Neutral Citation Number: [2018] EWHC 3422 (Ch)

Case No: CH-2017-000169

IN THE HIGH COURT OF JUSTICE
BUSINESS & PROPERTY COURTS OF ENGLAND AND WALES
INSOLVENCY AND COMPANIES LIST (Ch)

Royal Courts of Justice
Rolls Building,
London,
EC4A 1NL

Date: 12/12/2018

Before:

MRS JUSTICE ROSE

- -

Between :

MARTIN JOHN PEARSE **Appellant**

- and –

HER MAJESTY'S REVENUE AND CUSTOMS **Respondent**

- -
- -

Paul Lowenstein QC and Philip Hinks (instructed under the direct access scheme) for the Appellant
Christopher Brockman (instructed by Solicitors Office and Legal Services, HMRC) for the Respondent

Hearing date: 7 December 2018

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Approved Judgment

I direct that pursuant to CPR PD 39A para 6.1 no official shorthand note shall be taken of this Judgment and that copies of this version as handed down may be treated as authentic.

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ROSE J

Mrs Justice Rose :

1. This is an appeal from the order of Insolvency and Companies Court Judge Briggs dated 16 June 2017 dismissing Mr Pearse's application to set aside a statutory demand. The statutory demand was served on him by the Respondent, HMRC, on 25 October 2016 in the sum of £716,974.98. Mr Pearse was also ordered to pay the costs of that application. The notice of appeal was issued on 7 July 2017. Permission to appeal was granted by Arnold J by order dated 23 July 2018.

2. The debt underlying the statutory demand is a judgment debt obtained by HMRC on 14 February 2014. The judgment was for Mr Pearse's indebtedness to HMRC under a guarantee.

3. Mr Pearse was a partner and designated member of a firm of solicitors called Follett Stock LLP. By February 2013 Follett Stock owed HMRC about £1.2 million in taxes. On 27 February 2013, Follett Stock entered into a time to pay agreement ('TTPA') with HMRC under which it agreed to pay £600,000 by way of 24 monthly payments of £25,000 each. It was a condition of the TTPA that Mr Pearse and his fellow partner would give a personal guarantee for the sum of £600,000. The deed of guarantee referred to in the TTPA was entered into on 10 April 2013 ('the Guarantee'). Follett Stock only made one payment of £25,000. It defaulted on 2 July 2013 and was subsequently wound up by the court in an insolvent liquidation on 4 November 2013.

4. On 5 December 2013 HMRC issued proceedings in the High Court against Mr Pearse to recover the amounts due under the Guarantee, namely £575,000 plus interest. On 14 February 2014 judgment in default was entered for the sum of £589,115.26. That was made up of the Guarantee liability of £575,000 together with interest of £14,115.25 and costs of £1,800. Mr Pearse apply to set aside that judgment, but that application was dismissed by Master Kay on 1 May 2015.

5. Shortly after the debt proceedings were served on Mr Pearse but prior to judgment being entered, Mr Pearse put forward a proposal for an individual voluntary arrangement. There was a meeting of creditors on 27 February 2014. HMRC was admitted for voting purposes in the sum of £592,599 based on the judgment debt. HMRC voted against the proposal and the proposal was defeated. Mr Pearse then challenged the admission of the HMRC vote but that challenge was dismissed by Registrar Derrett in a judgment handed down on 8 March 2016. That judgment was not appealed.

6. On 25 October 2016 HMRC served the statutory demand on Mr Pearse. By this time the sum due was £716,674.98 made up of:

    i) the judgment debt (which included pre-judgment interest to the date of judgment) amounting to £589,115.26;

    ii) costs awarded on the entering of the default judgment in the sum of £1,800; and

    iii) interest from the date of judgment to 12 October 2016 totalling £125,759.72.

7. On 9 November 2016 Mr Pearse issued an application to set aside a statutory demand on the grounds that the judgment debt is covered by terms in the Guarantee which preclude HMRC from petitioning for Mr Pearse's bankruptcy. That was the hearing before Judge Briggs on 16 June 2017.

8. The relevant clauses of the TTPA were set out in a document called "Headline Terms" to which three Follett Stock entities were party, namely Follett Stock LLP, Follett Stock Holdings Ltd and Follett Stock Media Solutions Ltd. The terms were sent to the two partners under a covering letter dated 20 Feb 2013. The TTPA provided that:

   i) The amount covered was £1,055,032.40 and the period of the agreement was two years commencing on 31 March 2013.

   ii) Repayment was to be by £25,000 monthly payments starting on 31 March 2013. This would result in the payment of £600,000. The balance of the amount owed would be re-negotiated at the expiry of the TTPA.

   iii) In the event of a payment being missed, the agreement would lapse and all monies due by Follett Stock LLP would become payable.

   iv) The security to be provided was that there would be joint and several guarantees for £600,000 from Mr Pearse and his fellow partner. It provided that:

> "Any enforcement action taken by HMRC under this agreement against… Martin Pearse is limited to the amount and duration of the guarantee, and for the purposes of this specific liability such enforcement action excludes bankruptcy proceedings against either guarantor.
>
> HMRC reserves all enforcement rights against … Mr Pearse in all other circumstances outside of the terms of this agreement."

   v) Interest would be charged until the tax was paid.

   vi) Other conditions relating to the submission of future tax returns and the payment of future tax liabilities were imposed, failing which the agreement would lapse, although HMRC would be able to rely on its security.

   vii) In the event of another creditor filing a petition against any of the three Follett Stock entities, HMRC reserved the right to cancel the agreement and support the petition for any balance that remained outstanding at that time.

9. The Guarantee dated 10 April 2013 said in clause 2:

> "By letter dated 27 February 2013 Follett Stock LLP has agreed Time to Pay arrangements with HMRC in the terms set out in the letter from HMRC to Follett Stock LLP dated 20 February 2013 and attached at Annexe 1 to this Guarantee ("the Primary Obligations"). Such Time to Pay arrangements relate to the sum

> of £600,000 (six hundred thousand pounds) ("the Part Debt"). The liability of the Guarantors under this Guarantee is limited to the guarantee of payment of the Part Debt".

10. In other words, the guarantors were not liable for the remaining part of the £1,055,032.40 for which Follett Stock was still liable even if it paid off the £600,000 in accordance with the TTPA.

11. Clause 4 of the Guarantee provides:

> "Subject to the conditions set out in Clause 5 below the Guarantors agree that they will, and do hereby, jointly and severally guarantee to HMRC as a secondary liability the performance by Follett Stock LLP of its Primary Obligations and guarantee the payment of the Part Debt."

12. Clause 5 provides:

> "(1) Upon any default by Follett Stock LLP under the Primary Obligations HMRC will at its option immediately call in the security under this Guarantee. Failure to settle the secondary obligations under this Guarantee in respect of the Part Debt (or part thereof) will result in enforcement action being taken against the Guarantors, subject to the maximum liability of the Part Debt (£600,000) which shall become payable on demand.
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> (2) In consideration for the giving of this Guarantee HMRC agrees not to pursue the bankruptcy of the guarantors as a remedy for enforcement of the Part Debt or of the indemnity is provided for in sub-paragraphs (3) and (4) below. Such agreement is strictly without prejudice to HMRC's other rights and remedies (legal or otherwise) outside the terms of the Guarantee, including for the avoidance of doubt any enforcement remedies (other than bankruptcy) in respect of the Part Debt or the indemnities in sub- paragraphs (3) and (4) below.
>
> …
>
> (4) The Guarantors as a separate and independent obligation and liability from its obligations of liability under clause 5(1) agree to indemnify and keep indemnified HMRC from and against all losses, costs and expenses suffered or incurred by HMRC arising out of, or in connection with, any failure of Follett Stock LLP to perform or discharge the Primary Obligation".

13. Before Judge Briggs, Mr Pearse submitted that the Guarantee prevented HMRC from presenting a petition based on the judgment debt in the same way as they were prevented from presenting a petition based on the debt due under the Guarantee. This was because properly construed the definition of the Part Debt must include any

judgment into which HMRC's rights under the Guarantee had merged. Further, he argued that the term "Part Debt" not only included a judgment on the Part Debt but also any costs and interest included in that judgment. In the alternative, Mr Pearse contended that if the term "Part Debt" could not be construed as he submitted, a term should be implied into the Guarantee preventing HMRC from commencing bankruptcy proceedings on the basis of the judgment into which their rights had merged.

14. HMRC's position before Judge Briggs was that when the Guarantee debt merged into the default judgment, it shed the obligation not to present a bankruptcy petition. They argued that it was not part of the bargain that HMRC would never be able to enforce a judgment by means of a bankruptcy petition. Further, clause 5.2 was not intended to cover liabilities which arose after the Guarantee liability had been replaced by the judgment debt. It could not be said that any such bargain extended to liabilities arising after the Guarantee had been entered into, such as the costs and interest.

15. In his judgment, Judge Briggs stated that the issue before the court was whether or not the Guarantee had precluded HMRC from being able to serve a statutory demand for the sums due under the judgment debt. He noted that when the judgment debt was obtained, HMRC's rights under the Guarantee merged into the rights in respect of the judgment and were no longer enforceable. Judge Briggs referred to *Clark and Anor v Focus Asset Management Tax Solutions Ltd* [2014] 3 All ER, 313, [5] where Arden LJ said, "Merger explains what happens to a cause of action when a court or tribunal gives judgment. If a court or tribunal gives judgment on a cause of action, it is extinguished. The claimant, if successful, is then able to enforce the judgment, but only the judgment".

16. Having set out the relevant clauses and the rival submissions of the parties, Judge Briggs considered the legal principles applicable to the construction of contracts. He referred to the well-known cases of *Arnold v Britton and others* [2015] UKSC 36, and *Wood v Capita Insurance Ltd* [2017] UKSC 24. He held, [48], that reading the clauses of the Guarantee as a whole and adopting an objective approach, the parties were seeking to prevent enforcement of the Guarantee by bankruptcy proceedings. Given that the clause provides that "HMRC agree not to pursue the bankruptcy of the Guarantors as a remedy for the enforcement of the Part Debt", it was important to look at the definition of the words "Part Debt". That was specifically defined as £600,000. He held that giving the words their natural and ordinary meaning led him to conclude that the restriction imposed by clause 5(2) did not extend to presenting HMRC from petitioning on a judgment debt.

17. The Judge went on to say that it would have been a matter of ease for the parties who were legally qualified on both sides to have added a clause that HMRC would be precluded from invoking any insolvency process based on any judgment debt arising from a breach of the Guarantee. No such words were included and the judge found that they were not intended. He rejected the contention that the interpretation he considered right was nonsensical. The words chosen by the parties were clear and the authorities showed that when the natural meaning of the words is clear, there is little scope for imposing some different, "common sense" meaning.

18. In addition, Judge Briggs held that HMRC were entitled to serve a statutory demand for the costs and interest. These elements were not included in the definition of Part Debt and together exceeded the bankruptcy threshold.

19. The Judge then turned to deal with the argument that the court should imply some terms into the Guarantee. He referred to the well-known cases on implied terms, including *Marks & Spencer PLC v BNP Paribas Securities Services Trust Company (Jersey) Ltd* [2015] UKSC 72. He agreed with counsel for HMRC that the contract made commercial sense as it stood and there was no business efficacy requirement permitting a term to be implied: [60]. The final argument put forward by Mr Pearse was that the contract should be rectified. The Judge held that there was no evidence to support such an assertion. There is no appeal against the decision on rectification.

20. The Grounds of Appeal before me raise three matters. Ground 1 is that the Judge was wrong as a matter of law to construe the Guarantee in a way which entitled HMRC to present a bankruptcy petition against Mr Pearse on the basis of the default judgment. He should have found, it is submitted, that clause 5(2) prevented HMRC from doing so. Ground 2 is that the Judge should have found that the definition of the "Part Debt" included not only any judgment in which HMRC's rights under the Guarantee had merged but also any costs or interest which had accrued thereon. Ground 3 is that the Judge should have found that a term should be implied as a matter of obvious inference into the Guarantee preventing HMRC from presenting a bankruptcy petition.

21. The parties were agreed as to the test to that the court should apply when considering whether to set aside a statutory demand. The Insolvency Rules 1986 apply here; the ground relied on Rule 6.5(4) which provides that the court may grant an application where it is satisfied "on other grounds" that the demand ought to be set aside. Mr Lowenstein QC appearing for Mr Pearse reminded me of what was said by Nicholls LJ in *In Re a Debtor (No 1 of 1987)* [1989] 1 WLR 271, 276 that when considering whether to set aside a statutory demand the court must have regard to the fact that failure to comply with the demand has the consequence that the debtor is regarded as being unable to pay the debt, such that the creditor may then present a bankruptcy petition. Rule 6.5(4)(d) provides for the court to have a residual discretion to set aside a statutory demand in circumstances which make it unjust for the statutory demand to give rise to those consequences in the particular case. The court's intervention may be called for to prevent that injustice.

Ground 1: the construction of the Guarantee

22. The parties were agreed that the proper construction of the Guarantee has to be assessed in the light of the factors that Lord Neuberger of Abbotsbury PSC set out in *Arnold v Britton* at [15], namely by considering (i) the natural and ordinary meaning of the clause, (ii) any other relevant provisions of the contract, (iii) the overall purpose of the clause and the contract, (iv) the facts and circumstances known or assumed by the parties at the time that the document was executed, and (v) commercial common sense, but (vi) disregarding subjective evidence of any party's intentions. Lord Neuberger went on to emphasise that reliance on commercial common sense and surrounding circumstances "should not be invoked to undervalue the importance of the language of the provision which is to be construed". The meaning of a provision is most obviously to be gleaned by a reasonable reader from the language of the

provision, given that the parties have control over the language they use in a contract. If the words are less clear or badly drafted the court should be more ready to depart from their natural meaning. Further, commercial common sense is not to be invoked retrospectively; the fact that a contractual arrangement has worked disastrously for one of the parties is not a reason for departing from the natural language. Commercial common sense is only relevant to the extent of how matters would or could have been perceived by the parties or by reasonable people in the position of the parties as at the date the contract was made. Experience shows that it is by no means unknown for people to enter into arrangements which are ill-advised but it is not the function of the court when interpreting an agreement to relieve a party of the consequences of his imprudence or poor advice: "Accordingly, when interpreting a contract a judge should avoid rewriting it in an attempt to assist an unwise party or to penalise an astute party".

23. Mr Lowenstein fully accepted that HMRC's rights under the Guarantee have now merged in the default judgment and that that is separate from the debt under the Guarantee itself. His first argument was that given that obtaining a default judgment is the most likely way in which HMRC would take the first step of enforcing Mr Pearse's liability under the Guarantee, the parties must have contemplated that a default judgment would be obtained if the Guarantee was not met following demand. Therefore, the reference to the £600,000 as the definition of the "Part Debt" must be taken to include a judgment for that amount or for any part of that amount unpaid by Follett Stock. I do not agree. What clause 5(2) undoubtedly prevents is HMRC serving a statutory demand to recover the liquidated sum due under the Guarantee without first obtaining a judgment. There is no reason why, in the absence of clause 5(2), HMRC would need to apply for a judgment on the debt rather than moving straight to serving a statutory demand under the Guarantee itself.

24. Mr Lowenstein's principal argument was that a fact or circumstance well known to both Mr Pearse and HMRC at the time the Guarantee was concluded was that Mr Pearse was a practising solicitor and that his practising certificate would be suspended by the Solicitors' Regulation Authority if a bankruptcy order was made against him. He was anxious that he should not be prevented from practising and continuing to earn his livelihood. The common intention and understanding of the parties knowing that fact was, he submitted, that it was in both their interests to allow Mr Pearse and his co-partner to continue working as solicitors in order to have some chance of paying off the taxes owed by the firm. It must be right that on the basis of the parties' common understanding at the time they entered into the Guarantee, HMRC were precluded from pursuing Mr Pearse's bankruptcy not only for the direct enforcement of the £600,000 due under the Guarantee once it was properly demanded, but also the indirect enforcement of the £600,000 due under the Guarantee once it had been merged into a judgment. HMRC have always been able, Mr Lowenstein submits, to pursue the usual routes for enforcing a judgment under CPR 70 and Practice Direction 70 such as a writ or warrant of control, a third party debt order or a charging order. It was nonsensical to suggest that that protection related only to enforcement of the Guarantee itself and could be quickly and easily sidestepped by the expedient of obtaining a judgment.

25. On this point I agree entirely with Judge Briggs that the natural and ordinary meaning of the words "for enforcement of the Part Debt" limits HMRC's agreement to forbear

from pursuing bankruptcy to the enforcement of the £600,000 due under the Guarantee. The term Part Debt is defined as being the liability for £600,000 to which the TTPA was limited. Mr Lowenstein complained that Judge Briggs wrongly relied in his reasoning on the fact that the parties could have expressly referred to a judgment debt as well as the Part Debt if that is what they had intended. He referred me to the judgment of Lord Neuberger, dissenting, in *Re Sigma Finance Corp* [2008] EWCA Civ 1303. At [101] Lord Neuberger said that it is not normally convincing to argue that if the parties had meant a phrase to have a particular effect they could have made the point in different or clearer terms. Lord Neuberger described this as "a game which all parties can normally play on issues of interpretation". However, read in context I do not consider that the Judge was saying anything more than that both parties to the Guarantee had legal training, they were solicitors and they had control over the language that they used.

26. Mr Pearse also relied on *Aman v Southern Railway Company* [1926] 1 KB 59 as showing that in an appropriate case, a reference in a contractual document to a debt can encompass a judgment obtained on that debt. In that case a judgment had been obtained against a railway company for outstanding interest on debenture stock. The judgment was not satisfied, and the claimant bought the stock and took an assignment of the judgment. Under a scheme set up under the Railways Act 1921, the railway company's liabilities were transferred to Southern Railway and holders of stock in the old railway, including the plaintiff, became holders of stock in Southern Railway. Those holders were deemed by a term in the scheme to have accepted the stock allocated to them in substitution for the old stock and "in satisfaction of all claims thereunder including any arrears of interest". The issue was whether the plaintiff could still enforce his judgment debt or whether that was a claim under the old debenture stock and therefore extinguished by his acceptance of the new Southern Railway stock in accordance with the scheme. The Court of Appeal upheld Greer J's decision that the judgment debt could not be enforced. The question for the court was whether the judgment debt was to be deemed to be satisfied because the plaintiff's claim to the arrears of interest on the debenture stock had been satisfied by the acceptance of the new stock. The plaintiff argued that his rights as a judgment creditor were unaffected by the extinguishment of his rights as a debenture holder. Bankes LJ held that this contention rested on a mistake, namely failing to recognise that the judgment debt "merely operates as an additional security for the due payment of the debt and that if the debt is extinguished, the judgment goes with it"; p. 71. He also held that the judge had been right to conclude that the draftsman of the scheme, when providing that the allocation of new stock would be "in satisfaction of all claims" under the old debenture "must be understood as having intended to include under those words not only claims against the property charged but also claims under any collateral security" which the debenture holder would be bound to hand over to the former debtor once the debt had been paid. Eve J in *Aman* agreed that the judgment obtained in an action did not confer on the creditor "a right to have his money twice over". The right to interest under the old stock had been satisfied by the allotment of new stock so a judgment for the arrears of interest as an additional security for the payment could not be enforced.

27. I do not see that the decision in *Aman* really helps Mr Pearse. It shows that where a creditor agrees to accept payment in satisfaction of a debt which is expressed in a contract to be a debt due under a contract, he cannot then enforce a judgment that he

has previously obtained for that debt and thereby get his money twice. The issue of what a phrase means must, of course, be construed in its context and the context in *Aman* required a reference to claims "under" the old debenture stock to be construed as including the enforcement of a judgment debt obtained in respect of such claim. That does not mean that every reference in a contract to a debt incorporates a judgment obtained to enforce that debt.

28. So far as commercial common sense is concerned, I agree with Judge Briggs that the words chosen by the parties here are clear and there is no requirement to consider commercial common sense. Mr Lowenstein's submissions on this point overlapped with his submissions on the implied term alternative submission which I consider below. On the question of the construction I hold that clause 5(2) does what it says; it prevents HMRC from seeking to launch bankruptcy proceedings to enforce the Part Debt under the Guarantee. It does not prevent them from enforcing a judgment obtained for the payment of the Part Debt.

Ground 2: inclusion of interest and costs

29. A further hurdle that Mr Pearse must overcome is that even if he is right that HMRC are precluded by the terms of the Guarantee from basing bankruptcy proceedings on the judgment into which the liability for the Part Debt was merged, Mr Pearse is separately liable under clause 5(4) for losses, costs and expenses which would include the costs of £1,800 and interest under the Judgments Act 1838 calculated at £125,759.72. Although the costs by themselves are below the bankruptcy threshold, the interest is not. HMRC argues that these elements covered by the statutory demand form a separate basis for the service of the statutory demand and there is nothing in the Guarantee to prevent HMRC launching bankruptcy proceedings in respect of those liabilities.

30. Mr Pearse's answer to this is to argue that the term "Part Debt" must be construed as including the whole of the judgment debt into which the Part Debt is merged, including interest and costs on the principal sum of £575,000. Mr Pearse again relies on *Aman* where the plaintiff contended that if he was wrong in asserting his claim to the principal amount of the judgment, he could at least still claim the interest element in the judgment. Bankes LJ disagreed saying that "the interest is nothing but the fruit of the judgment and if the tree dies the fruit must die with it". The same applied, he held, to the costs of obtaining the judgment. Scrutton LJ also held that Greer J had been wrong to hold that the claim to statutory interest included in the judgment could not be described as a claim "under" the debenture stock. He held that the judge had taken "rather too narrow and technical a view" and that if the judgment is gone then the incidents of the judgment were equally gone including statutory interest. Eve J agreed, holding that to say that the judgment interest was still payable even though the whole of the principal and contractual interest due under the security had in fact been paid was contrary to the principles on which such matters had always been dealt with in the Chancery Division. A mortgagee when taking the account was obliged to bring into the account everything he received including interest and costs. Again, I do not accept that that reasoning is applicable here. *Aman* was dealing with the situation where the creditor accepts new rights expressed in the contract as being in satisfaction of a pre-existing debt - those rights extinguish a judgment based on that debt plus interest and costs. Here, there has been nothing accepted by HMRC as satisfying the Part Debt owed by Mr Pearse or as satisfying the judgment. I do not regard *Aman* as

authority for the proposition that where a document refers to a specified sum as the debt, then that must be read as including a judgment on that debt and interest and costs. The wording of the clause is clear that the Part Debt is limited to £600,000, not to that amount plus additional amounts which only became due after the Guarantee was concluded.

Ground 3: implication of a term

31. Mr Pearse argues that if, contrary to his primary argument, the wording of clause 5(2) does not cover the judgment debt, commercial sense and business efficacy require that a term be implied extending the effect of clause 5(2) to prevent HMRC from pursuing the judgment debt by means a statutory demand.

32. Judge Briggs referred to the decision of Lord Neuberger in *Marks & Spencer PLC v BNP Paribas Securities Services Trust Company (Jersey) Ltd* [2015] UKSC 72, [21]. Mr Lowenstein argued that it would have been obvious to the notional reasonable person that the clause was designed to prevent HMRC from enforcing the Guarantee by bankrupting Mr Pearse because Mr Pearse was anxious to make sure his practising certificate was not at risk. It would similarly have been obvious that HMRC should not be allowed to sidestep that clause by obtaining judgment on its claim and then bankrupting Mr Pearse on that judgment. The prohibition on HMRC issuing a statutory demand made no sense if it was only for the short period between calling in the Guarantee and obtaining a judgment based on that demand, given that there could be no real defence to the claim to the Part Debt.

33. I agree with Judge Briggs that there is no basis for implying such a term here. The contract works perfectly well as it is. It places before HMRC the hurdle in terms of time and cost of obtaining a default judgment. As this case illustrates, this can be a significant hurdle given that Follett Stock defaulted on the TTPA in July 2013, judgment was obtained by HMRC under the Guarantee on 14 February 2014 and the application to set aside the default judgment was obtained in May 2015. There was no commercial advantage to HMRC in agreeing to any broader protection for Mr Pearse than that provided for in the contract as the price for him and his co-partner agreeing to provide the Guarantee for Follett Stock's performance of the primary obligations under the TTPA. There is no overriding reason why HMRC should regard it as in the interest of the general body as taxpayers for Mr Pearse to be immune from bankruptcy proceedings in respect of taxes owed by his former firm if he fails to meet his obligations under the Guarantee and judgment is obtained against him. For as long as HMRC considers that it is in their interests to allow Mr Pearse to continue to practice in the hope that he will use his earnings to pay off the debt, they can forbear from serving a statutory demand without needing to be contractually prevented from doing so. The submission that a term should be applied extending the protection conferred by clause 5(2) must be rejected.

34. In the light of the reasons set out above the appeal is dismissed.