Neutral Citation Number: [2019] EWHC 3363 (Ch)

BL-2018-000544

IN THE HIGH COURT OF JUSTICE
BUSINESS AND PROPERTY COURTS OF ENGLAND AND WALES
BUSINESS LIST (ChD)
DERIVATIVE ACTION

Royal Courts of Justice
Strand, London, WC2A 2LL

Date:5 December 2019

Before :

MR JUSTICE ZACAROLI

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Between :

(1) TONSTATE GROUP LIMITED **Claimants**
(2) TONSTATE EDINBURGH LIMITED
(3) DAN-TON INVESTMENTS LIMITED
(4) ARTHUR MATYAS

- and -

Defendants

(1) EDWARD WOJAKOVSKI
(2) TH HOLDINGS LIMITED
(3) TONSTATE METROPOLE HOTELS LIMITED
(4) SUMMERHILL CARDIFF LIMITED
(5) TONSTATE (BOURNEMOUTH) LIMITED
(6) TONSTATE (RETAIL) LIMITED
(7) TONSTATE (ST ANDREW'S SQUARE) LIMITED
(8) TONSTATE (STAPLE INN) LIMITED
(9) TONSTATE (YEOVIL LEISURE) LIMITED

(10) GLASGOW AIRPORT HOTEL HOLDINGS LIMITED
(11) OVERSEAS HOLDINGS CAPITAL GROUP LIMITED
(12) FIRSTSTAR LIMITED

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Andrew Fulton and Sam Goodman (instructed by **Rechtschaffen Law**) for the **Claimants**
Muhammed Haque QC (instructed by **Candey Solicitors**) for the 1st **Defendant**

Hearing dates: 20 November 2019

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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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MR JUSTICE ZACAROLI

Mr Justice Zacaroli:

1. At a case management conference held in this matter on 20 November 2019, the claimants applied to strike out part of the defence of Edward Wojakovski ("EW"). I determined that application in favour of the claimants and made an order striking out the relevant parts of EW's defence, with reasons to follow. These are my reasons.

2. There is a long and complicated background to this matter. The following is a summary of that background so far as is relevant to the strike-out application.

3. EW is the former son-in-law of Arthur Matyas ("AM"), the fourth claimant. They worked together for many years in a property development business conducted through a group of companies (which I will refer to as the "Tonstate Group"). The genesis of these proceedings, according to the claimants, is the discovery by AM that EW had over a number of years caused payments to be made by one or other of the companies in the Tonstate Group to companies owned or controlled by or associated with EW (the "EW Companies") without the knowledge of AM and in breach of EW's duty to the companies.

4. The claimants therefore commenced an action against (among others) EW to recover approximately £13.5 million alleged to have been extracted from the claimants by EW in breach of duty (the "EW Extractions") and for certain other sums. I will refer to this as the "Main Action". In a further action AM and his wife assert a claim to certain shares held by EW in the Tonstate Group, on the basis that they were procured by deceit. EW has himself commenced proceedings against AM, his wife and certain Tonstate Group companies by way of petition under s.994 of the Companies Act 2006 (the "Petition").

5. EW's essential case in relation to the EW Extractions is that he and AM long ago agreed to adopt a practice, in connection with the property development deals they were involved in, of causing companies in the Tonstate Group to make payments, purportedly for the purposes of the relevant company in connection with the development, but in reality to benefit themselves at the expense of the companies. EW contends that these payments were used to disguise the profits made by the relevant company in the Tonstate Group with the purpose of defrauding, at least, the revenue. He contends that over the years AM also caused payments running to many millions of pounds to be made to companies controlled by or associated with AM (the "AM Extractions"). He says that there was an arrangement between him and AM that, at a point in time when AM decided to retire from the business, there would be an overall reckoning between them, such that they would each ultimately benefit from 50% of all the AM Extractions and the EW Extractions.

6. EW's defence to the Main Claim, therefore, is that while he accepts that the EW Extractions had no legitimate business purpose, and would therefore otherwise amount to a breach of duty, they were made with the agreement of AM and his wife and thus with the approval of all of the shareholders of the relevant companies. He relies on the *Duomatic* principle (named after *Re Duomatic Ltd* [1969] 2 Ch 365, although dating from much earlier) that the informal approval of all the members of a company is sufficient to ratify a breach of fiduciary duty.

7. Mr Haque QC, who appears for EW, accepts that – but for the *Duomatic* principle – EW's conduct in procuring the EW Extractions constituted a breach of fiduciary duty, including because the payments were made for the unlawful purpose of defrauding the revenue.

8. Mr Fulton, who appears for the claimants, contends that the *Duomatic* principle cannot be applied to ratify such a breach of duty.

9. I should add that among the matters raised in the Petition is an allegation that the EW Extractions are no different in substance to the AM Extractions and not therefore something about which the relevant companies can fairly complain. AM, for his part, has accepted that as a result of the AM Extractions the revenue has been deprived of tax that it should otherwise have been paid. He has, however, sought to put matters right by making voluntary disclosure to the revenue. I note that AM's defence to the allegation in the Petition concerning the AM Extractions includes the plea that the payments were approved by all of the members of the company. Mr Fulton, who appears for the claimants, accepts the logic of the conclusion that, if the strike-out application brought by the claimants succeeds, it must follow that to the extent the AM Extractions were made for the same purpose as the EW Extractions then the mirror-image defence to the equivalent allegations in the Petition is similarly defective. While Mr Fulton accepts that the consequence of the AM Extractions was to cause insufficient tax to be paid to the revenue, and that at least some of the AM Extractions may well have constituted a breach of duty on precisely the same basis as the breach of duty alleged against EW, he did not go so far as to accept that they were in fact made in breach of duty. There is currently no mirror-image application by EW to strike out the relevant part of AM's defence to the Petition.

The scope of the *Duomatic* principle

10. It is common ground that the *Duomatic* principle is subject to at least some limitation. Mr Haque accepts, for example, that it does not apply where the company is or is likely to become insolvent, consistent with the principle that where a company is or is likely to become insolvent the directors owe a duty to take into account the interests of creditors: see *BTI 2014 LLC v Sequana S.A.* [2019] EWCA Civ 112 , per David Richards LJ at [220].

11. He also accepted that the principle does not apply where the acts in question are ultra vires the company for an improper purpose.

12. He contends, however, that in this case the EW Extractions were entered into for the proper purpose of remunerating directors or reducing capital at a time when the companies were solvent and, accordingly, were not caught by either of those limitations.

13. The claimants referred me to authorities which suggested a wider limitation, to the effect that the *Duomatic* principle cannot apply where the breach of duty is dishonest: in particular *Madoff Securities International Ltd v Raven* [2011] EWHC 3012 (Comm) at [123] where Flaux J, having extensively reviewed the authorities, concluded as follows:-

> "However, as I have already indicated, it does seem to me that not only *Bowthorpe Holdings* itself, but a number of other cases, including *Cox v Cox*, recognise the existence of a wider exception to the effect that a transaction can be impugned by the company if it is not honest, bona fide and in the best interests of the company. One explanation of that exception may be that public policy demands that a transaction which is not honest, bona fide and in the best interests of the company is not binding on the company. However, whatever the precise juridical basis of the wider exception, I consider that the claimants can show a serious issue to be tried that that exception applies here."

14. It is unnecessary, however, to consider the precise limits of an exception to the *Duomatic* principle based upon dishonesty, since whatever those limits I am satisfied that it cannot apply to conduct which the company could not lawfully carry out itself. That was the conclusion reached by Robin Knowles J in *Auden McKenzie (Pharma Division) Ltd v Patel* [2019] EWHC 1257 (Comm). In that case the defendants procured that the first claimant make payments to accounts owned by the defendants against invoices falsely describing them as in respect of research and development. The purpose was to extract money for the defendants and avoid payment of tax on the payments. The first claimant sought summary judgment on the basis that the first defendant acted in breach of his fiduciary duties as a director of the claimant. The first defendant relied on the approval of the members of the company on the basis of the *Duomatic* principle. His counsel contended that the scope of the principle was something on which differing opinions had been expressed both in this jurisdiction and across the Commonwealth which made the point inappropriate for summary determination.

15. The judge disagreed, concluding that the principle did not apply in a case where the transaction was one which the company itself could not lawfully undertake: see the judgment at [16]:

> "In the present case payments were procured dishonestly; they were said to be for research and development when they were not; they were for the Defendants to have for themselves and to have in a way that dishonestly evaded the tax consequences. Whatever else may be the precise compass of the *Re Duomatic* principle, as a principle developed to save conduct it has not been developed to save conduct of this nature. The company, the First Claimant, could not do lawfully what was done and the assent of all its members could not alter that. The principle is for transactions that are "honest": *Parker and Cooper Ltd v Reading* [1926] Ch 975 at 984 (per Astbury J) cited with approval in *Randhawa and Another v Turpin and Another (as former Joint Administrators of BW Estates Limited)* [2017] EWCA Civ 1021; [2018] Ch 511 at [56]-[57] (Court of Appeal; Sir Geoffrey Vos CHC)."

16. This, being a decision of a judge of co-ordinate jurisdiction, is one which I should follow unless persuaded that it was plainly wrong. Mr Haque QC did not attempt to persuade me of that.

17. He submitted, however, that the relevant limitation to the *Duomatic* principle is a matter of public policy such that it does not apply (or at least it is sufficiently arguable to avoid a strike-out that it does not apply) in circumstances where EW was subsequently excluded from the company and has thus been unable to "put things right" with the revenue. He relies on the reference by Flaux J in the passage cited above from the *Madoff* case to the possibility that public policy is the juridical basis of the limitation to the principle under consideration in that case. I reject this submission. Whatever the juridical basis of the limitation to the *Duomatic* principle (that it does not apply where the company could not itself have carried out the relevant transaction lawfully) it is a limitation that applies as a matter of law, and is not dependent upon an exercise of discretion based upon public policy.

18. As to Mr Haque's submission that payments in the amount of all or some of the EW Extractions could have been made to EW or the EW Companies in an intra vires and lawful fashion, for example by a lawful distribution of capital, I regard this as irrelevant. Such payments would have been wholly different and would have required a different procedure from the payments that were in fact made. I do not think that the *Duomatic* principle applies to ratify payments which it is accepted the company could not lawfully make, because the company could have made different payments, albeit to the same entity, in a lawful manner.

19. Finally, Mr Haque submitted that the fact that payments could have lawfully been made in the amount of at least some of the EW Extractions means that the loss suffered by the relevant claimant company is less than the full amount of the EW Extractions. He refers to a similar argument made in the *Auden McKenzie* case. The first answer to this point is that the claimants claim, apart from equitable compensation, an account of the sums paid away by EW and payment of the sums found due under the account to the claimants. Secondly, the similar point made in the *Auden McKenzie* case was dismissed by Robin Knowles J (save insofar as the company's loss was reduced by tax rebates that it received as a result of the first defendant's dishonesty, which it should never have received and which had been repaid by the first defendant to HMRC). As he pointed out at [21] of his judgment: "There is no question that the First Defendant caused loss in the amount of the payments by reason of the breaches. If the payments had not been made unlawfully then the company would still have the money "in the till"".

20. Accordingly, the relevant paragraphs of the defence which plead a defence based on the *Duomatic* principle will be struck out.