claims on Marsh Avenue and Launde Lodge Farm. On Marsh Avenue, I will enter judgment against Mr and Mrs Rutter for £30,226.56. In respect of Launde Lodge Farm, I will enter judgment for £225,852.48 plus interest against Mr and Mrs Rutter and order an equitable lien on their home.

135. Having heard the further evidence on the re-opened loan account claim and decided it, I also heard argument on costs and finalised my order. In summary it is that there will be judgment for the Claimant in the sum of £350,747.16 (all three successful claims) plus interest of £40,707.96 continuing to accrue at the daily rate of £38.44; that Launde Lodge Farm will be subject to an equitable lien in respect of £225,852.48 plus interest at 4% from the date of liquidation, namely £26,210.25 and accruing at a daily rate of £24.75, making a total of £252,062.73; and that the Defendants will pay the Claimant's costs of the claim – and indeed of their last-minute applications in the insolvency proceedings - in the terms of my order.

HHJ Tindal