FIRST DIVISION, INNER HOUSE, COURT OF SESSION

[2023] CSIH 10
CA1/21

Lord President
Lord Woolman
Lady Wise

OPINION OF THE COURT

delivered by LORD CARLOWAY, the LORD PRESIDENT

in the reclaiming motion

in the cause

(FIRST) COLONNADE PROPERTIES LIMITED, KEITH BRIGGS STEPHEN and OLIVER JAMES STEPHEN AS TRUSTEES OF THE NEWBATTLE PENSION FUND; and (SECOND) COLONNADE PROPERTIES LIMITED

Pursuers and Reclaimers

against

BEECHMOUNT LIMITED (IN LIQUIDATION)

Defenders and Respondents

Pursuers and Reclaimers: MacColl KC; Brodies LLP
Defenders and Respondents: Ower; Morton Fraser LLP

17 February 2023

Introduction

[1] Beechmount House is a large Italianate-style villa on Corstorphine Hill in Edinburgh. It was sold on 5 April 2019 for £3,250,000. The parties disagree on how the sale proceeds

ought to be divided. The pursuers argue that they should be distributed in terms of a settlement agreement. The liquidator of Beechmount argues that: the company's obligation to pay under the agreement never crystallised; the agreement was frustrated by the appointment of a liquidator; and the agreement is accordingly not binding. The commercial judge agreed with the liquidator and refused to grant decree for payment to the pursuers of the sum provided for in the agreement. This reclaiming motion (appeal) concerns whether, on a proper construction of the agreement, the judge was correct to do so.

Facts and the Agreement

[2] Beechmount were incorporated on 5 March 1996. Their only significant asset was Beechmount House. The company has three shareholders: the Newbattle Pension Fund; Colonnade Properties (formerly Newbattle Properties Ltd) and Iain Dewar. Mr Dewar was one of two directors; the other being Keith Stephen, who is an NPF trustee. The relationship between the two men broke down. This resulted in two litigations; one raised by the pursuers against Beechmount and Mr Dewar in 2017, the other raised by Mr Dewar against the pursuers, Mr Stephen and Beechmount in 2018.

[3] On 17 October 2018, at the conclusion of a long session of mediation, the litigations were settled extra judicially. The parties to the settlement agreement are Beechmount, its three shareholders and Mr Stephen. The purpose of the agreement was described in a preamble as follows:

> "BACKGROUND:
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> The parties have entered into this agreement in order to settle the current dispute(s) between them, to regulate the sale of Beechmount House by Beechmount Limited, the liquidation of Beechmount Limited and the distribution of the proceeds and a mechanism to encourage co-operation between the parties in relation to the settlement of certain potential tax issues with HMRC."

[4] The phrase "certain potential tax issues" was a reference to the fiscal consequences of Mr Stephen, and his family, and relatives of Mr Dewar having spent periods of time living at the property. The concern was that HM Revenue and Customs would treat such use of the property as benefits in kind, and that either the individuals concerned or Beechmount would have incurred a tax liability. The agreement therefore provided that the parties would take certain steps to ascertain whether that might be the case.

[5] The provisions dealing with the potential tax liability read:

> "3. ARRANGEMENTS WITH HMRC
>
> Each party shall use reasonable endeavours to co-operate with the others in relation to agreeing with HMRC any tax outcomes relevant to any benefits in kind that the directors and/or their families or connected parties may have enjoyed from Beechmount Limited. Specifically, each party shall appoint a recognised tax adviser to represent them in discussions with HMRC and instruct such advisers to co-operate and use reasonable endeavours to reach agreeable positions on the level and nature of any benefits in kind.
>
> …
>
> The parties shall appoint an independent expert on behalf of Beechmount Limited, nominated by agreement or in the absence of agreement by the President of the Institute of Chartered Accountants Scotland who shall represent the interests of Beechmount Limited in those discussions with HMRC."

[6] The parties agreed in terms of clause 4 that certain payments would be paid by Mr Stephen and Mr Dewar to Beechmount in respect of benefits in kind which had been provided by Beechmount, although these were to be set off against loans which they had made to Beechmount. It was subsequently agreed that these payments would not be made. This clause thus falls out of the equation.

[7] The parties disagree about whether, or to what extent, clause 3 was obtempered. After proof, the commercial judge found that in October and December 2018 Brian Rudkin, of JCCA (tax advisors) had met with Mr Stephen's son, and with an advisor for Mr Dewar, with a view to addressing the benefits in kind issue. Thereafter Mr Rudkin drafted a "strategy" note, advising a declaration to HMRC. He also suggested that Mr Dewar and Mr Stephen should each discuss their personal positions once settlement had been reached between Beechmount and HMRC. JCCA invoiced Beechmount for that work. In April 2019, Mr Stephen's son again approached Mr Rudkin. On 16 April, Mr Dewar's law agents emailed Mr Rudkin saying that Mr Dewar had "confirmed his intention to instruct JCCA to act on behalf of Beechmount". They asked the pursuers' agent to arrange for Mr Stephen and his son to do the same. On 17 April, Mr Rudkin confirmed to Mr Stephen's son that instructions had been received from Mr Dewar's agents to appoint JCCA as Beechmount's advisors. He requested a "formal appointment" from Beechmount "itself" because of the relationship between Mr Dewar and Mr Stephen. No formal engagement letter was, however, issued.

[8] Clause 5 of the agreement deals with the distribution of the proceeds as follows:

> "5. DISTRIBUTION OF FUNDS
>
> The parties agree that further to the resolution of matters in paragraphs 3 and 4 and the completion of the sale of the property (with the payment of any relevant tax liabilities) that the net assets held by Beechmount Limited will be distributed in the following manner:
>
> 1. The first £800,000 is paid to [the first and second pursuers] in proportion to their respective shareholdings.
>
> 2. The remaining surplus is paid 50% to Iain Dewar and 50% to [the first and second pursuers] in proportion to their respective shareholdings.

> The parties agree following the sale of Beechmount House promptly to put Beechmount Limited into solvent members voluntary liquidation by appointing a liquidator as agreed, or in the absence of agreement, as nominated by the President of the Institute of Chartered Accountants Scotland. The liquidator is hereby directed to distribute the net assets of the company as agreed.
>
> ...".

[9] No payment in terms of clause 5 was made. The pursuers issued a winding-up notice in July 2019, but it was not progressed. In November 2019, Mr Dewar petitioned the court for a winding-up order. The pursuers did not oppose this. On 17 December 2019 the court ordered a winding-up and appointed an interim liquidator, who was later appointed liquidator on 31 January 2020.

[10] The liquidator began to ingather the company's assets. By 18 February 2020, she had received £3,112,683.86 of the sale proceeds. Mr Stephen's solicitors requested that distribution should be made in accordance with the settlement agreement. Mr Dewar disputed this. The liquidator followed "robust" legal advice from counsel that the agreement was "not binding upon her" and refused to distribute in terms of clause 5. During 2020 all creditors were paid. In January 2021, the liquidator made interim payments as follows: £400,000 to Mr Dewar; £200,000 to each of Colonnade Properties and the NPF. This left £1,261,345.73. The liquidator resolved not to make a declaration to HMRC regarding any benefits in kind as she had no knowledge or evidence on that matter. Any tax liability would be payable by the directors as individuals.

The commercial judge

[11] The commercial judge reasoned that the appointment of an independent expert in terms of clause 3 must involve that expert agreeing to be appointed. Mr Rudkin had said

that he had asked for a formal instruction from Beechmount, but that instruction never came. Although JCCA provided, and invoiced for, services to Beechmount, they were never formally appointed by them. No letter of engagement was issued. Compulsory liquidation gave the liquidator control of Beechmount. This removed the ability of the directors to appoint an expert. This frustrated the contract. It became impossible for the parties to perform the obligations in clause 3. The decision by the liquidator not to make any declaration to HMRC regarding the benefits in kind was made post-frustration, and did not, and could not, amount to a means of resolving matters. As clause 3 was never implemented, the obligation on Beechmount to distribute the sale proceeds in terms of clause 5 had never crystallised.

Submissions

Pursuers

[12] The commercial judge erred in holding that clause 3 had not been purified prior to liquidation. The parties' overarching obligation was to use reasonable endeavours to co-operate with HMRC in relation to benefits in kind. The pursuers had done so. JCCA had been instructed to act for Beechmount. No formal agreement was required. The judge found that both directors had given their instructions on behalf of Beechmount. The fact that JCCA had carried out work, and issued a fee note for that work, to Beechmount meant that they must have been instructed to act for the company. The dispute turned on whether clause 5 gave rise to a crystallised obligation to pay £800,000. The judge had correctly observed that, if the conditions of clause 3 had been purified, the obligation in clause 5 would have crystallised. Given his error in respect of clause 3, he had also erred regarding clause 5.

[13] In any event the commercial judge had erred in determining that performance of clause 5 had been frustrated. The purpose of clause 3 had been to resolve Beechmount's potential tax liabilities. The liquidator had determined that there was no need to discuss benefits in kind with HMRC. That had resolved clause 3. In light of that resolution, clause 5 remained capable of performance. The agreement had not been frustrated.

The liquidator

[14] The commercial judge was correct to hold that clause 3 had not been purified. It required more than reasonable endeavours to appoint an expert. If agreement on the appointment could not be reached, there was a fallback position involving the Institute of Chartered Accountants. No steps had been taken to pursue that. The commercial judge had summarised the issue neatly by stating that the appointment of an expert must involve that expert's agreement. Mr Rudkin had said that there was no such agreement. That was not challenged and was fatal to the pursuers' argument. Their law agents had proposed a supplementary agreement to deal with the formal appointment of JCCA. No such agreement had been reached.

[15] Beechmount's obligation to make payment under clause 5 was dependent upon the conditions in clauses 3 and 4 having been met. They had not been satisfied at the time of the liquidator's appointment. The commercial judge was correct to hold that the directors' ability to appoint an expert had ceased when the liquidator had been appointed. That rendered performance of the outstanding obligations impossible.

[16] The liquidator had not stated that there was no need to address benefits in kind with HMRC. The issue had not been resolved as at the date of liquidation or at the date of her witness statement.

Decision

[17] The proof focused on whether, and to what extent, the parties had complied with clause 3. That may have deflected attention away from the more important legal aspects of the case. Liquidation does not, without express provision, terminate or invalidate a contract. Should it occur, a liquidator has a choice. She can adopt the contract, in which case she must perform the obligations contained within it. Alternatively, she can repudiate the contract, in which case, and depending on the value of the assets, the company will require to pay damages for the breach. In either event the contract remains "binding" on the company.

[18] The purpose of the settlement agreement was to resolve the disputes between the parties (including, notably, Mr Stephen and Mr Dewar as individuals). It mapped out a framework to regulate the sale of Beechmount House, to distribute the sale proceeds and to place Beechmount in liquidation. In addition, it encouraged co-operation between the parties in relation to the settlement of potential tax issues with HM Revenue and Customs. A contract should be interpreted in a manner which gives effect to its terms. There is little difficulty in doing so in this case. The settlement agreement appears to have been reached after considerable difficulty. If it is disregarded, the pursuers will lose their hard fought benefit of £800,000.

[19] The key provision is clause 5. It stipulates how the "net assets" of Beechmount should be distributed. Clause 3 is merely aspirational. At its heart is a desire for parties to use reasonable endeavours to resolve any fiscal issues; with a narrative of the steps which can be taken in order to achieve this. Although it is anticipated that performance of clause 5 will follow these steps being taken, it is not dependent upon clause 3 being obtempered.

[20] Clause 5 contains an obligation which could only be performed by Beechmount; the planned mechanism being by way of a voluntary liquidation. Although that was the intended route, it is the obligation to pay the £800,000 to the pursuers, and thereafter to divide the remaining surplus, that is at its heart. The interposition of a liquidator in a compulsory winding up does not remove the core obligation on Beechmount as a party to the contract. It does not terminate that obligation.

[21] As already observed, the liquidator had the option of adopting or repudiating the contract. She chose the latter; expressing her position as being, in terms of the legal advice, that she was not "bound" by its terms. It may not be clear what counsel meant by that, but the consequence of the liquidator's decision must be that the contract is repudiated. That results in a liability to pay damages; being *prima facie* the sum of £800,000 specified as due, but which had not been paid, under clause 5.

[22] The obligations under clause 3 have been rendered redundant, in so far as Beechmount are concerned. The liquidator determined that no approach to HMRC is required; any tax liability resting solely on the individuals concerned. She intends to distribute the net assets once this litigation is resolved. It does appear that JCCA acted on instructions from Beechmount in late 2018, before the exchange of emails in April 2019, but that is now of no moment.

[23] The appointment of the liquidator did not frustrate the agreement. Frustration is a rare creature in the world of contract. It requires there to be a supervening event, which was not foreseen or provided for by the parties at the time of the contract. The agreement here expressly contemplated the appointment of a liquidator, albeit in the context a voluntary, rather than a compulsory, winding up. That difference is immaterial. Performance of the

obligations was not rendered impossible by the liquidator's appointment; it remained open to the liquidator to adopt the agreement and to perform accordingly. There was no radical change in the obligations under the agreement.

[24] The reclaiming motion will be allowed. The commercial judge's interlocutor of 30 March 2022 will be recalled. The pursuers' first to third pleas-in-law will be sustained and the defenders' second to fifth pleas-in-law will be repelled. Decree will be granted in terms of the first conclusion of the summons.