SHERIFFDOM OF TAYSIDE, CENTRAL AND FIFE AT KIRKCALDY

[2024] SC KIR 52

PER-CA25-24

JUDGMENT OF SHERIFF CHARLES LUGTON

in the cause

LINDA HASTINGS,
Hastings & Co, Suite 3GA, The Pentagon Centre, Washington Street, Glasgow, G3 8AZ, the liquidator of Beath Retail Limited (in liquidation), a company incorporated under the Companies Acts (registered number SC538197) and having its registered office at Hastings & Co, Suite 3GA, The Pentagon Centre, Washington Street, Glasgow, G3 8AZ

Noter

For an order in terms of section 212 of the Insolvency Act 1986

Act: Massaro, advocate
Alt: Hankinson

Kirkcaldy, 21 October 2024

Introduction

[1] This is an application for an order in terms of section 212 of the Insolvency Act 1986 ("the 1986 Act"), which called for a diet of debate on the noter's averments on 23 September 2024.

[2] The noter is the liquidator of Beath Retail Limited ("the company"). The first respondent is a former director of the company. The second respondent is the husband of the first respondent, and the noter alleges that he was a de facto director of the company (this is disputed, but the issue was not raised at the debate).

[3] The noter avers that she has received claims in the liquidation totalling £420,970. She seeks decree in this sum against the respondents.

Section 212

[4] Insofar as material for present purposes, section 212 is in the following terms:

> "**212 Summary remedy against delinquent directors, liquidators, etc.**
>
> (1) This section applies if in the course of the winding up of a company it appears that a person who—
>
> (a) is or has been an officer of the company,
> (b) has acted as liquidator . . . or administrative receiver of the company, or
> (c) not being a person falling within paragraph (a) or (b), is or has been concerned, or has taken part, in the promotion, formation or management of the company,
> has misapplied or retained, or become accountable for, any money or other property of the company, or been guilty of any misfeasance or breach of any fiduciary or other duty in relation to the company.
>
> . . .
>
> (3) The court may, on the application of the official receiver or the liquidator, or of any creditor or contributory, examine into the conduct of the person falling within subsection (1) and compel him—
>
> (a) to repay, restore or account for the money or property or any part of it, with interest at such rate as the court thinks just, or
> (b) to contribute such sum to the company's assets by way of compensation in respect of the misfeasance or breach of fiduciary or other duty as the court thinks just."

The section provides a summary procedure under which the court may investigate and supply a remedy for the wrongful acts of directors. It does not create new rights and obligations, but the whole range of existing director's duties may be investigated under section 212: *Ross* v *Davy* 1996 SCLR 369.

The pleadings

[5] To put the arguments that were advanced in context, it is necessary to summarize the pleadings in some detail:

The company

a. The respondents aver that the company ran a petrol station until ceasing trading as such in or around March 2020 (ans 6), after which it continued to trade as a car wash and repairs business.

b. The noter avers that the second respondent was a shadow director of the Company (cond 3). In particular, it is averred that the second respondent was employed as the company's manager and that the company was not being run by the first respondent.

c. A person known as Mr Todor Tsikalov was appointed as a director of the company on 15 November 2019. The noter avers that she has been unable to locate Mr Tsikalov or find any evidence that he has had any involvement in the business (cond 4).

Accounts and VAT returns

d. Accounts for the financial years ending 30 June 2017 and 30 June 2018 were lodged with Companies House which show that the company had total assets of £1. The respondents admit that those accounts "do not correlate with the funds credited to the
company's bank account" (ans 14) although they do not aver any explanation for why that might be.

e. The last set of accounts lodged with Companies House was that for the financial year in 2018 (there is an admission in ans 15 to the effect that these accounts were for the period up to 30 September 2018, whereas the noter avers that they were for the period up to 30 June 2018).

f. It is admitted that no accounting records for the company have been delivered to the noter despite requests (ans 26). Therefore, the noter does not have access to any accounting information for the company for the period from some point in 2018 until the date of the winding up, and the accounting information for the period prior to that date shows assets and liabilities of £1.

g. The noter avers that the accounts lodged for the company with Companies House were false and misleading. There was substantial trading evident from the company's bank account in the financial years ending June 2017 (£1,999,008.94) and June 2018 (£846,625.16) (cond 13 and 14).

h. The noter avers that the company did not submit any VAT returns to HM Revenue and Customs for the period June 2017 – December 2019 (cond 17).

Loan and grant applications

i. It is admitted that the company applied for several loans or grants in 2020, including:

i. A retail, hospitality and leisure support grant of £25,000. The application was completed by the second respondent. The company received those funds on 22 May 2020; and

ii. A loan from Barclays Bank PLC of £50,000. The application was completed by the second respondent. The company received those funds on 26 May 2020.

j. The respondents admit that the second respondent represented to Barclays Bank PLC in the company's 2020 loan application that it had a turnover of £1,800,000 (ans 22).

k. The basis upon which the loan was sought in 2020 from Barclays PLC was that the company was trading as a petrol station (cond 19). The noter's position is that the company was not entitled to the loan because by that point it had stopped trading (cond 23).

l. It is admitted that neither the loan nor the grant has been repaid (ans 24).

Payment of company money to the respondents

m. It is admitted that between 2018 and 2020, £128,795 was withdrawn from the company's bank account and paid to the respondents' solicitors, Innes Johnstone. Those funds were used to fund property transactions on behalf of the respondents (ans 5).

Transfer of business to Forecourt Group Ltd: email of 30 March 2023

n. The noter avers that the first respondent sent the noter an email on 30 March 2023 (cond 6). The email is incorporated into the pleadings and is lodged as production 6/12. In the email the first respondent writes inter alia that:

i. She "stepped away from any duties as a director and was not involved in the business and its ongoings" in or around January 2018 after her son was born. The second respondent was "on and off with the business" and "had no firm dealings with the business." The staff ran the business themselves until Mr Tsikalov was appointed a director in November 2019;

ii. The company ceased trading in March 2020;

iii. A company known as The Forecourt Group Ltd ("Forecourt") took over the business on that date;

iv. The company does not have any physical assets;

v. Mr Tsikalov continued to use the parts of the property which were not used as a petrol station for an unspecified period after March 2020, but that was not the company's trading. She is not in contact with Mr Tsikalov and does not know how to contact him.

The present position

o. The noter avers the following regarding the present position:

i Forecourt now trades from the property (cond 6);

ii As at the date of liquidation, the company had no assets (cond 9);

iii Claims in the liquidation have been received amounting to £420,970 (cond 27).

Alleged wrongful conduct

[6] The noter relies on sections 170 – 177 of the Companies Act 2006 ("the 2006 Act"), in particular:

a. Section 171, which requires directors to act in accordance with the company's constitution and only to exercise powers for the purpose that they were conferred;

b. Section 172, which imposes a duty on a director to act in the way he or she considers, in good faith, would be most likely to promote the success of the Company. When a company is financially distressed, the director's fiduciary duty to the company to act

in its interests is modified to include a duty to act in the interests of creditors as a whole (*BTI 2014 LLC v Sequana SA* [2022] 3 WLR 709; for example, per Lord Reed at paras [46] – [49]);

c. Section 174, under which directors must exercise reasonable care, skill and diligence. That is defined in section 174(2) both as the care, skill and diligence to be expected of the director in relation to that particular company, and separately to be expected of a director of a company more generally; and

d. Section 175, which imposes a duty on directors to avoid conflicts of interest.

The noter also avers that the respondents owed a fiduciary duty to the company at common law.

[7] The noter avers that the respondent breached their statutory and common law duties in the following ways:

a. Withdrawing £128,785 for their personal use;

b. Transferring the company's assets to Forecourt without any obvious consideration or obtaining any valuation of the business in advance with the result that the noter cannot value the assets transferred (cond 9);

c. Failing to keep appropriate accounting records with the result that the noter does not know what the assets and liabilities of the company should be, nor what has happened to the company's assets (cond 15);

d. Preparing and filing false and misleading accounts for the accounting years 2017 – 2018;

e. Failing to prepare and file accounts for the period 1 July 2018 onwards;

f. Failing to submit VAT returns; and

g. Applying for a grant and loan on a false premise and misappropriating the funds thereafter (£75,000).

Summary of issues

[8] I am grateful to the parties' representatives for their careful submissions. In the course of the argument, the following issues were raised for determination:

1. The terms of the craves: as the noter's craves are narrowly framed, does this render many of her averments irrelevant?

2. Requirement to aver causation and loss: as the noter seeks to recover all of the company's debts, must she offer to prove that those debts were caused by the respondents' breach of duty?

3. Specification points: are various sets of the noter's averments lacking in specification?

I shall deal with these points in turn.

The terms of the craves

Respondents' submission

[9] The respondents' agent submitted that many of the factual averments in the Note were irrelevant, standing the terms of the noter's craves and plea in law. This was because, while section 212 was concerned with various forms of misconduct and breach of duty, the craves and plea referred only to the misapplication and retention of money. Crave 3 sought an order in terms of section 212 that the respondents had "jointly and severally *misapplied* the sum of £420,970" (my italics). Crave 4 sought decree either in this sum of in "such other sum as may be ascertained to be the amount *misapplied or retained*" by the respondents.

Correspondingly, the noter's plea in law referred to the respondents having "jointly and severally *misapplied or misappropriated* money of the company."

[10] Where an averment, if proved, would not give rise to the remedy sought, that averment was irrelevant: *JD* v *Lothian Health Board* [2017] CSIH 27, per Lord Brodie at paragraph [33]. While abbreviated pleadings were permitted in a section 212 application, the noter's averments still required to be relevant. In the present application, as the noter sought a remedy in respect of money that had been misapplied or retained, any factual averments that did not relate to the misapplication or retention of money were irrelevant and should be deleted. The following averments fell into this category:

(a) Cond 8 to 9: these averments related to an alleged transfer of assets to Forecourt;

(b) Cond 10 to 17: these averments related to the financial accounts of the company and to the failure to submit VAT returns;

(c) Cond 19 and 22: these averments related to the circumstances in which applications were made to Fife Council for a grant and to Barclays bank for a loan;

(d) Cond 25: these averments related to the apparent duty of the company to keep adequate accounting records;

(e) Cond 26 to 27: these averments related to the absence of accounting records. The noter averred that she could not ascertain the true nature and extent of the company's affairs, ascertain trading losses, or pursue a gratuitous alienation claim;

(f) The following averments from cond 28:

> "(ii) transfer the assets of the company to a successor entity on cessation of trade without obtaining a valuation of the assets or obtaining any payment for the transfer of the assets; (iii) fail to maintain appropriate accounting records; (iv) prepare and file false and misleading financial accounts for the periods ended 30 June 2017 and 30 June 2018; (v) fail to prepare and file

> financial accounts for the period from 1 July 2018 onwards for the company; (vi) fail to submit VAT returns for the company over an extended period…".

Noter's submission

[11] Counsel for the noter submitted that section 212 provided a summary procedure to which the usual rules of pleading did not apply: *Liquidators of Glasgow City Bank* v *Mackinnon* (1882) 9R 535; *Blin* v *Johnstone* 1988 SC 63; *Ross* v *Davey* 1996 SCLR 369. The only question was whether the respondents had notice of the facts relied on by the noter to justify a remedy under section 212. The terms of the note provided the respondents with fair notice.

[12] In any event, the forms of conduct to which section 212(1) referred should be read as a whole, rather than compartmentalised. It was artificial to divide the component parts of the subsection, as they overlapped – for example, while both "misapplying or retaining money" and "breach of fiduciary" were separately mentioned in the wording of the provision, to misapply or retain funds constituted a breach of fiduciary duty.

[13] Counsel further submitted that the phrase "misapplication or retention of money" was wide in its terms and might be said to cover a number of the averments that were challenged by the Respondent.

Analysis

[14] A defining feature of section 212(1) is the broad sweep of wrongful conduct that is caught by its terms: it is concerned with directors (and other persons identified in the subsection) who have misapplied or retained, or become accountable for, any money or other property of the company, or have been guilty of any misfeasance or breach of any fiduciary or other duty in relation to the company.

[15] Consonantly with this all-encompassing formulation, the present noter avers that the respondents have engaged in a variety of forms of misfeasance and breach of duty, which I have summarised above. But in contrast to her averments, the noter's craves (and plea in law) are narrowly framed. They refer only to the misapplication or retention of money, making no mention of the other forms of delinquency with which section 212 is concerned. The respondents contend that by drafting her craves in these terms, the noter has confined herself to seeking a remedy in respect of misapplied or retained sums, meaning the averments that are identified above (at paragraph [10]), are irrelevant and should be deleted.

[16] The respondents' contention that not all of the noter's averments concern the misapplication or retention of sums is correct. Of the various sets of averments identified above, only those which concern the alleged transfer of assets to Forecourt could reasonably be said to fall under this banner. By contrast, the averments relating to the failures to keep accounting records or to submit VAT returns, and to the circumstances of applications for loans and grants, relate to different forms of wrongful conduct.

[17] Notwithstanding this, the problem with the respondents' argument is that it assumes both that the normal rules of pleading apply to a section 212 application and that the court's hands would be fettered by the narrow terms of the noter's craves. This approach to the pleadings is irreconcilable with the summary nature of the proceedings and the active role that the court plays in "examining into the conduct" of the respondents, in terms of subsection (3). This was first explained by Lord President Inglis (with whom the court agreed), when addressing the equivalent provision under the Companies Act 1862, in *Liquidators of Glasgow City Bank:*

> "This is a very special proceeding, under a particular clause of the Companies Act, section 165, which directs an inquiry to be made in a summary manner into the conduct of any director who is alleged to have misapplied funds, or to have

> committed various other delinquencies in connection with the management of the affairs of a company. . . we are quite entitled, under that section of the statute, to direct the inquiry to be made in any way we think expedient, and to appoint parties either to make statements or not to make statements according as the exigencies of the particular proceeding may require. We are not, therefore, I think, bound by any of the ordinary rules of pleading, and all that we ought to do, I think, is to make sure that no injustice is done to the respondent here by reason of the want of notice of which he complains." (p 564)

More recently the Second Division applied *Liquidators of Glasgow City Bank* in *Blin*:

> "So far as Scotland is concerned, it has been made plain in Liquidators of City of Glasgow Bank v. Mackinnon (1882) 9 R. 535 that the strict rules of pleading do not apply. Lord President Inglis in that case referred to proceedings under sec. 165 of the Companies Act 1862 (the precursor of sec. 333 of the Act of 1948) as very special, and he opined that it was not necessary for the court in an incidental proceeding of this kind in a liquidation to resort to the forms of process appropriate to ordinary actions in the Court of Session." (p 68)

It is clear from these passages that the normal rules of pleading do not apply. This is not because the procedure prescribes a specific form of abbreviated pleadings, as happens in other contexts (e.g. actions for personal injury brought under Chapter 43 of the Court of Session rules). Instead, the relaxation of the rules of pleading is a facet of the role that the court is entitled to play in directing proceedings. In my opinion, the corollary of this is that when the court has completed its examination of a director's conduct and is at the point of determining whether an order should be made under section 212(3), it is not bound by the terms in which the craves of the Note are framed.

[18] This conclusion is consistent with the fact that section 212(3) provides the court with a choice of remedies and a discretion as to the mode and amount of repayment or compensation that may be ordered, as discussed in more detail below. Within the parameters that are laid down by the provision, the court is clothed with broad powers both to inquire into the conduct of a director and to fashion an appropriate disposal.

[19] As the court would not be restricted by the terms of the craves at the point of disposing of the application, those of the noter's averments which do not concern the misapplication or retention of funds cannot be said to be irrelevant. It follows that while the noter's craves might have been drafted with greater care and precision, the respondents' submission must be rejected.

[20] The submission which I have been addressing is a technical criticism of the noter's craves and plea in law, but it is worth pausing to highlight that the respondents also advanced specification arguments at the debate. While the strict rules of pleading do not apply to section 212 applications, the authorities referred to above make plain that the requirement of fair notice remains, as the court must prevent any injustice from being done to the respondents. Those of the respondents' submissions which concern fair notice are dealt with later in this opinion.

Requirement for averments of causation and loss?

Respondents' submission

[21] The respondents' agent submitted that the noter's case was irrelevant insofar as recovery of the whole debts of the company was sought, as averred at cond 27. While the noter had identified specific company transactions, VAT penalties and interest which came to a total of £258,403.74, she had not craved this sum. Instead, the sum of £420,970 was sought, which equated to all of the claims that the noter had received in the liquidation. In order to recover this sum under section 212, the noter would have to prove that all of the company's losses were caused by the respondents' breach of duty: but she did not offer to do so.

[22] Section 212 was a summary procedure, which did not create obligations or remedies. It followed that the noter must find her remedy in the general law: *Ross* v *Davy 1996* SCLR 369. As regards the remedies that were available under the general law, section 178(2) of the 2006 Act provided that the duties imposed by sections 171 to 177 (excluding section 174) were fiduciary duties and were enforceable in the same way as any other fiduciary duty owed to a company by its directors. Section 174 was not a fiduciary duty, but a duty to exercise reasonable care, skill and diligence. But where a company had sustained a loss because of a breach of either a fiduciary duty or the duty under section 174, remedies of damages or compensation were available: *A Practical Guide to Corporate Governance*, 5th Edition, Mark Cardale. To obtain such a remedy, a liquidator must aver and prove causation and loss*: Cohen & Anor* v *Selby & Ors Re Simmons Box (Diamonds) Limited* [2002] BCC 82; *Joint Liquidators of CS Properties (Sales) Limited* [2018] CSOH 24.

[23] The agent for the respondents acknowledged that in *The Liquidator of Glasgow and Weir Blacksmiths Limited* v *Glasgow* [2016] SCEDIN 20, Sheriff Principal Stephen had opined that section 212 conferred upon the court a discretion in the quantification of compensation, in the exercise of which there was "no requirement that the court have regard only to actual loss of the company." He submitted that notwithstanding this, in many cases loss and causation would be the necessary starting point for assessing compensation or repayment. The court must not make an order arbitrarily, as this would be contrary to natural justice and could not be reconciled with the reasoning in *Ross* v *Davy*, to which Sheriff Principal Stephen had referred in her opinion. Moreover, the facts that were before her were distinguishable from those of the present case, as the liquidator had been seeking the repayment of specific sums that had been misapplied, instead of craving decree for the whole losses of the company.

[24] Turning to the noter's pleadings, the respondents' agent referred to cond 27, in which the noter sought to justify the recovery from the respondents of the full debts of the company for the following reasons: (i) the respondents had failed to keep accounting records and to deliver them to the noter, meaning that she had been unable to ascertain the true nature and extent of the company's affairs, including identifying any trading losses of the company; and (ii) the noter has been unable to ascertain the loss to the creditors as a result of the respondents' failure to value the assets and business when it was transferred to Forecourt. As a result, the noter has been unable to pursue Forecourt for the value of the assets and business transferred to it.

[25] These averments were deficient as the noter did not offer to prove that the respondents' alleged breach of duty had caused the company a loss that was commensurate with the company's whole debts. If a director failed to keep accounting records and deliver them to the liquidator, it did not follow that he would be liable for all of the company's debts: the onus was on the noter to prove any losses that flowed from the breach of duty.

[26] The respondents' agent accepted that the onus was on a director to demonstrate what had become of company property in his hands: *GHLM Trading Ltd* v *Maroo* [2012] EWHC 61 (Ch)*; Liquidator of Glam and Tan Limited* v *Litras* [2022] EWHC 855 (Ch). But these authorities were concerned with specific transactions and they did not support the general proposition that once the liquidator had established breach of duty on the part of a director, the onus passed to the director to disprove that he had caused the company loss; in particular, loss amounting to whole of a company's debts.

[27] In any case, the duty of a director to deliver up books and records to a liquidator was not a duty owed by a director to the company: it was a statutory duty, enforceable by a liquidator (as distinct from the company) by summary application. A failure to deliver

books and records to a liquidator was irrelevant to a claim under section 212, because such an application was a procedure for pursuing causes of action of a company, rather than those of a liquidator. Similarly, the duty on directors to deliver to the registrar of companies each year certain accounts and reports, in terms of section 441 of the Companies Act 2006 ("the 2006 Act"), was not a duty owed by a director to a company. Instead, it was a statutory duty which was enforceable by criminal prosecution in terms of section 451 of the 2006 Act, meaning that it was irrelevant to a section 212 claim. The correct analysis of obligations of directors to maintain adequate books and records was that, in terms of section 386 of the 2006 Act, companies (as distinct from directors) had a statutory duty to keep adequate accounting records. It followed that if directors failed to keep adequate accounting records, they had failed in their duty to act with reasonable skill and care. This was not a fiduciary duty.

[28] In these circumstances, the whole of cond 27 was irrelevant and ought to be excluded from probation.

Noter's submission

[29] Counsel for the noter began by emphasising the paucity of material that was available to show the financial position of the company from 2017 onwards. The accounts for the financial years ending 30 June 2017 and 30 June 2018 showed the company as having total assets of £1. This did not correlate with the funds credited to the company's bank account, which showed substantial trading in both years (£1,999,008.94 and £846,625.16, respectively). The noter had no accounting information dated later than 2018. In an email to the noter, dated 30 March 2023, the first respondent had written that the company ceased trading in March 2020 (though one of the directors, Mr Tsikalov, had continued to run a

carwash from the premises after this date). But in May 2020 the second respondent had applied on behalf of the company for a retail, hospitality, leisure support grant of £25,000; and for a "bounce back" loan of £50,000 from Barclays bank plc. In the loan application, the second respondent had represented the company's turnover as £1,800,000 to the bank; but this was not evident in the company's bank account in 2019. On the face of it, this was a company with substantial trading, but very little information was available.

[30] Meanwhile, the noter had received claims in the liquidation of £420,920. She had yet to adjudicate this, as it was necessary first to establish whether recovery from the respondents was possible. The noter could say only that ostensibly the company had been earning around £1,800,000 in 2019, which meant that there ought to be at least some funds available to pay the creditors. Alternatively, the figure of £1,800,000 might be fictitious, meaning that the company's turnover was unknown: only the respondents could tell the court. The practical effect of this was that whatever sum the noter opted to conclude for would be random, but the obvious number to pick was the total sum claimed by the creditors. Ultimately, it would be for the court to determine in what sum decree should be pronounced. The uncertainty that underlay this was the fault of the respondents.

[31] Counsel moved on to analyse the nature of the duties in issue. The respondents were under statutory duties to prepare accounting information, to ensure that records were lodged with Companies House and to provide those records to the noter. But they also owed fiduciary duties to the company to take these steps. It was trite law that a fiduciary must account to his or her principal for what he or she did with the principal's assets; and consequently, the duties of company directors to maintain and lodge accounts, and to provide those accounts to a liquidator, should be categorised as fiduciary duties, as opposed to falling within a director's duty to exercise reasonable skill and care. The significance of

this was that a potential remedy for breach of a fiduciary's duty to account lay in the form of an action for count, reckoning and payment. By contrast, where the breach in question was a failure to exercise reasonable care, it fell to the liquidator to make out a claim for damages by establishing loss and causation: *Cohen.*

[32] Insofar as the noter's averments of breach of duty were concerned, counsel submitted that the pleadings made the noter's position clear. The company's assets had gone, there were no records and there were debts of £420,920. In effect, the noter was posing the question to the respondents: where are the company's assets?

[33] Counsel submitted that section 212 conferred a discretion upon the court to order a director to pay to the company the relevant property or any part of it or to contribute such sum as the court considered just: *Liquidator of Glam and Tan Limited*, paragraph 50. A Note brought under section 212 was not the equivalent of an action, in which the court should consider whether the sum sued for represented the loss to the company. There was no requirement to assess compensation by reference to any established loss: *Liquidator of Glasgow and Weir Blacksmiths Ltd* v *Glasgow 20*16 SLT (Sh Ct) 171, at paragraph 31.

[34] The facts of the present case were a good example of the reason for this. The noter offered to prove that she could not say what assets the company should have, or what had happened to those assets, because she did not have the company's accounting records. In these circumstances the noter was entitled to crave for the highest sum that he could possibly be entitled to as a default figure, just as in an action for count, reckoning and payment. Counsel relied on *Smith* v *Barclay 19*62 SC 1, which concerned such an action, as authority for the proposition that every reasonable presumption will operate in a pursuer's favour if a defender fails to comply with a duty to account, per Lord Justice-Clerk Thomson, page 9. Similarly, in *Liquidator of Glam and Tan Limited* Judge Briggs held that in an

insolvency the burden of proof is placed on a defender director to demonstrate why or how an event took place, in the absence of documentation (paragraph 29).

Analysis

Section 212: summary remedy

[35] If a director has breached his or her obligations to the company, section 212(3) provides a summary remedy for the breach and confers a discretion upon the court as to the mode and amount of repayment or compensation that the director should be compelled to pay: *Liquidator of Glasgow and Weir Blacksmiths Ltd*, paragraph 31; *Liquidator of Glam and Tan Limited,* paragraph 50. The discretionary nature of the remedy is apparent from the wording of section 212(3). The court may order the repayment, restoration or accounting for property or money "or any part of it . . . as the court thinks just" under section 212(3)(a). Similarly, such compensation "as the court thinks just" may be ordered, in terms of section 232(3)(b). It is implicit to the discretionary nature of the remedy that the court is not confined to employing the traditional methodologies for the assessment of damages: the requirement is that the court should make an order which it considers to be just in the circumstances of the case.

[36] The respondents' agent contended that, contrary to this, section 212(3) is not a source of remedy in itself. He submitted that the noter must find her remedy under the general law, meaning that she must prove causation and loss. He relied on Lord Penrose's dicta in *Ross*, regarding the nature of the provision:

> "the provision must not be taken as itself the source of obligation. It does not define directors' obligations. The reference to the source of the obligation is ancillary merely to defining the scope of the summary remedy and to ensuring that so far as practicable there are no technical objections to the application of that remedy across a very wide range of conduct in relation to the administration of companies' affairs. In

> the present case, that is another reason for holding the conclusion incompetent. As expressed, it appears to derive the basis of the remedy from the section and to ignore the injunction in the authorities that that basis must be found in general law. In my opinion it would be wrong to construe section 212 in these circumstances as if it were intended to define in any way the scope of remedies available against directors." (page 379E)

But I do not think that this passage supports the argument that the respondents' agent advanced. The context within which Lord Penrose made these observations must be understood: *Ross* was an ordinary action in which the liquidator was seeking to introduce a conclusion for an order in terms of section 212 into the summons. Lord Penrose refused the amendment in part because section 212 was a procedural provision, the scope of which depended on the general law of remedies for wrongs of the kind identified in it: page 378B – F. This analysis led on to the conclusion that the section was not a source of obligations in itself; and that consequently, the amendment was incompetent. It follows that Lord Penrose was addressing the primary question of the legal basis of the wrongs that fall within the terms of section 212. He was not concerned with the secondary question of the method by which the court should determine the appropriate level of repayment or compensation under section 212, after wrongful conduct on the part of a director had been established. The phrases the "basis of remedy" and the "scope of remedies" in the passage quoted above are references to the obligations with which the section is concerned; they do not form part of a commentary on the discretionary nature of the summary remedy, nor do they seek to place limits upon it.

[37] While the court may be armed with a discretion, this has often been exercised to order repayment or compensation that is commensurate with a loss arising from wrongful conduct, which it has fallen to the liquidator to prove. The respondents' agent relied on two

cases in which this approach was taken: *Cohen & Anor* v *Selby & Ors Re Simmons Box (Diamonds) Limited, [2002] B.C.C. 82.; and Joint Liquidators of CS Properties (Sales) Limited.*

[38] *Cohen* was a section 212 application based on common law negligence, which concerned a company that bought and sold jewellery. A de facto director of the company took £393,000 worth of uninsured jewellery on a selling trip to Europe, which was lost or stolen while he was on a cross-channel ferry. The company had no funds to pay for the lost jewellery and went into voluntary liquidation. The company's liquidators sought relief against the respondents for misfeasance under section 212 on the basis that it was negligent to fail to insure the jewellery. The Court of Appeal held that to proceed with a negligence claim under section 212, the liquidator had to show that the breach of duty complained of caused loss or damage, in proportion to which compensation would be awarded.

[39] Although *Cohen* was a negligence case, it was applied in *Joint Liquidators of CS Properties (Sales) Limited*, which concerned, inter alia, a breach of fiduciary duty. The respondents leased several of the company's properties to themselves and to a company that was owned by their relatives, thereby diverting income away from the company to their benefit. Lord Bannatyne opined that:

> "If the court considers that compensation ought to be ordered under section 212(3) of the 1986 Act, there ought to be a causal connection between the sum ordered and the company's loss (*Cohen v Selby*)" (paragraph [5])

He found that there was a causal nexus between the respondents' breach of the duty and a loss to the company. Compensation was awarded on this basis. But the court's approach to compensation is unsurprising, as the noter had proposed various measures by which the loss said to flow from the breaches of duty might be measured; and the prospect of

compensation being assessed other than with reference to loss does not appear to have been raised by either party.

[40] These cases stand in apparent contrast to Sheriff Principal Stephen's dicta in *Liquidator of Glasgow and Weir Blacksmiths Ltd*, regarding the operation of section 212(3):

> "Once a misfeasance or breach of fiduciary duty is established the court may order or impose one of the remedies set out in section 212(3). It is important to note that the court has a discretion as to the mode and amount of repayment or compensation. There is no requirement to assess that compensation by reference to any established loss to the company . . .
>
> The dicta of Lord Scott of Foscote in Stone and Rolls Ltd (in liquidation) (supra) are indeed strictly obiter, as that case involved an action based on the negligence of the company's auditors. It did not involve an application under section 212. That, however, does not detract from the correctness of his observation that section 212(3)(b) confers on the court a judgmental discretion as to the quantum of compensation that would not be applicable in an ordinary damages action. I agree with that analysis." (paragraphs 31 – 32)"

In this passage the sheriff principal emphasised the discretionary nature of the summary remedy and held that compensation need not be assessed with reference to actual loss. But it is necessary to understand the context within which she made these observations. The appellant had wrongfully paid certain sums to a third party company, Weir Windows Limited ("Windows"), and he was ordered to pay compensation in an amount equal to these sums. It was argued on his behalf that no overall loss had resulted in the payments being made, as Windows was a creditor of the company. On the facts that were found at first instance, Windows' creditor status was not made out. But it was while addressing the appellant's argument that Sheriff Principal Stephen held that compensation need not be assessed with reference to loss. She distinguished the case from the facts of *Derek Randall Enterprises Limited [1990] BCC 749*, in which a misfeasance claim failed on the basis that no loss had been sustained by the company. The sheriff principal's judgment is silent on the question of what the result would have been had it been established that there was no loss,

as in *Randall*, and this leaves open the possibility that the outcome might have been similar. As this was the background, there is no inconsistency between what was said in *Liquidator of Glasgow and Weir Blacksmiths Ltd* and the view that where a loss is proved, this will often determine the extent of any repayment or compensation awarded.

[41] Finally, *Liquidator of Glam and Tan Limited* is an example of the court's discretion under section 212(3) being exercised to achieve a just outcome in a set of special and unusual circumstances. The case concerned the misapplication of various sums. The respondent was found liable to repay several wrongful payments, but the court held that she should not be liable for other payments which had been made when her free will had been subjugated to the will of her husband under threat of violence. Judge Briggs made clear that in disposing of the case in this way he was availing himself of the discretion with which the section provides the court: paragraphs [50] - [52].

[42] The foregoing authorities do not prescribe a uniform approach to be adopted when the court is making an order under section 212(3): they are examples of individual cases being disposed of according to their circumstances. It is unremarkable that in *Cohen* and *Joint Liquidators of CS Properties (Sales) Limited* the liquidators were required to establish that the breaches of duty in question had caused loss to the company. Section 212(3) requires the court to order such repayment or compensation as it thinks just, and the identification of a loss resulting from wrongful conduct will often be the logical and intuitive means of determining a just disposal. Having said that, *Liquidator of Glasgow and Weir Blacksmiths Ltd* and *Liquidator of Glam and Tan Limited* are examples of the courts approaching compensation from a different perspective, to do justice in the circumstances of those cases.

[43] While the question of whether a remedy under section 212(3) should be determined with reference to proven loss featured prominently at the debate, I am not convinced that it

really lies at the heart of the parties' dispute. A more pertinent question may be this: on whom does the onus fall to explain the financial position of the company leading up to the insolvency? I shall return to this point shortly.

The present case

[44] Turning to this case, it is necessary to start by categorising the duties that are in issue. The competing arguments centred on the noter's averments that the respondents failed to keep accounting records and deliver them to the noter, meaning that she had been unable to ascertain the true nature and extent of the company's affairs; and that they had failed to value the assets and business when they were transferred to Forecourt, with the result that the noter has been unable to ascertain the loss to the creditors (cond 27).

[45] The noter argued that these failures constituted a breach of the respondents' fiduciary duty to account to the company and, by extension, to the noter. Conversely, the respondents contended that the duties to lodge accounts and records with the registrar of companies and to deliver up books and records to a liquidator were statutory duties (section 441 of the 2006 Act; and sections 234 and 235 of the 1986 Act, respectively), rather than fiduciary duties owed to the company. The failure on the part of a director to comply with these statutory requirements and to keep adequate accounting records was a breach of the duty to act with reasonable skill, care and diligence, in terms of section 174.

[46] I think the correct analysis is that these duties are not mutually exclusive. The proposition that a director's statutory (and common law) duty to act with reasonable skill, care and diligence will entail complying with his or her statutory duties and maintaining adequate accounting records, seems uncontroversial. But a director is also a fiduciary of the company and is, therefore, under a duty to account to it for the company property in his or

her hands. Maintaining company accounts and records is a necessary part of this duty. While it may be true that the statutory duties referred to in the paragraph above are not themselves actionable under section 212(3) as they are not owed directly by the respondents to the company (I did not understand the noter to take issue with this), they form part of the factual background to the respondents' fiduciary duty to account.

[47] In my view, the noter gives fair notice of this position in her pleadings. As I have mentioned already, at cond 27 she justifies seeking the company's whole debts with reference to the respondents' failures to maintain and deliver adequate accounting records, and to obtain a valuation prior to the transfer of the business to Forecourt. And at cond 28 she avers that these (and other) failures constituted breaches of the fiduciary duties which the respondents owed to the company.

[48] This categorisation of the duties at hand supplies an answer to the respondents' assertion that the noter must offer to prove loss and causation. In this case the noter is not akin to a pursuer in an action for damages, who must establish a loss arising from the defender's breach of duty: she appears in the guise of a principal who calls upon her fiduciaries to account for the company's property. In vindication of this right, she avails herself of a remedy in the form of count, reckoning and payment. As the respondents are subject to the duty to account, the onus rests on them. It is a matter of admission that no accounts were lodged with Companies House after 2018 and that in the two preceding years those accounts which were lodged did not correlate with the funds credited to the company's bank account, which showed substantial trading. The respondents' answers are largely skeletal, shedding no light on the company's affairs, including the value of its assets and any losses. Consequently, the noter seeks to recover the full deficiency of the liquidation in the absence of either records or an explanation from the respondents. This is

the rationale for the sum craved and while determination of the appropriate level of repayment or compensation would have to follow probation, the total losses of the company are a logical starting point for the noter to have adopted. This approach is consistent with *Smith* v *Barclay*, the *ratio* of which is that every reasonable presumption will operate against a fiduciary who fails entirely to produce an intelligible account (per Lord Justice Clerk Thomson, page 9).

[49] In reaching this conclusion it is necessary to reject the respondents' submission that while a director must account for company property, he or she is not required to disprove loss and causation in relation to the whole of the company's debts. Relying on *GHLM Trading Ltd* and *Liquidator of Glam and Tan Limited*, their agent submitted that the shift in onus was limited to specific transactions: it fell to the liquidator to prove that the transaction had been made, after which the onus was imposed on the director to show that the payment was proper. But these authorities do not limit the scope of the duty of a fiduciary to account to his or her principal: they are examples of its application to particular facts. In *GHLM Trading Ltd* the directors sold the company's stock to a second company of which they were the owners, as a means of repaying themselves for a personal loan. The action was concerned with various transactions between the directors' businesses and involved scrutiny of the directors' loan account. The court held that once it was shown that a company director had received company money, it was for him to show that the payment was proper (paragraph 148). In *Liquidator of Glam and Tan Limited* accounts were lodged in 2015 and 2016, before the company entered voluntary liquidation in 2017. The focus of enquiry was on several impugned payments. The respondent's position was that documentation relating to these specific payments had been destroyed in a flood. In the

absence of documentary evidence, the burden of proof was placed on the respondent to explain the transactions.

[50] Thus, in these cases there was sufficient financial documentation to identify the transactions on which the proceedings focussed, after which it fell to the directors to justify them. Neither case involved a situation in which the absence of accounting information precluded the liquidator from obtaining a proper understanding of the company's affairs as a whole, as the noter avers is the position here. In such stark circumstances, the duty manifests itself in a requirement to account for the financial position of the company and to explain what has become of the company's property. But the principle is the same in all three cases and is encapsulated in the following passage from *Liquidator of Glam and Tan Limited*:

> "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." (paragraph 29)

[51] To summarise, this is not a case in which the court is being invited to grant a remedy without reference to established loss or to award an arbitrary figure to the noter. While the noter has craved the whole losses of the company as a starting point, as in an action of count, reckoning and payment, the extent of any order for repayment or compensation will fall to be determined after the respondents have either accounted for the company's property or failed to fulfil their duty to do so.

Specification points

[52] The final matters for determination are two specification points which were raised by the respondents' agent.

Condescendence 8 and 27: averments of transfer of assets

[53] The first of these concerned the noter's averments regarding the purported transfer of the company's assets to Forecourt (which are at cond 8 and 27). The respondents' agent submitted that these averments were lacking in specification. The onus was on the noter to prove that a transfer of assets had taken place; and only after this would the onus shift to the respondents to justify the transfer. The noter's averments did not provide the respondents with notice of what assets were alleged to have been transferred. If the noter's allegation that assets were transferred was premised on the first respondent's email of 30 Mach 2023, this did not provide a proper basis for that position. Further, the noter's averments to the effect that the absence of a valuation of the company's assets at the time of the transfer had precluded a gratuitous alienation claim from being pursued were misconceived, as this was not a prerequisite for such a claim.

[54] I do not consider this submission to be well founded, as it places the onus on the wrong party. As discussed above, the context is that the respondents have failed to keep adequate accounting records, making it impossible for the noter to ascertain the extent of the company's assets both at the point of transfer and in the preceding years. At risk of repetition, the failure of a director to account for company property is a breach of the fiduciary duty that he or she owes to the company. In these circumstances, it cannot be incumbent upon the noter to specify the assets that were transferred, nor can it lie in the mouth of the respondents to insist that she does so.

[55] The email of 30 March 2023 (which is incorporated into the pleadings, and the contents of which are summarized above at paragraph [5], letter n) provides ample basis for the noter to put the matter in issue. In the email, the first respondent refers to Forecourt "taking over." While she writes that "The company does not have any physical assets," it is not clear whether she is referring to the position prior to or following the "take over" by Forecourt. It seems to me that following probation, the court might well be prepared to interpret the email as communicating that value was transferred from the company to Forecourt; and accordingly, the noter is entitled to advance this position in her pleadings.

[56] Finally, I am not persuaded of the irrelevance of the noter's averment that a claim against Forecourt could not be pursued because of the respondents' failure to value the company's assets and business. While this would not preclude such a claim as a matter of law, it is not difficult to imagine that a paucity of information regarding the value of the company might create a practical barrier to this. The noter is entitled to probation on this point.

Condescendence 17: failure to submit VAT returns

[57] The respondents' second specification point concerns the noter's averments of the respondents' failure to submit VAT returns. Their agent criticised the reference to breach of fiduciary duty that featured in these averments, suggesting that on a proper analysis the averred failure to submit VAT returns constituted a breach of the duty to act with reasonable skill, care and diligence, in terms of section 174 of the 2006 Act.

[58] But this criticism of the noter's pleadings proceeds on a misreading of condescendence 17. The article opens with averments regarding the company's failure to

submit VAT returns, the issuing of penalties and VAT assessments, and the subsequent charging of surcharges and interest. The averments then continue as follows:

> "The interest, surcharges and penalties issued by HMRC to the company is a loss to the company resulting from the respondents' breach of their fiduciary duties. In the absence of accounting records for the company, as hereinafter explained, it is not possible for the noter to verify whether the VAT assessments issued by HMRC were accurate, or if they were excessive."

On these averments, the breach of fiduciary duty on which the noter appears to be founding is not the failure to submit VAT returns per se, but the failure to keep adequate accounting records. As explained above, I consider the failure to maintain such records to be a breach of fiduciary duty.

[59] It follows that the respondents' submission must be rejected.

Disposal

[60] As I have rejected the respondents' submissions, the noter's pleadings survive in their original form.

[61] I shall fix a hearing for determination of the questions of expenses and of further procedure.