



Neutral Citation Number: [2023] EWHC 483 (Ch)

Case No: BL-2021-BRS-000035

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

Bristol Civil Justice Centre
2 Redcliff St
Bristol BS1 6GR

Date: 09 March 2023

Before :

MR JUSTICE ZACAROLI

Between :

ERNEST RICHARD HEMMINGS

Claimant

- and -

(1) JEROME CARL MATHIAS

Defendants

(2) TEMPLE BRIGHT LLP

Simon Passfield (instructed by **Reynolds Porter Chamberlain LLP**) for the **Claimant**

Gerard McMeel KC (instructed by **DAC Beachcroft LLP**) for the **First Defendant**

The Second Defendant did not appear and was not represented

Hearing date: 27 February 2023

JUDGMENT

Mr Justice Zacaroli:

1. The main question raised by this trial of preliminary issues is whether the settlement of claims between two companies amounted to “repayment” of an amount due from one to the other, so as to satisfy an obligation in a share purchase agreement.
2. The claimant (“Mr Hemmings”) was, prior to 13 November 2014, a director and shareholder of three companies, forming part of the “ERH Group”:
 - (1) E R H (Holdings) Limited (“Holdings”);
 - (2) ERH Communications Limited (“Communications”);
 - (3) ERH Construction Limited (“Construction”).
3. Mr Hemmings owned all of the shares in Holdings. Holdings owned all the shares in Construction and 99% of the shares in Communications (the other 1% being held by Mr Hemmings).
4. Prior to October 2014, Construction had entered into five construction contracts with Bath & North East Somerset Council (the “Council”) (the “Construction Contracts”), and a further two contracts with the Council which it had subcontracted to Communications (the “Communications Contracts”).
5. By October 2014, Construction was in financial difficulties. Construction owed Communications £122,637.18 in respect of work carried out by Communications, as subcontractor, in relation to the Communications Contracts.
6. Mr Hemmings caused Construction to: (1) transfer the Construction Contracts to Communications; and (2) direct the Council to pay all sums falling due in respect of the Communications Contracts directly to Communications. This exposed Mr Hemmings to the risk of a claim by Construction, or any subsequently appointed insolvency officeholder of Construction, to a claim for breach of fiduciary duty as a director of Construction.
7. Construction then sought advice from Grant Thornton UK LLP (“GT”). GT advised the directors of Construction (including Mr Hemmings) that, if appointed as administrators: (1) they would require Communications to repay to Construction any monies paid to it by the Council in respect of work carried out by Construction; and (2) if Communications failed to do so, Mr Hemmings and the other directors of Construction could be personally liable to do so.
8. Mr Hemmings wished to ensure Communications’ survival and so did not follow that advice. The other directors disagreed, and resigned between 27 and 28 October 2014.
9. Mr Hemmings received from Construction’s commercial director, Mr Keith Hollingsworth, an analysis of how the monies received by Communications from the Council should be allocated between Communications and Construction. He advised that Communications had received a total sum of

£271,182.78, of which (1) £148,545.59 related to work carried out in respect of the Construction Contracts; and (2) £122,637.18 related to work carried out in respect of the Communications Contracts.

10. In fact, that information turned out to be incorrect: the Council paid to Communications the total sum of £355,214.45, of which (1) £171,027.18 related to work carried out in respect of the Construction Contracts; and (2) the sum of £184,187.27 related to work carried out in respect of the Communications Contracts.
11. Construction entered administration on or about 4 November 2014. Another company in the EHR Group, E.R. Hemmings (Building) Limited (“Building”) was also placed into administration.
12. At about the same time, Mr Hemmings entered into negotiations with the first defendant (“Mr Mathias”) for the sale of most of his shares in Holdings and all of his shares in Communications.
13. This resulted in a share purchase agreement dated 13 November 2014 (the “SPA”). This provides, materially, as follows:
 - (1) Clause 1 defined “the BANES Debt” as the sum of “£150,000 (approximately) of indebtedness outstanding from [Communications] to [Construction].”
 - (2) By clause 9:

“9.1 [Mr Mathias] undertakes to procure that [Communications] shall repay the BANES Debt to [Construction] no later than 12 months from the date of this agreement or in accordance with any formal request for or on behalf of [Construction].

9.2 In the event that a demand is made against the Seller [Mr Hemmings] to repay the BANES Debt (or any part thereof) by an administrator, liquidator, receiver or other similar appointee of [Construction] as a result of the non-payment by [Communications] pursuant to clause 9.1, the Buyer agrees to indemnify the Seller on demand in respect of any amount the Seller is required to repay up to a maximum of £150,000 plus any interest, penalties due as a result of non payment by the Buyer in accordance with clause 9.1, if any.”
 - (3) By clause 10.1.11 Mr Hemmings warranted that the BANES Debt “does not exceed £150,000”.
14. By clause 10.1.9, Mr Hemmings warranted that, “save in relation to the “Outstanding Liabilities, there is no outstanding indebtedness, guarantee or other liability (actual or contingent) and no outstanding contract, commitment or arrangement between [Communication] and any Group Company”. The Outstanding Liabilities were defined as the BANES Debt and the Communications Indebtedness (being the debts outstanding from Communications to Holdings, and warranted to be no more than £1,200,000).

Group Company was defined as Holdings and each of its subsidiaries, including therefore Construction.

15. Mr Mathias did not cause Communications to repay the BANES Debt within 12 months of the SPA. In November 2015, Construction and Building were both placed into creditors' voluntary liquidation.
16. Following their appointment, the liquidators of Construction identified potential monies alleged to be owed by Communications and Holdings to Construction and Building, including:
 - (1) £355,214.45, being payments which were due to Construction from the Council but which had been diverted to Communications;
 - (2) £114,528.24, representing retention payments from the Council for works not completed by Construction as at the date Construction went into administration, and which were subsequently completed by Communications;
 - (3) £120,000 in respect of a separate project which Construction had not completed as at the date it went into administration, and which was subsequently completed by Communications; and
 - (4) £1,104,462.66 in respect of an alleged claim of inter-company debt owed by Communications and Holdings to Construction.
17. According to Mr Mathias (whose evidence is accepted as true for the purposes of this preliminary issue) Holdings and Communications had identified a number of matters which gave rise to substantial claims against Construction, including where Communications completed work without payment, either to correct defects in work previously carried out by Construction, or to protect Holdings which had given a guarantee for Construction's work, and in respect of VAT liabilities which ought to have fallen on Construction but which fell on Holdings and Communications. He said that, in negotiations with the liquidators of Construction: "The liquidator said that the starting point for any discussion should be £150,000, based on the provision within the SPA. We countered with arguments about the liabilities that Communications and Holding had to take on ... and they agreed that there were strong arguments on both sides in relation to the recovery of debts."
18. On 4 April 2016, Holdings, Communications, Construction (by its liquidators) and Building (by its liquidators), entered into a settlement agreement (the "Settlement Agreement"). This recited the four claims referred to in paragraph 16 above (which were defined as the "Demand"), recited that Communications and Holdings, while recognising that some amount was due, disputed the amount of the Demand, and provided, by clause 3.1 as follows:

"In consideration of Construction, Building and the Liquidators agreeing to waive in full and final settlement all and any claims howsoever arising including the Demand that they may have against Holdings, Communications and the Current Directors,

Communications will pay the Settlement Sum [defined as £200,000] to Construction payable as follows:-

3.1.1. £100,000 (one hundred thousand pounds) of the Settlement Sum on the First Instalment Date; followed by

3.1.2. the remaining £100,000 (one hundred thousand pounds) of the Settlement Sum on the Second Instalment Date.

All sums payable shall be paid in full and without any set-off, condition or counterclaim whatsoever and free and clear of any deductions or withholdings whatsoever.

3.2. Subject to clause 3.3, the Settlement Sum shall be inclusive of all interest and the Parties shall bear their own costs.”

19. By clause 5.1 of the Settlement Agreement, it was stated to be in full and final settlement of all and any claims and “releases and forever discharges” any and all claims that Construction, Building and/or their liquidators had against Holdings, Communications or their current directors (including Mr Mathias) or that Holdings and/or Communications had against Construction, Building and/or their liquidators.
20. On 19 September 2016, the liquidators of Construction wrote to Mr Hemmings (and one of his co-directors of Construction at the relevant time) claiming damages for breach of duty and/or as relief available for a transaction at an undervalue or preference within s.241 of the Insolvency Act 1986, arising from the transfer of contracts from Construction to Communications, and the misdirection to Communications of payments due to Construction from the Council. The sum claimed was based on the totality of the diverted payments: £355,214.45.
21. On 23 May 2019, Mr Hemmings’ solicitors served on Mr Mathias a written demand for payment of the sum of £150,000 said to be due pursuant to clause 9.2 of the SPA, on the basis that Mr Hemmings was being pursued by the liquidators of Construction for the BANES Debt. Upon Mr Mathias refusing to pay, these proceedings were commenced on 10 December 2021.
22. In the meantime, on 20 January 2020, Mr Hemmings entered into a settlement agreement with the liquidators of Construction, agreeing to pay £165,000 in full and final settlement of the liquidators’ claims against him. The claims, according to the recital, included those relating to the transfer of contracts from Construction to Communications, and two arising out of additional matters (unrelated to the misdirected funds).
23. On 14 June 2022, District Judge Wales ordered that the following issues be determined as preliminary issues:
 - (1) Has Mr Mathias procured that Communications repay the BANES Debt (as defined in clause 1.1. of the SPA) to Construction in accordance with clause 9.1 of the SPA?

- (2) If not, was Mr Hemmings required to personally repay “the BANES Debt” (as defined in clause 1.1 of the SPA) as a result of the non-payment by Communications pursuant to clause 9.1 of the SPA, such that Mr Mathias is liable to indemnify Mr Hemmings pursuant to clause 9.2 of the SPA?
24. The first issue turns on what is meant by the *repayment* of the BANES Debt in clause 9.1 of the SPA.
25. It is common ground that the “BANES Debt” refers to at least some part of the liability of Communications to pay Construction arising from its receipt of payments from the Council that were due – before the purported novation – to Construction (the “diverted payments”).
26. There is a dispute, however, as to whether it means (as Mr McMeel KC contended on behalf of Mr Mathias) a sum in the region of (and no more than) £150,000 of indebtedness due from Communications to Construction arising from the diverted payments, or whether it means (as Mr Passfield contended on behalf of Mr Hemmings) whatever sum it turned out was due from Communications to Construction as a result of the diverted payments, being a sum which the parties *believed* at the time to be in the region of £150,000.
27. While the resolution of this dispute is not essential to the determination of the preliminary issues, I consider that Mr McMeel’s construction is the correct one. The natural reading of the definition of the BANES Debt is that it is a particular amount of indebtedness, i.e. approximately £150,000, not that it is any indebtedness, which the parties merely believe to be in the sum of approximately £150,000. That is fortified by the fact that the BANES Debt is warranted by Mr Hemmings to be no more than £150,000, and by the fact that clause 9.2 limits any obligation on the part of Mr Mathias, in the event that he does not procure Communications to pay the BANES Debt, to the sum of £150,000. Mr Passfield accepted that the practical effect of clause 9 was to limit recovery in respect of the BANES Debt, whether against Mr Mathias or Communications, to £150,000 of the diverted payments. The risk that more money might turn out to have been wrongly diverted to Communications was, as between Mr Hemmings and Mr Mathias, assumed by the former.
28. Assuming that the BANES Debt indeed means £150,000 of indebtedness from Communications to Construction, Mr Passfield initially submitted that it required £150,000 of cash to be deposited by Communications with Construction. He also accepted, however, that it could include the provision by Communications of full value to Construction by exercising a set-off or mutual release between the BANES Debt and another debt or debts due from Construction to Communications in the sum of £150,000 or more. That concession was in my view rightly made. As a matter of ordinary language, “payment” of a debt may be effected as much by an offset of a cross-claim as by transfer of cash from debtor to creditor. There is no language in the SPA which limits the ordinary meaning of payment (such as, for example, language to the effect that payment must be made without set-off).
29. Mr Passfield submitted, however, that the offset of a cross-claim could only constitute payment if the cross-claim was undisputed as to existence and

undisputed as to an amount at least equal to the size of the debt. Before such a compromise could be accepted as constituting payment, therefore, it would be necessary to establish that the value of the cross-claim released or offset as against the BANES Debt was indeed the same as or greater than the value of the BANES Debt.

30. Mr McMeel, on the other hand, submitted that *any* compromise entered into between Construction and Communications would be sufficient to constitute payment provided the liquidators of Construction were prepared to accept what was offered in satisfaction of the BANES Debt.
31. I consider that Mr McMeel's construction is to be preferred. Once it is accepted that the offset of a cross-claim can constitute payment of a debt, I cannot see any reason to limit the concept of payment to the offset only of a claim that is certain both as to existence and amount. The critical question is whether the creditor agrees to discharge the whole of the debt in return for the consideration received.
32. There would be significant difficulties in assigning a value to the release of a disputed claim or claims. The value to a creditor of the release of a cross-claim it owes is influenced by a range of factors, including its subjective view of the strength and likely quantum of the cross-claim, and the appropriate discount it is prepared to apply for uncertainties and avoiding the time and cost of litigating.
33. I do not think it can have been the parties' intention that 'payment' would be made by the set-off of a disputed cross-claim only where its existence and quantum were established by litigation, or its value was objectively established by expert evidence to be an amount equal to or greater than the BANES Debt.
34. Mr Passfield agreed with that, but submitted that these difficulties of valuation showed that Mr McMeel's construction was unworkable. The only workable construction was one which limited the concept of payment by offset of another claim to the circumstances that the claim is undisputedly in an amount equal to or greater than the BANES Debt. I do not accept that Mr McMeel's construction is unworkable. The critical issue is whether the creditor agrees that the debt owed to it is discharged by the release and discharge of the cross-claim. That is something which should ordinarily be revealed by the terms of the agreement reached between the creditor and debtor.
35. In this case, that is indeed so, albeit the picture is complicated by the fact that, while Communications in fact paid a sum *greater* than the value of the BANES Debt to the liquidators of Construction, that was part of a wider settlement. Under that wider settlement: Communications agreed to the release of all claims which it had against Construction and Building; and Construction and Building agreed to the release by them of all claims they had against Communications, Holdings and their current directors.
36. In my judgment, the Settlement Agreement resulted in payment of the BANES Debt because the liquidators of Construction agreed that, in consideration of the payment by Communications and the release of other claims, the BANES Debt was wholly released and discharged. It is unnecessary to enquire to what extent

the consideration received by Construction was apportioned to the BANES Debt and to what extent the liquidators of Construction viewed the BANES Debt as having been repaid. There is no need to enquire into those matters because it is an express term of the Settlement Agreement that the BANES Debt was discharged in its entirety.

37. Mr Passfield objected that the purpose of clause 9.1 was to protect Mr Hemmings from a claim against him by liquidators of Construction arising from the fact that he caused the diverted payments to be made. Such a claim, it was thought, could not be made if Communications repaid the BANES Debt to Construction. If Mr Mathias procured that Communications paid to Construction a sum *less* than the BANES Debt, that would not achieve the purpose. I agree with Mr Passfield as to the purpose of clause 9.1, and I agree that in the unlikely event that the liquidators of Construction simply accepted less than the full amount of the BANES Debt from Communications (i.e. without any additional consideration, such as the mutual release of claims, and without agreeing to the discharge of the BANES Debt in full) that would not constitute payment. Contrary to Mr McMeel's objection that this would in itself be an uncommercial construction, I find nothing uncommercial in Mr Mathias being required to procure that Communications pay the full amount of the BANES Debt, having agreed, for Mr Hemmings' protection, that he would do so.
38. That is not what happened in this case, however. Whatever value the various claims and cross-claims released under the settlement agreement might ultimately have had, the liquidators of Construction agreed to accept the payment of £200,000, and the release of other cross-claims, in discharge of, among other things, the BANES Debt. In other words, the value of the total consideration provided by Communications under the Settlement Agreement was accepted by Construction as being in an amount sufficient to discharge the BANES Debt.
39. For these reasons, I conclude in answer to preliminary issue 1 that Mr Mathias did procure that Communications repay the BANES Debt to Construction in accordance with clause 9.1 of the SPA.
40. In these circumstances, issue 2 does not arise. I merely note that the discharge of the BANES Debt in the Settlement Agreement should have the same impact (in determining whether loss and, if so in what amount, was caused to Construction by Mr Hemmings' actions in causing the diverted payments to be made) as if Communications had simply paid £150,000 to Construction. I do not know whether and to what extent credit was in fact given by the liquidators (for having discharged the BANES Debt in full as against Communications) when they sought recovery from Mr Hemmings. It is not possible to tell from the face of the settlement agreement with Mr Hemmings since, as I have noted above, the claim against Mr Hemmings was not limited to the loss caused to Construction by the diverted payments in the amount of the BANES Debt, but included loss caused by the diversion of payments between that amount and £355,214.45, and the loss arising under two other claims. Whatever the position as between Mr Hemmings and the liquidators of Construction, however, it does

not affect my conclusion that Communications has repaid the BANES Debt in accordance with clause 9.1 of the SPA.