Neutral Citation Number: [2020] EWHC 3521 (Ch)

Case No: BL-2017-000194

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

7 Rolls Building
Fetter Lane, London
EC4A 1NL

Date: 21st December 2020

Before:

MR JUSTICE ZACAROLI

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Between:

SSF REALISATIONS LIMITED (In Liquidation)	**Claimant**
- and –	
(1) LOCH FYNE OYSTERS LIMITED	**Defendants**
(2) ROBERT HARVEY CRAIG	
(3) TIMOTHY LUCAS	
(4) RICHARD JULIAN ORGAN	
(5) BRUCE CHARLES DAVIDSON	
(6) STEPHEN ALEXANDER SUTHERLAND	

Alexander Cook (instructed by **Sherrards LLP Solicitors**) for the **Claimants**
Philip Hinks (instructed by **Brodies LLP Solicitors**) for the **First, Second and Fifth Defendants**
The **Third Defendant** appeared in person
The **Fourth** and **Sixth Defendants** were not present or represented

Hearing dates: 25, 26 and 27 November 2020

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APPROVED JUDGMENT

COVID-19: This judgment was handed down remotely by circulation to the parties' representatives by email. It will also be released for publication on BAILII and other websites. The date and time for hand-down is deemed to be 10.30 a.m. on Monday 21st December 2020.

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MR JUSTICE ZACAROLI

Mr Justice Zacaroli:

Introduction

1. This claim concerns the lawfulness of a distribution made by the claimant company (the "Company") to its shareholder, the first defendant, Loch Fyne Oysters Limited ("LFO") in November 2011.

2. The Company was incorporated on 18 April 1974 under the name Shrewville Limited. It carried on business as a supplier of fresh, frozen and live fish to shops and restaurants, trading under the name Simson's Fisheries. On 6 June 2008 the Company's entire share capital was acquired by LFO from the Company's then shareholders, Mr Tim Lucas ("Mr Lucas", the third defendant), Mr Richard Organ ("Mr Organ", the fourth defendant) and Mr Charles Organ, for a consideration of approximately £1.9 million, of which a substantial portion was deferred.

3. In November 2011 the directors of the Company were: Mr Robert Craig ("Mr Craig", the second defendant); Mr Lucas; Mr Organ; Mr Bruce Davidson ("Mr Davidson", the fifth defendant); and Mr Stephen Sutherland ("Mr Sutherland", the sixth defendant).

4. LFO is also in the wholesale and retail seafood business. Its main customer in 2008 was Loch Fyne Restaurants Limited ("LFR") which operated a restaurant chain. In November 2011 its directors included Mr Craig, Mr Davidson and Mr Sutherland.

5. Following LFO's acquisition of the Company, the inter-company account between them consisted of an increasing balance due from LFO to the Company: £262,929 (as at June 2008); £317,734 (as at June 2009); £793,342 (as at June 2010) and £904,414 (as at June 2011). In the Company's October 2011 management accounts the debt due from LFO stood at £944,089.

6. The debt had built up principally in two ways: the Company sourced and supplied fish, at its own cost, to customers of LFO in the south of England and also bore the cost of transportation of LFO's products delivered to customers in the south of England.

7. By 2011 LFO and the Company were in financial difficulties. By September 2011 a plan had emerged for the acquisition of LFO by Scottish Salmon Company Limited ("SSCL"). Before it would acquire LFO, however, SCCL required a clean break between LFO and the Company. It required that the Company be sold to a third party and that nothing be owed by way of debt from LFO to the Company.

8. In relation to the first of those conditions, LFO entered into negotiations with James Knight of Mayfair Limited ("JKM") for the sale of the Company.

9. In relation to the second of the two conditions, at a board meeting of the Company held on 21 November 2011 the directors resolved upon two matters with a view to reducing the debt due from LFO to the Company. The first was to approve an interim dividend and the second was to assume a management charge in favour of LFO. Each of these was to be offset against the debt due from LFO.

10. Sometime in the weeks following the board meeting, an interim dividend in the sum of £500,000 (the "Dividend") and a management charge in favour of LFO in the sum of £330,000 (the "Management Charge") were entered in the Company's books and records, with an effective date of 27 November 2011.

11. The claimant contends that the Management Charge was itself a disguised distribution to LFO and that the Dividend and the Management Charge together comprised an unlawful distribution out of capital in breach of Part 23 of the Companies Act 2006 (the "2006 Act").

12. The Company's management accounts for November 2011 indicated that, as a result of the Dividend and Management Charge, the Company was insolvent (with net liabilities of £142,710).

13. The negotiations with JKM ultimately failed and on 17 February 2012 the Company was sold to Mr Lucas for £1. It continued to trade for a number of years, albeit it never returned to solvency. On 2 June 2016 Mr Andrew Hosking and Mr Simon Bonney of Quantuma LLP were appointed administrators of the Company. On 10 November 2016, the Company entered creditors' voluntary liquidation. Mr Hosking and Mr Bonney were appointed joint liquidators.

14. This claim was commenced by a claim form dated 25 October 2017.

<u>The Defendants</u>

15. Mr Craig, Mr Davidson and Mr Lucas provided witness statements and attended trial to be cross examined on them.

16. Mr Craig was the chairman of both LFO and the Company. He had extensive accountancy experience, having been a partner in an accountancy practice for over 25 years.

17. Mr Davidson, as well as being a director of the Company, was the managing director of LFO. He had extensive prior commercial experience, having sat on the board of the Imperial Tobacco Group for 6 years.

18. Mr Sutherland was the director with principal responsibility for the financial affairs of the Company. He had previously been a partner in Cook & Co, the auditors for LFO and the Company. He prepared the management accounts for the Company and was the main point of contact between the Company and its auditors. Following the acquisition by LFO the accounting functions of the Company were moved to LFO's head office in Scotland. Mr Sutherland worked there alongside Ms Helen Seaborne, the company secretary to the

Company, who undertook similar responsibilities in relation to LFO. Mr Sutherland has never been served with these proceedings and he has taken no part in them.

19. Mr Lucas was the operations director of the Company. He worked from the Company's premises in the south of England. He had no accounting experience.

20. Mr Organ was the sales director of the Company. The claimant reached a settlement with Mr Organ and he played no part in the trial.

21. I also heard evidence from Mr Hugh Johnston ("Mr Johnston"), the financial controller and employee elected director of LFO at the relevant time.

22. Mr Craig, Mr Davidson, Mr Johnston and Mr Lucas were honest witnesses doing their best to assist the Court. In circumstances, however, where their recollection of events which occurred over nine years ago was (as they each acknowledged) poor, the contemporaneous documents and inherent probabilities are likely to be a more accurate guide to what happened.

Circumstances leading up to the board meeting on 21 November 2011

23. The first mention in the contemporaneous documents of a possible dividend by the Company is in a letter from Mr Sutherland (as director of LFO) to JKM. Mr Sutherland indicated that the intercompany loan position between the Company and LFO would be resolved by a dividend "in the region of £800k".

24. The minutes of the LFO board meeting of 7 September 2011 (at which, among others, Mr Craig, Mr Davidson and Mr Sutherland were present) also referred, under the heading "Disposal of Simson's", to a "plan to create Dividend to clear intercompany balance."

25. At this stage, the plan appeared to be to offset the whole of the intercompany debt by way of a dividend and there was no mention of an offsetting management charge.

26. The Company's board meeting of 21 November 2011 was (according to the draft minutes of the meeting) its first formal board meeting for three years. It was first mooted in an email of 17 November 2011 from Mr Craig to Mr Lucas, Mr Organ, Mr Davidson and Mr Sutherland. Mr Craig said that it was "high time" they had another proper board meeting "as there are answers to be given to audit queries…". Nothing was said in this email about the proposal to declare a dividend at the meeting.

27. On 18 November 2011 (the Friday before the board meeting on the Monday) Mr Craig emailed Mr Sutherland a draft agenda for the board meeting which included, under the heading "Report on Financial Position": "Draft Statutory Accounts to 30th June 2011 and audit queries; Adjustments to be agreed." There was no indication that the meeting was being convened in order to declare a dividend. In his covering email, however, Mr Craig asked Mr

Sutherland, among other things, what the Company's balance sheet would look like once the inter-company dividend was voted through and what were the outstanding audit points. Mr Craig emailed the agenda to the other directors, including Mr Lucas, later that day.

28. Early in the morning of 21 November 2011 Mr Sutherland emailed a copy of the management accounts for October 2011 (the "October management accounts") to among others, Mr Craig and Mr Davidson, but not Mr Lucas.

29. Prior to the board meeting, Mr Sutherland met with Mr Craig and Mr Davidson over breakfast.

30. It is an important factor in this case that the October management accounts contained a significant error in that they understated the liabilities of the Company by approximately £178,000 and correspondingly overstated the distributable profits in the same amount, in circumstances which I describe briefly in the following paragraphs.

31. By November 2011, the audit in respect of both companies would have been well under way.

32. On 8 November 2011, Jennifer Tulloch of Cook & Co emailed Mr Sutherland a list of three points (and 13 additional outstanding points) on which further information was required in relation to the Company for the purposes of the "Audit 2011". The first of the points was a reconciliation of payments made on 6th July regarding creditors' balances at the year end. This raised a concern (which I will refer to as the "creditor cut-off issue") that where goods had been received by the year end, but not paid for, both the goods (as an asset) and the debt due (the corresponding liability) must be included in the accounts. She also enclosed a list of potential accruals to be included, relating to the accounts for the year ended 30 June 2011 (I will refer to this as the "accruals issue").

33. While this email related to the accounts for the year ended 30 June 2011, it is apparent that it prompted Mr Sutherland to revisit the audited accounts for the year ended 30 June 2010 in relation to both the creditor cut-off issue and the accruals issue. As a result, he produced a series of spreadsheets addressing these issues for the years ending 30 June 2010 and 30 June 2011 respectively. The spreadsheets relating to the year ending 30 June 2010 identified additional liabilities that ought to have been included in the audited accounts as a result of the creditor cut-off issue (totalling approximately £190,000) and the accruals issue (totalling approximately £38,000). Trade creditors and accruals had accordingly been understated in the audited accounts for the year ending 30 June 2010 by these amounts. That error followed through into the monthly management accounts in the current year.

34. The metadata for these spreadsheets reveals that they were first created on 8 November 2011, just over two hours after Mr Sutherland received the email of that date from Ms Tulloch. The metadata also reveals that the document was last saved on 5 March 2012. In the Company's management accounts for November 2011, the figures for trade creditors and for accruals have been adjusted downwards (compared to the numbers in the October management

accounts) by the precise amount identified in the spreadsheets for each of the months June to October 2011. The November management accounts were prepared no later than 30 December 2011 (being the date appearing on the version in the trial bundles). They were sent to a Mr Stuart Marshall of Vineyard Consulting (an entity which was interested in acquiring the Company) by Mr Sutherland on 5 January 2012. In that email, Mr Sutherland explained as follows:

> "In answering some of the points raised by our auditors on the 2011 year end I could not understand a timing issue which had occurred on creditors. The error relates to the 2010 year end to the extent that creditors were understated in 2010 by £190k (because they were reconciled to an incorrect report). Given a prior year adjustment needs to be processed, I wanted to ensure all the accruals relating to 2010 were also properly captured in 2010 (£38k). This amendment will mean that the £50k tax liability paid will now be refunded."

35. As Mr Sutherland explained in that email, the increase in liabilities was offset by a tax refund in the region of £50,000. Accordingly, the net understatement of liabilities in the management accounts for each of June, July, August, September and October 2011 was £178,000. The net assets and the distributable profits were overstated by the same amount. In the November 2011 management accounts, the net assets and distributable profits were revised downwards by that amount for each of the prior months, including the October management accounts.

36. I will need to consider in more detail later in this judgment the precise point in time on or after 8 November 2011 at which Mr Sutherland appreciated the full extent of this error in the 2010 accounts, and thus in the management accounts for June to October 2011. It appears, however, that he had appreciated there was a significant problem in relation to the creditor cut-off issue by the date of the board meeting, by reference to a document headed "Shrewville Limited t/a Simson's Fisheries Year end 30 June 2011 audit issues" which Mr Sutherland emailed to his own private email address on the morning of the board meeting on 21 November 2011. The first of the issues identified related to an adjustment to the net assets in the financial statements for the year ended 30 June 2010 and read as follows:

"Trade creditors cut-off – y/e 30 June 2010	£(150,000)
CT adjustment	£50,000
Prior year / net assets adjustment	£(100,000)"

<u>What was approved at the board meeting?</u>

37. There are in evidence two versions of draft minutes of the board meeting on 21 November 2011. The first was prepared by Mr Craig and emailed to Mr Davidson and Mr Sutherland on 5 December 2011. In his covering email Mr Craig said: "I think we need a minute, if only for our own purposes confirming the inter-company dividend and I leave it to you to decide whether all the

Directors, including Tim [Lucas] and Richard [Organ], should be given a copy."

38. The first draft minutes recorded as present Mr Craig (chairman), Mr Lucas, Mr Organ, Mr Davidson and Mr Sutherland. It was noted that this was the first formal board meeting since November 2008. The minutes included the following of direct relevance to the Dividend and Management Charge:

(1) It was reported that liquidity was tight and "the company really had no working capital at all". There was little prospect of this improving as they moved into the quieter months (meaning the first two or three months in the calendar year).

(2) The current management accounts were tabled (being those for October 2011). Reference was also made to the draft statutory accounts for the year ending 30 June 2011 and to "Audit Queries". As to the latter, the minutes stated:

> "The Auditors had raised various queries, amongst which was the lack of a cross charge from LFO for the time and travelling expenses of LFO staff engaged in the business of Simson's. There was a considerable amount of tidying up to be done as between the individual sets of accounts, including allocation of transport costs, squaring up of LFO goods sold by Simson's and the resultant lopsided effect of a substantial balance due on paper by LFO to Shrewville. £500K of this could be traced back to the amount taken by Bank of Scotland at the outset towards the purchase price of the acquisition and the balance was these other factors he had just mentioned."

(3) Under the heading "Inter Company Dividend", it was stated:

> "To effect a square up between the two companies Stephen proposed that an interim Company Dividend of £800K be declared and this was approved. It was appreciated that the practical effect was to leave Shrewville with a net assets value of only £105,719."

39. Mr Sutherland amended the draft minutes and emailed them to Mr Craig and Mr Davidson later on the morning of 5 December 2011. The most significant change, so far as the Dividend and Management Charge is concerned, was to the paragraph headed "Inter Company Dividend", the opening sentences of which now read:

> "To effect a square-up between the two companies Stephen proposed that an interim Company Dividend of £500K be declared and this was approved, with the balance (circa £350K, depending on the various day-to-day trading between the companies) be cleared by raising a management charge from LFO to Shrewville to offset. It was appreciated that the

practical effect was to leave Shrewville with a net assets value of only £105,719."

40. There is no evidence that the draft board minutes were ever signed. Nor is there any evidence that they were sent to any of the directors other than Mr Craig, Mr Sutherland and Mr Davidson. Mr Lucas' evidence (which I accept on this point) is that he never received a copy of either draft of the minutes until after these proceedings commenced.

41. As noted above, the draft minutes recorded the October management accounts being tabled. Mr Craig and Mr Davidson both said that the October management accounts were used to consider whether a dividend could be declared or not. Those management accounts recorded the following:

(1) Net profit for the year to date (that is 1 July to 31 October 2011) was £3,549 (a reduction of £153,088 from the equivalent period in the previous year);

(2) Net current assets were £500,016;

(3) Total net assets were £905,719;

(4) The inter-company balance due from LFO was £944,089; and

(5) Reserves (made up of the profit and loss account) were £605,720.

42. The claimant contends that the first draft of the minutes is accurate, and that the directors approved a dividend of £800,000.

43. The first, second and fifth defendants contend that the second draft of the minutes is accurate, and that the directors approved a dividend in the sum of £500,000 and that the remaining balance of the inter-company debt due from LFO be cleared by raising a management charge.

44. Mr Craig and Mr Davidson, while having only a hazy recollection of the meeting, said that they remembered the dividend *and* management charge being discussed at the meeting, that the figure mentioned for the dividend was £500,000 but that no figure was agreed upon for the management charge, as the inter-company balance was fluctuating so that the precise amount of offsetting charge needed to clear the debt from LFO was not then known. Mr Lucas recalls a discussion of these elements but not any figures that were mentioned.

45. Mr Craig was unable to explain the reference to a dividend in the sum of £800,000 in his initial draft minutes, other than it must have been a mistake. It is not plausible that Mr Craig's "mistake" in the first draft of the minutes was a mere typographical one (writing £800,000 for £500,000). That is because his draft minutes went on to note that the Company would be left with net assets of £105,719, which is precisely £800,000 less than the net assets stated in the October management accounts. Mr Craig suggested that he must have been thinking of the impact on distributable reserves, not net assets. While it

is true that deducting £500,000 from the figure for distributable profits in the October management accounts leaves an amount of £105,720 (a difference of only £1 from the amount referred to in the draft minutes) the fact that the *specific* sum of £105,719 is mentioned in the minutes suggests that Mr Craig's calculation had been achieved by reference to the net assets figure.

46. Nevertheless, I find that it is the revised draft minutes which accurately reflect the decisions reached by the directors at the board meeting on 21 November 2011, for the following reasons.

47. First, the declaration of a lawful dividend of £800,000 was clearly impossible on the face of the October management accounts, which were discussed at the meeting and which disclosed distributable profits of only £605,720. Each of Mr Craig, Mr Davidson and Mr Sutherland was an experienced businessman with sufficient financial awareness to have realised this. There is no suggestion that they acted dishonestly. I find it inherently unlikely that they would have declared a dividend in an amount which they knew was greater than the available profits on the face of the management accounts upon which they were relying.

48. Second, Mr Craig's draft minutes refer to the concept of an offsetting management charge, under the heading "Draft Statutory Accounts to 30th June 2011 and Audit Queries". Although (as I explain below) I do not accept that it was the auditors who raised the need for an offsetting management charge, this passage in the draft minutes is consistent with the issue having been raised at the meeting.

49. Third, Mr Davidson had himself raised the issue of the LFO debt being eliminated by a combination of a dividend and management charge shortly before the board meeting, in an email of 14 November 2011 to (among others) Mr Craig and Mr Sutherland.

50. Fourth, the document that Mr Sutherland emailed to himself on the morning of the board meeting referred to raising a cross-charge against the Company in respect of staff, transport costs and transfer pricing. I infer from the fact that he sent this to himself immediately before the board meeting that it contained information he was likely to want to refer to at the meeting.

51. Fifth, Mr Sutherland's amendment to the draft minutes, to make express reference to a management charge, was effected within minutes of receiving Mr Craig's first draft and the management charge was effected shortly thereafter, with no objection raised by Mr Craig or Mr Davidson. While Mr Davidson accepted that he received a copy of Mr Craig's first draft minutes and raised no objection to them, he also received a copy of Mr Sutherland's amended draft less than an hour later. His lack of objection to the first draft is therefore likely to be explained by the fact that he saw Mr Craig's draft only after or at the same time that he saw Mr Sutherland's corrected draft, so there was no need for him to make his own corrections.

52. In light of these factors, I consider that Mr Craig's mistake in the first draft minutes was, having identified what he thought was roughly the amount of the

LFO debt which needed to be eliminated (£800,000), to refer to the directors having resolved to eliminate it by way of a dividend instead of a dividend and offsetting management charge.

The proper characterisation of the management charge

53. The claimant contends that even if the directors in fact resolved (as I have found) to eliminate the LFO debt by way of dividend *and* Management Charge, the Management Charge is nevertheless properly to be characterised as a disguised distribution.

54. A "distribution" for the purposes of Part 23 of the 2006 Act is any description of distribution of a company's assets to its members, whether in cash or otherwise: s.829.

55. In *Progress Property Company Ltd v Moorgath Group Ltd* [2010] UKSC 55, per Lord Walker at [1] said:

> "Whether a transaction amounts to an unlawful distribution of capital is not simply a matter of form. As Hoffmann J said in *Aveling Barford Ltd v Perion Ltd* [1989] BCLC 626, 631: "Whether or not the transaction is a distribution to shareholders does not depend exclusively on what the parties choose to call it. The court looks at the substance rather than the outward appearance." Similarly Pennycuick J observed in *Ridge Securities Ltd v Inland Revenue Commissioners* [1964] 1 WLR 479, 495:
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> > "A company can only lawfully deal with its assets in furtherance of its objects. The corporators may take assets out of the company by way of dividend, or, with the leave of the court, by way of reduction of capital, or in a winding up. They may, of course, acquire them for full consideration. They cannot take assets out of the company by way of voluntary distribution, however described, and, if they attempt to do so, the distribution is ultra vires the company."

56. It is common ground that prior to November 2011 LFO had never imposed a management charge on the Company. On the contrary, the Company had (as I have set out above) imposed a charge on LFO since 2008 for services supplied by the Company for LFO's benefit, and this had been consistently reflected in the books and records of both companies, as a debt due from LFO to the Company.

57. The first mention of an offsetting management charge being imposed on the Company in any contemporaneous document appears to be in Mr Davidson's email of 14 November 2011 in which he referred to the LFO debt being eliminated by a dividend and management charge. As I have noted above, at the LFO board meeting on 7 September 2011 the plan was that the intercompany debt would be eliminated solely by a dividend from the Company.

58. On 9 December 2011, Mr Sutherland sent a copy of the amended draft board minutes to Campbell Shirlaw (representing SSCL in the negotiations with LFO), together with the “dividend paperwork” (consisting of a tax voucher for an interim dividend for the year ended 30 June 2012 of £500,001.00). In his email to Mr Shirlaw he said that the invoice (for the Management Charge referred to in the minutes) would be made out for “£330k + VAT”.

59. On 12 December 2011 Mr Sutherland emailed Mr Johnston asking him to prepare an invoice from LFO to the Company for £330,000 plus VAT, noting: “You mentioned that under the “details” section the option of using “see attached” and I think we should go with this for now. I will forward some wording later.”

60. Later on that afternoon, Mr Sutherland emailed a narrative for the Management Charge to Ms Seaborne (the “Breakdown”). This read as follows:

“Use of LFO employees – at cost		£
P Raven – 3 years		75,000
M Montgomery – 1.5 years		29,904
E/er NI (est)		10,490
Share of Cornwall Transport Costs		
Oct 08 to June 2009	207,613	
Year to June 2010	278,061	
Year to June 2011	281,652	
5 months to Nov 2011	96,953	
	864,279	
50% thereof		432,140
Accommodation costs – Coulsdon Manor		
Year to June 2010	11,682	
Year to June 2011	13,581	
5 months to Nov 2011	857	
		26,120
Discounted goods		
Sales at cost to produce		
Year to June 2011	1,187,608	
5 months to Nov 2011	411,453	
	1,599,061	
Lost margin at assumed 15%		282,187
		855,841
Restricted to:-		
		330,000
Vat at 20%		66,000
Total due		396,000”

61. The Breakdown appeared to indicate that although a management charge in the sum of £885,841 was justified, LFO was prepared to charge only £330,000, as this was all that was needed in order to eliminate the debt due from LFO to the Company. There is no evidence that the Breakdown was discussed with any of the other directors of LFO. Mr Davidson and Mr Craig said that the first time they saw it was in the context of these proceedings.

62. Ms Seaborne responded almost immediately to say that it seemed fine to her, but recommending that a file note be prepared explaining the "whys/wherefors – so that in the future when you are not around someone will understand what & why you were recharging".

63. Shortly afterwards, Mr Johnston emailed an invoice to Mr Sutherland on LFO headed paper in the sum of £396,000 inclusive of VAT, with the description "Miscellaneous see attached", due by 11 January 2012. No attachment has been found.

64. A nominal ledger print-out provided by Cook & Co suggests that the deemed date of entry for both the Dividend and the Management charge was 27 November 2011. The latter is included in the books at the VAT-exclusive figure of £330,000. It is likely, however, that neither had actually been entered in the Company's books and records until around 9 December 2011. That is because it is only on that date that the amount of the management charge is identified. Moreover, an intercompany schedule bearing the date 9 December 2011, updated for October and November, implied that neither the Dividend nor the Management Charge had been credited to LFO as of that date.

65. The claimant contends that the Management Charge was arrived at by Mr Sutherland working backwards from a pre-conceived figure (the outstanding indebtedness of LFO to the Company) so as to achieve a "square up" between the two companies. It was not calculated by reference to any perceived liabilities but by reference to the desired amount of the distribution, being one sufficient to clear LFO's liability to the Company. The claimant does not accept that all of the items in the Breakdown were costs actually incurred by LFO, at least not in the amounts there set out, and in any event does not accept that they were costs which LFO had any entitlement to recharge to the Company.

66. The defendants do not deny that the purpose of imposing the Management Charge was so as to eliminate that part of the LFO debt that was not offset against the Dividend. They deny, however, that it was not a proper charge. They contend that the items in the Breakdown were costs actually incurred by LFO which it was fair to recharge to the Company because the Company had received the benefit of the various items:

(1) The two employees of LFO identified in the Breakdown had been seconded to the work at the Company's premises in England, and it was fair that LFO should be reimbursed for the cost of providing them;

(2) The Company's produce had been included in shipments carried out by Cornwall Transport Limited for which LFO alone had been invoiced,

and LFO was therefore justified in recharging a proportion of those costs to the Company;

(3) LFO's directors and employees had stayed at Coulsdon Manor when attending the Company's premises, so it was fair that the payments LFO had made for that accommodation should be recharged to the Company; and

(4) LFO had sold its produce to the Company at discounted prices, which had greatly benefitted the Company such that the Company should now reimburse LFO for its lost margin on those sales.

67. Mr Hinks, who appeared for LFO, Mr Craig and Mr Davidson, submitted that on this basis, the assumption of the Management Charge by the directors of the Company was a proper exercise of their powers.

68. As was pointed out by the Court of Appeal in *Heis v MF Global UK Services Limited* [2016] EWCA Civ 569, the fact that one company in a group has provided staff to another group company does not mean that the second company has an obligation to reimburse the first company, even where the second company had in fact reimbursed the first company for a long period. An obligation would exist only if the criteria for implying a contract were satisfied, namely: "(a) agreement on essentials of sufficient certainty to be enforceable, (b) an intention to create legal relations and (c) consideration": per Vos LJ at [36].

69. Mr Hinks accepted that there had been no agreement of any kind, whether express or implied, that the Company would reimburse LFO. Mr Davidson's and Mr Craig's evidence was to the same effect: there had been no discussion, let alone any decision or agreement, that the Company would reimburse LFO for any of the matters referred to in the Breakdown prior to November 2011. As I have indicated above, the possibility of an offsetting charge was raised in response to SSCL's requirements for its acquisition of LFO.

70. Indeed, it was an important part of the defendants' case that no obligation arose at all until the issue of the invoice in December 2011 because, had there been any obligation prior to that date, it would have to have been reflected in the Company's accounts. Had it been, it would have caused a very substantial reduction in distributable profits. Indeed, if the quantum of the management charge was as high as that identified in the Breakdown, it would have eliminated the distributable profits altogether (such that no Dividend at all could lawfully have been paid).

71. In my judgment, it follows from the fact that the Company was at the time of the board meeting under no obligation of any kind to reimburse LFO for any of the matters identified in the Breakdown, that the true characterisation of the assumption of the Management Charge is as a voluntary distribution to the shareholder, LFO.

72. This accords with commercial realities. It is generally in the interests of a parent company that its subsidiary's business is successful. The parent can expect to benefit from its subsidiary's success through the increased value in its shares in the subsidiary. A parent company might therefore choose to support a subsidiary financially by contributing capital as opposed to debt, or by providing benefits in kind such as the supply of services or goods without imposing an obligation on the subsidiary to pay for them.

73. In the absence of any agreement, whether express or implied, for reimbursement, the legal relationship under which LFO provided any support to the Company must have been that of shareholder/company not creditor/debtor. LFO's entitlement to benefit from having provided those goods and services is via the rights conferred on it as shareholder (e.g. via dividends or an increase in the value of its shares).

74. By subsequently determining to assume a liability to pay for those goods and services (otherwise than via declaring a dividend) the Company was necessarily agreeing to make that payment for no consideration recognised in law. That was, in substance, a voluntary distribution of its assets to its shareholder.

75. It is not enough, as the defendants contend in this case, to say that it was a proper exercise of the directors' "powers" to reimburse LFO because it had provided services (including secondment of staff, payment for transport costs and selling goods at a discount) from which the Company had benefitted. The critical question is which power the directors were exercising. It cannot have been the power to cause the Company to pay a debt due in respect of services rendered to it, because that power could only be exercised where there was an obligation on the Company to make payment. The power the directors were in fact exercising was the power to return assets to the shareholder in the absence of any legal obligation (other than the shareholder/company relationship) to do so.

76. It was tentatively suggested that, although a promise to pay for services rendered in the past would normally be unsupported by consideration (and therefore unenforceable), that might not be the case if the payment was in consideration for a promise to *continue* making supplies. It is true that LFO and the Company continued, for a few months after the board meeting, to assist each other in the ways that they had before. There is, however, no evidence that any agreement was made to the effect that LFO would only continue to provide benefits to the Company if the outstanding debt was paid. Indeed, that would be contrary to the fact that the sole reason for levying the Management Charge was because the two companies were parting ways, such that the arrangement which had caused the intercompany debt from LFO to the Company to build up would be shortly coming to an end.

77. Mr Hinks referred to *Re Chalcot Training Ltd* [2020] EWHC 1054 (Ch), a decision of Michael Green QC sitting as a deputy High Court Judge (as he then was) for the proposition that the test for characterising a transaction as a disguised distribution of capital was not purely objective, and that the subjective state of mind of those deciding upon the transaction could be a

relevant factor, along with the way the parties have chosen to describe the transaction. In light of that authority, he submitted that the Management Charge was a genuine charge, for six reasons: (1) the documents giving rise to the Management Charge uniformly describe it as a charge for services rendered and expenses incurred; (2) the payment was presented to the outside world (for example in later filed accounts) as a charge for services; (3) the subjective evidence of Mr Craig and Mr Davidson was that it was a charge for services and not a shareholder distribution; (4) although there is a lack of documentation evidencing LFO's entitlement to charge the Company (or the Company's agreement to repay) at the time the services were rendered, it cannot be seriously disputed that the services were in large part supplied or that the Company benefitted from them; (5) the Management Charge is to be contrasted with the Dividend, which is obviously a shareholder distribution; and (6) the criticism as to the amount of the overall Management Charge is irrelevant because it was only levied in the smaller sum of £330,000 and, ultimately, only £244,916 was paid.

78. The first, second, third and fifth reasons given would be of relevance if the question was the true nature of the arrangement made between LFO and the Company at the time the expenses were incurred and services provided. Here, however, as I have already noted it is common ground that no arrangement at all was made at that stage, so that the Company was under no liability of any kind at the date of the board meeting. In those circumstances, the characterisation of the Management Charge as a voluntary distribution is a conclusion of law, derived from the fact that the payment is (by necessity) made for no consideration. I do not consider it of any relevance that at the time the directors decided to make a payment for the historic services they viewed it, described it in documents or presented it to the outside world as a charge for services rendered.

79. The fourth reason merely goes to the question whether the Company benefitted from the services provided by LFO but that, as I have already concluded, is of no assistance in characterising the nature of the subsequent payment from the Company to LFO.

80. Given my conclusion that the assumption of an obligation to pay for the services rendered in the past, where no obligation previously existed, is to be characterised as a voluntary distribution to the shareholder, it is unnecessary to consider the extent to which the Breakdown accurately reflected services provided by LFO for the Company's benefit.

81. Had it been necessary to do so, I would have found as follows. First, LFO had provided at least some services from which the Company had benefitted. The defendants' evidence was consistent on this point. Second, however, no proper consideration was ever given to the extent to which the amounts contained in the Breakdown could be justified. The speed at which the Breakdown was prepared by Mr Sutherland, combined with the fact that there is no evidence that anyone else had any input in its preparation, strongly points to it being no more than Mr Sutherland's personal estimate of what value might be placed on the various items. I make the following points on the individual items contained in the Breakdown:

(1) There is no evidence of any analysis, by reference to invoices from Cornwall Travel, as to which part of the transport costs incurred by LFO were solely for the Company's benefit.

(2) The recharge of the salary of Ms Raven, whose salary comprised the bulk of the employee recharge, is not supported by the evidence of Mr Lucas (the person with the most direct knowledge of the work done by her). He said that she worked both on LFO and Company matters.

(3) The only justification for the recharge of accommodation costs is that it was for those times that LFO's directors and employees were visiting the Company's premises in England. There is no analysis, however, as to the extent that they were conducting LFO's or the Company's business. It does not follow that just because a parent company's director visits the subsidiary's premises he or she is carrying out work on behalf of the subsidiary.

(4) The evidence in relation to the "discounted goods" item in the Breakdown was that goods had been sold by LFO to the Company at a reduced price (although not cost price). They had been invoiced and paid for at that price. I do not consider that any legal basis has been established for LFO being entitled to re-open the bargain it made with the Company in respect of each and every past sale. As to the amount, there is no evidence to support Mr Sutherland's assumption that the lost margin was 15%.

82. For the above reasons, I conclude that the proper characterisation of the Management Charge was a distribution within s.829 of the 2006 Act. Accordingly, what the directors approved at the board meeting on 21 November 2011 was a distribution in an amount which was yet to be finalised but which would be at least £500,000 and would ultimately equal the amount of the debt owed by LFO to the Company. I shall refer to this in the remainder of this Judgment as the "Distribution".

83. The last of the six reasons relied on by the defendants - the size of the Management Charge - is not relevant to its characterisation but is relevant to the determination of the precise amount of the Distribution (and thus the extent to which it was paid out of capital).

84. On one view, since the accounting entries made in the Company's books and records in December 2011 reflected the vat-exclusive amount of the Management Charge as indicated in the invoice of 12 December 2011, it follows that the Distribution was in the total amount of £830,000.

85. That, however, is an overly simplistic analysis, where the Distribution was effected not by payment of cash but by way of an offsetting accounting entry and, as I describe below, that accounting entry was subsequently altered.

86. By a credit note issued by LFO dated 20 March 2012 the Management Charge was reduced by £133,740. By an invoice dated 20 April 2012 it was increased by £48,655.83. As a result, the amount of the Management Charge ultimately

recorded in the Company's books was £244,916. That was the amount which was necessary to offset that part of the LFO debt which was not eliminated by the Dividend.

87. The reason for these adjustments was because subsequent inter-company transactions had the effect of reducing the net amount of the debt owed by LFO. Although I have concluded that the absence of any obligation on the Company, prior to the board meeting, to reimburse LFO for services provided meant that the Management Charge was a voluntary distribution, that does not mean that for inter-company supplies after that date there was no entitlement to recharge. The effect of subsequent supplies to the Company for which LFO was entitled to payment would accordingly reduce the extent to which the debt from LFO needed to offset. It is clear that the purpose of the Management Charge was to eliminate that part of the LFO debt that was not offset against the Dividend. In my judgment, it is accordingly right to calculate the Distribution at an amount equal to (1) the Dividend and (2) the Management Charge that was ultimately offset against the LFO debt, that is in the sum of £744,916.

The lawfulness of the Distribution

88. The following principles were not in dispute, by reference to the provisions of the 2006 Act:

(1) A company may only make a distribution out of profits available for the purpose, being its accumulated, realised profits, so far as not previously utilised by distribution or capitalisation, less its accumulated, realised losses, so far as not previously written off in a reduction or reorganisation of capital duly made: s.830(1) and (2).

(2) Whether a distribution can be made by a company without contravening Part 23 is determined by reference to (1) the profits, losses, assets and liabilities, (2) provisions of certain specified kinds and (3) share capital and reserves (including undistributable reserves) as stated in the relevant accounts: s.836(1).

(3) The relevant accounts are the company's last annual accounts, except that (so far as relevant for this case) where the distribution would be found to contravene Part 23 by reference to the company's last annual accounts, it may be justified by reference to interim accounts: s.836(2).

(4) For the company's last annual accounts (being those last circulated to members) to be relied on, they must have been properly prepared in accordance with the 2006 Act (or have been so prepared subject only to matters that are not material for determining whether the distribution would contravene Part 23): s.837(1) and (2).

(5) For interim accounts to be relied on, they must be accounts that enable a reasonable judgment to be made as to the amounts of the items mentioned in s.836(1): see s.838(1).

(6) If any applicable requirement of s.837 (in relation to the last annual accounts) or s.838 (in relation to interim accounts) is not complied with, then "the accounts may not be relied on for the purposes of this Part and the distribution is accordingly treated as contravening this Part": s.836(4).

89. The question whether a distribution contravenes Part 23 (as opposed to the question of the directors' or shareholders' liability in respect of an unlawful distribution) is answered objectively by reference to relevant accounts as defined by s.836(2): see, for example, *It's a Wrap (UK) Ltd v Gula* [2006] BCC 626, at [43], where Chadwick LJ noted that the question whether there has been a contravention of Part 23 does not turn on whether the company making the distribution knew the facts or knew the legal rules.

90. The first step is to identify the relevant accounts. The last annual accounts were the audited accounts for the year ending 30 June 2010. The amount of distributable profits stated in those accounts was £519,328. The Distribution (which on the basis of the estimate amount of the Management Charge at the board meeting was in the region of £850,000 and which was ultimately in the sum of £744,916) would clearly contravene Part 23 by reference to those accounts. As it turns out, therefore, albeit the directors did not go through the appropriate steps, they were right to disregard the 2010 audited accounts when determining whether the Distribution could be made.

91. Accordingly, it is necessary to consider whether the Distribution could be justified by reference to interim accounts. Since the distributable profits stated in the October management accounts were only £605,720, they were clearly insufficient to justify the Distribution.

92. Irrespective, therefore, of whether the October management accounts complied with the requirements of s.838(1), the Distribution was unlawful, being made in contravention of Part 23.

93. In addition, however, I am satisfied that the October management accounts did not comply with the requirements of s.838(1) because they failed to enable a reasonable judgment to be formed as to the liabilities and the distributable profits of the Company. That conclusion is based on the fact that, because of the creditor cut-off issue and the accruals issue (and taking into account the consequent right to a tax refund), the October management accounts understated the Company's liabilities by a sum in the region of £178,000, and overstated the Company's net assets and its distributable reserves by the same amount.

94. As I have noted above, the error was appreciated by Mr Sutherland at some point prior to 30 December 2011, and the November 2011 management accounts included an adjustment in that net amount to the figures as at 31 October 2011. The revised amount of distributable profits in the adjusted October management accounts was £428,057. As a consequence, the Distribution was paid out of capital to the extent that it exceeded £428,057.

95. Mr Hinks sought to argue, by reference to UK Generally Accepted Accounting Practice (in particular FRS 3 and FRS 12) that the misstatement was neither material nor fundamental so as to prevent the 2010 audited accounts from presenting a "true and fair view". Given my conclusion that the 2010 audited accounts were not the "relevant accounts" irrespective of the misstatement contained in them, it is unnecessary to decide this point. I understood Mr Hinks to make a similar contention, albeit with less force, in relation to the October management accounts. I have no doubt that, in the context of management accounts which revealed distributable profits of just over £600,000, an overstatement of such profits by £178,000 was manifestly material, whether the board meeting at which the accounts were presented was considering a distribution of £500,000, £850,000 (being the estimated amount at the board meeting) or £744,916.

96. On that basis, the amount of the Distribution that exceeded the distributable profits was (£744,916 - £428,057) = £316,859.

The liability of LFO and the directors in respect of the Distribution

Legal principles: liability of a shareholder

97. Section 847 of the 2006 Act applies where a distribution, or part of one, made by a company to one of its members is made in contravention of Part 23. If at the time of the distribution the member "knows or has reasonable grounds for believing that it is so made", he is liable (a) to repay it (or that part of it, as the case may be) to the company, or (b) in the case of a distribution made otherwise than in cash, to pay the company a sum equal to the value of the distribution (or part) at that time: s.847(2). This is without prejudice to any obligation imposed apart from s.847 on a member of a company to repay a distribution unlawfully made to him.

98. In *It's a Wrap (UK) Ltd v Gula* (above), the Court of Appeal held that it is enough, in order to establish that a shareholder knew or had reasonable grounds for believing that the distribution was made in contravention of the Companies Act 1985 that it had the relevant knowledge of facts which, if they existed, led to the conclusion that the distribution contravened the statute. It was not necessary that the shareholder had knowledge of the legal rules and the consequences of those rules when applied to the facts.

99. It was unnecessary for the Court of Appeal in that case to determine the precise meaning of "had reasonable grounds for believing", but Arden LJ and Chadwick LJ went on to give (obiter) consideration to that question. The statutory provision was enacted in order to give effect to Article 16 of the second EC directive on company law (77/91/EEC). Article 16 provides as follows:

> "Any distribution made contrary to Article 15 must be returned by shareholders who have received it if the company proves that these shareholders knew of the irregularity of the distribution made to them, or could not in view of the circumstances have been unaware of it."

100. Arden LJ, at [24] considered that the concluding words of Article 16 (and thus the words "has reasonable grounds for believing" in the UK statute) "must be directed to a situation where the shareholders ought reasonably to have been aware of the factual situation that the distribution contravened the Act." Chadwick LJ, on the other hand, at [52], considered that it was by no means self-evident that the words "has reasonable grounds for believing" were to be equated with constructive knowledge, "if by that expression is meant knowledge which a person would have but for his negligence". He cited *Swain v Natui ram Puri* [1996] PIQR P442 (a case concerned with liability under the Occupiers Liability Act 1984) for the proposition that the phrase "has reasonable grounds to believe" was not equivalent to "ought to have known". While it would not permit an occupier to turn a blind eye, it was not sufficient (in the words of Evans LJ at P488) to prove that the occupier ought to have known particular facts. The occupier must be proved "either to have actual knowledge of the relevant fact or to have known facts which gave reasonable grounds for the relevant fact." Chadwick LJ's provisional view, therefore, was that:

> "The knowledge which the legislature has sought to describe in s.277(1) of the 1985 Act is, I think, knowledge which the member has and knowledge which the member "must be taken to have" or, perhaps, "may reasonably be taken to have"."

101. The statutory remedy is without prejudice to any relief available at common law: s.847(3) of the 2006 Act. At common law, a distribution of a company's assets to a shareholder, except in accordance with specific statutory provisions, is unlawful and *ultra vires* the company: *Progress Property Co Ltd v Moore* [2011] 1 WLR 1, per Lord Walker JSC at [15].

102. In *Precision Dippings Ltd v Precision Dippings Marketing Ltd* [1986] Ch 447, Dillon LJ, at p.457H to 458A held that because the shareholder, who received a dividend pursuant to an ultra vires act on the part of the company, "had notice of the facts and was a volunteer in the sense that it did not give valuable consideration for the money", it was a constructive trustee for the company, citing *Rolled Steel Products (Holdings) Ltd v British Steel Corporation* [1986] Ch 246, 298 (per Slade LJ) and 303 (per Browne-Wilkinson LJ), who held that those who received money from a company as a consequence of its directors' breach of duty were liable where they had notice of the breach.

103. The parties were in agreement that the liability of LFO under s.847 as recipient of the Distribution is limited to that part of the Distribution which LFO knew or had reasonable grounds for believing was made in contravention of Part 23. No argument was advanced that the measure of relief at common law would be different.

Legal principles: liability of directors

104. The parties were also in agreement that the relevant legal principles as to the liability of a director for causing the company to pay an unlawful dividend were as recently summarised in *Burnden Holdings (UK) Ltd v Fielding* [2019] EWHC 1566 (Ch) at [139] and [157]:

> "First, directors, although not trustees, were to be treated as if they were trustees in relation to the company's funds. Second, if they knew the facts which constituted an unlawful dividend, then they would be liable as if for breach of trust irrespective of whether they knew that the dividend was unlawful. Third, however, if they were unaware of the facts which rendered the dividend unlawful then provided they had taken reasonable care to secure the preparation of accounts so as to establish the availability of sufficient profits to render the dividend lawful, they would not be personally liable if it turned out that there were in fact insufficient profits for that purpose. Fourth, they were entitled to rely in this respect upon the opinion of others, in particular auditors, as to the accuracy of statements appearing in the company's accounts."

105. The parties disagreed, however, as to the extent of a director's liability in respect of a dividend which was partially made out of profits and partially out of capital.

106. The claimant relied on *Re Paycheck Services 3 Ltd* [2010] 1 WLR 2793 for the proposition that a director is liable for the whole of the dividend, not merely the difference between the unlawful distribution and the distribution which could lawfully have been paid. At [49], Lord Hope said:

> "Where dividends have been paid unlawfully, the directors' obligation is to account to the company for the full amount of those dividends: see *Bairstow v Queens Moat Houses Plc* [2001] EWCA Civ 712, [2002] B.C.C. 91, [54], per Robert Walker L.J."

107. He went on, however, to conclude that it was open to the court to limit the amount the director should pay to what the only creditor in the liquidation of the company had lost (relying upon a discretion which he considered arose under s.212 of the Insolvency Act 1986).

108. In *Bairstow*, it was contended that directors were liable to the extent that their actions caused the company loss, in accordance with the decision of the House of Lords in *Target Holdings Ltd v Redferns* [1996] 1 AC 421 and, on that test, it was apparent that there was no actionable loss occasioned by the unlawful dividends since they could have been declared and paid by the company in a lawful manner, if the company's subsidiary had first paid up its distributable profits to the company (see [52]). Robert Walker LJ rejected that argument (at [53] to [54]), noting that the case was very different from *Target Holdings*: the directors in *Bairstow* had deliberately and (at least in relation to one of the relevant years of account) dishonestly paid unlawful dividends.

109. In *Paycheck* in the Court of Appeal ([2010] Bus LR 259), a similar argument based on *Target Holdings* was advanced. Rimer LJ rejected it, at [96], concluding that the basic remedy was one of restitution because directors, if not trustees in the strict sense, owe a duty as a trustee not to misapply the company's assets, and referring among other things to the judgment of Robert

Walker LJ in *Bairstow* (above). In the Supreme Court, Lord Walker (at [124] to [125]) and Lord Clarke (at [146]) agreed on this issue with Rimer LJ.

110. The first, second and fifth defendants in this case advance a different argument to that run in *Bairstow* and *Paycheck*. Mr Hinks submitted, not that the directors' liability was limited to loss caused to the Company, but that they were liable (subject to any defence based on s.1157 of the 2006 Act) for the Distribution *to the extent that it was unlawful*, that is to the extent that the October management accounts (once adjusted by a reduction of the distributable profits to reflect the creditor cut-off and accruals issues) did not reveal sufficient distributable reserves.

111. In my judgment, the defendants' approach is to be preferred both as a matter of principle and on authority. So far as authority is concerned, that was the conclusion reached by HHJ Richard Seymour in *Re Marini Ltd* [2003] EWHC 334 (Ch), at [48] to [50]. As a matter of principle, there is a difference between (1) seeking to justify an unlawful dividend on the basis that the company could have done something different which would have enabled it to make a distribution in the relevant amount and (2) a dividend which, on the basis of what the company in fact did (and the accounts which it in fact had in front of it) was only out of capital as to part of the payment.

112. Accordingly, the liability of the directors to compensate the Company in respect of the Distribution is limited in amount by reference to that part of the Distribution which was made out of capital and thus in contravention of Part 23.

113. It was common ground that the directors also owed the statutory duties set out in s.171, 172 and 174 of the 2006 Act: (1) to act in accordance with the company's constitution and not to make dispositions which are *ultra vires* the company; (2) to exercise powers only for the purposes for which they were conferred; (3) to act in ways which they considered, in good faith, would be most likely to promote to the success of the company, including the duty to act in the interests of creditors where the company is, or is likely to become, insolvent; and (4) to exercise reasonable care, skill and diligence.

Liability of LFO in respect of the Distribution

114. I will consider, first, the liability of LFO in respect of the Distribution. It is common ground that the knowledge of Mr Sutherland, Mr Craig and Mr Davidson is to be imputed to LFO.

115. In my judgment each of Mr Sutherland, Mr Craig and Mr Davidson was aware of all of the facts which give rise to the legal conclusion that the Management Charge was in substance a voluntary distribution. They knew, in particular (as I have already found), that at no time prior to their approval of the Management Charge had there been any discussion, let alone any decision or agreement, that the Company would reimburse LFO. They also knew (because it was obvious on the face of the October management accounts) that a distribution in the sum of the Dividend plus the Management Charge would exceed the amount of distributable profits.

116. LFO accordingly knew the same, such that it was aware of the facts which rendered the Distribution unlawful (at least to the extent that the amount of the Distribution exceeded the distributable profits as disclosed in the October management accounts) and therefore knew or had reasonable grounds for believing that the Distribution was made, to that extent, in contravention of Part 23 of the 2006 Act. That is so whichever view is taken – that of Arden LJ or Chadwick LJ in the *It's a Wrap* case – as to the meaning of "has reasonable grounds for believing".

117. Whether LFO also knew or had reasonable grounds for believing that the Distribution was made in contravention of Part 23 to the further extent that it exceeded the distributable profits which should have been stated in the relevant accounts (i.e. £428,057) depends on the knowledge of the directors of LFO of the fact that the October management accounts overstated the Company's distributable profits by a further £178,000. I consider the knowledge of Mr Craig and Mr Davidson in detail below (when addressing their personal liability). Since, however, Mr Sutherland was a director of LFO (particularly as he was the director with primary responsibility for preparing the accounts of the Company), even if he alone had the requisite knowledge, that is sufficient to fix LFO with liability.

118. I have referred above to the fact that Mr Sutherland was prompted, by an email from Cook & Co of 8 November 2011, to appreciate that there may have been an understatement of the Company's liabilities in the 2010 audited accounts (and that this would have carried through into the subsequent management accounts, including the relevant accounts), and that he had appreciated the full extent of this (i.e. that there was a net understatement of £178,000) by the end of December 2011 at the latest.

119. In the absence of any evidence from Mr Sutherland himself, it is necessary to draw inferences from such evidence as there is. There is nothing inherently unfair in doing so, notwithstanding that Mr Sutherland was not able to defend himself, since he was a director of LFO (to which his knowledge is to be imputed) and LFO has played a full part in the proceedings.

120. Neither Mr Craig nor Mr Davidson has any recollection of Mr Sutherland telling them at any time that an adjustment was required to the 2010 audited accounts. (I address this point further when considering their own potential liability below, but for present purposes the relevant point is that they do not provide any evidence *against* Mr Sutherland on this issue.)

121. Mr Lucas said in his statement that Mr Sutherland had told the board meeting on 21 November 2011 that a prior year adjustment (i.e. to the accounts for the year ending 30 June 2010) had been approved, but without giving specific details. He also said that Mr Sutherland had told him about the prior year adjustment in the weeks prior to the board meeting. In his oral evidence, he reiterated that Mr Sutherland, who had sat at a desk opposite him, had indeed told him about the prior year adjustment before the board meeting. He was less clear, however, about whether it had been mentioned in the board meeting, saying that he thought there had been prior deductions discussed at the meeting, and that he assumed that they were talking about the one that Mr

Sutherland had told him about before. He does not say that he told any of the other directors prior to the board meeting what Mr Sutherland had told him.

122. I place little weight on Mr Lucas' evidence on this point. It is clear that Mr Sutherland was working on various matters relating to the 2011 audit in the run-up to the board meeting. Given, as he accepted, Mr Lucas had no understanding of accounting matters I am doubtful that he would be able to recollect, at this distance in time, having been told about a specific adjustment to the 2010 accounts.

123. I accept (as the defendants contended) that it is unlikely that Mr Sutherland had concluded his work on the adjustments to be made to the 2010 audited accounts by the time of the board meeting. I accept therefore that he had not by then concluded that there was an understatement of liabilities in those accounts (and thus the ensuing monthly management accounts) in the sum of £178,000. That is because, had he known that, he was bound to have concluded that the amount of the Dividend (£500,000) was less than the distributable profits following the adjustment (£428,057) and so could not be lawfully made. It is also inconsistent with the document he sent himself on the morning of the board meeting which identified an increase in liabilities of only £100,000. There is no evidence that Mr Sutherland was other than honest. I find it unlikely, therefore, that he would knowingly have caused the directors to declare an unlawful dividend.

124. I am satisfied, however, on the basis of the contemporaneous documents, particularly the spreadsheets referred to at [33] above, the document Mr Sutherland emailed to himself on the morning of the board meeting and the subsequent adjustment to the October management accounts, that Mr Sutherland knew three things: first, he had by this time appreciated that there was a problem with the understatement of liabilities in the 2010 accounts and, therefore, the subsequent management accounts (prompted by Cook & Co's email of 8 November 2011) and he had done a significant amount of work on this by the time of the board meeting; second, his work to that point indicated that liabilities appear to have been understated in the accounts to the year ending 30 June 2010 by about £100,000; and, third, that since his work was ongoing he could not be sure that, ultimately, the liabilities would not turn out to have been overstated by a greater amount.

125. In my judgment, that knowledge of Mr Sutherland is sufficient to constitute reasonable grounds for believing that to the extent that the Distribution exceeded £428,057 (being the amount of distributable profits once the creditor cut-off issue and the accruals issue was resolved), it contravened Part 23. That is so even if the test is as defined by Chadwick LJ in the *It's a Wrap* case (above).

126. In the language of Chadwick LJ at [54], a person who knows that there is an error in the relevant accounts such that the amount of distributable profits is overstated, but who does not know the precise amount of the overstatement because they have not completed their work on the issue, must be taken to know, or have reasonable grounds for knowing, that the overstatement is in the sum which it eventually turns out to be. The only reason such a person does

not know the actual amount is because they have chosen not to bottom the issue out so as to find out. This is not merely knowledge which a person would have had but for their negligence, and is more akin to 'blind-eye' knowledge which Pill LJ, in *Swain v Ram Puri* (above) at p.446, considered sufficient to constitute reasonable grounds for belief. If the test is as defined by Arden LJ in *It's a Wrap*, then there is no doubt that LFO's knowledge (through Mr Sutherland) is sufficient to render it liable to repay that part of the Distribution rendered unlawful by the misstatement of distributable profits in the October management accounts.

Liability of the directors in respect of the Distribution

127. I turn to the position of the other directors. As a starting point, I accept that they would have had no reason to be alerted to the possible understatement of liabilities in the relevant accounts unless Mr Sutherland told them about it. That is because the tasks of preparing the accounts and liaising with the auditors were delegated to Mr Sutherland, someone with relevant expertise, and the auditors had signed off on the annual accounts for the year ending 30 June 2010 (from which the problem stemmed) without noticing the issue.

128. The claimant contends that the defendants must have known of the possibility, at least, that the Company's liabilities were understated in the relevant accounts, and relies on the numerous references to "audit issues" or "audit queries" in the contemporaneous documents. I have referred to some of these above, but draw them together here:

(1) The first mention of audit issues is in an email from Ms Lowe of Cook & Co to Mr Sutherland and Ms Seaborne of 3 November 2011. That relates solely to the LFO audit. The only point of relevance to the Company is the reference to reconciliation of the intercompany balances. That however, related only to the fact that there was a different figure for "creditor" in LFO's books to the figure for "debtor" in the Company's books. The email made no reference to a possible management charge to be levied on the Company.

(2) The first mention of audit issues relating specifically to the Company is in the email from Ms Tulloch of Cook & Co to Mr Sutherland of 8 November 2011. Although, as I have noted above, this referred to the creditor cut-off issue and the accruals issue, it did so solely in connection with the audit of the 2011 accounts.

(3) The first document indicating that Mr Davidson or Mr Craig were aware of any audit issues is Mr Davidson's email to (among others) Ms Seaborne, Mr Sutherland and Mr Craig of 14 November 2011. He referred to a "post year end adjustment" and to responses to 17 points for a management/audit meeting. The latter is most likely a reference to the email from Ms Lowe referring to the LFO audit (as it was that email that contained 17 points). As to the former, it is not clear whether the "post-year adjustment" related to the 2010, or 2011, accounts.

(4) On 15 November 2011, Mr Sutherland responded to emails from Mr Johnston asking him whether he wanted the "year end process run on access accounts for [the Company]"). Mr Sutherland's reply requested him to "hang fire" for the moment, as he still needed to "process a few adjustments for the year end accounts."

(5) On 17 November 2011 Mr Craig emailed all the other directors to set up the board meeting as, among other things, "there are answers to be given to audit queries". The agenda for the board meeting included reference to "audit issues" and "adjustments to be agreed" under the heading "Report on Financial Position".

(6) In his email of 18 November 2011 Mr Craig asked Mr Sutherland what were the "outstanding audit points".

(7) Mr Sutherland sent himself his "aide memoire" on the morning of the board meeting which referred both to the creditor cut-off issue (indicating a net increase in liabilities to the 2010 accounts of £100,000) and the potential "cross-charge" from LFO in respect of staff, transport and transfer pricing.

(8) The draft minutes of the board meeting referred (under the heading "Draft Statutory Accounts to 30th June 2011 and Audit Queries") to the auditors having raised various queries, "amongst which" was the lack of a cross charge from LFO for the time and travelling expenses of LFO's staff engaged in the Company's business.

129. As I have already noted, neither Mr Craig nor Mr Davidson recalls being told anything at all about an adjustment having to be made to the accounts for the year ending 30 June 2010 by reason of the creditor cut-off issue or the accruals issue, or about a similar adjustment having to be made to the October management accounts.

130. As for the numerous references to "audit issues" in the documents, Mr Craig was adamant in his oral evidence that the only issues of which he had been made aware were that "the auditors were very keen to square off balances between the companies", that "the auditors were asking for the intercompany balance to be tidied up" and that they were to do with the "settling of the intercompany balance".

131. Both he and Mr Davidson said that, at the board meeting itself, the only audit issues discussed related to the Management Charge. There is some support for this in the draft minutes of the board meeting, in that the only issue specifically mentioned under the heading "Audit Queries" was the lack of a cross-charge.

132. In his written evidence Mr Craig said that he was very clear that neither Mr Sutherland nor anyone else had told him in advance of or at the board meeting that there was any issue with the 2010 accounts or the October management accounts. Had he been aware, then he would have wanted to know the impact on the Company's ability to declare a dividend. As a possible explanation of

why Mr Sutherland would not have raised the issue, Mr Craig suggested in oral evidence that Mr Sutherland would only inform them of the issue once he had considered the full amount of the adjustment.

133. When asked why the Dividend was in the sum of £500,000, when the October management accounts indicated there were sufficient distributable profits to declare a dividend in a sum of £600,000, Mr Craig said that the £500,000 figure had come from Mr Shirlaw of SSCL as the amount needed to reduce the value of the Company in the books of LFO. There was nothing to this effect in Mr Craig's witness statements. Nor is there any documentary record of Mr Shirlaw having required a dividend to be paid in the sum of £500,000. The debt owed by LFO was, between June 2011 and November 2011, in excess of £900,000. I consider that Mr Craig was therefore mistaken in saying that the reason the Dividend was in the sum of £500,000 was due to that being a specific requirement of SSCL.

134. Mr Davidson said in his witness statement that while he cannot recall doing so, he believes he would have asked Mr Sutherland and Mr Craig whether they were satisfied that an interim dividend could have been paid and would have "taken it on their advice". He did not recall the document Mr Sutherland sent to himself on the morning of the board meeting being discussed either at the breakfast meeting or at the board meeting itself. He said that while there was some discussion at the board meeting of assuming a management charge to LFO, he does not think it was in the level of detail referred to in Mr Sutherland's document.

135. In contrast to Mr Craig, Mr Davidson said that the references to audit queries in the emails prior to the board meeting (including his own of 14 November 2011) were to a range of points that had been raised by Cook & Co. In some of his answers in cross-examination, it appeared that Mr Davidson was accepting that he was aware that there was an issue with the 2010 audited accounts. In view of the fact that in places the questioning did not clearly distinguish which year of account was being referred to, I accept Mr Davidson's subsequent clarification that he understood all points raised by Cook & Co to relate to the 2011 audit. He also explained that he considered that the level of adjustment that was needed to the 2011 accounts was in the region of £30,000, and he did not imagine that it would be more than £100,000. He did not recall Mr Sutherland telling him or the other directors at any time that there was a creditor cut-off issue relating to the 2010 accounts in the sum of £100,000.

136. I do not accept Mr Craig's evidence that the only issues identified by the auditors in the run up to the board minute related to the inter-company cross-charge. On the contrary, I do not think that Cook & Co had raised that issue at all. Not only is there no evidence that Cook & Co ever told Mr Sutherland or anyone else that the accounts should reflect a debt due from the Company to LFO in respect of the matters that were later included in the Management Charge, it is unlikely that they would have done so for three reasons:

(1) Cook & Co had signed off on an audit of the year end accounts for 2008 to 2010 inclusive, in circumstances where those accounts had contained no reference to any indebtedness from the Company to LFO;

(2) Those accounts had, on the contrary, stated a substantial indebtedness from LFO to the Company, increasing year on year; and

(3) The impetus for the offsetting charge came from SSCL.

137. The only point Cook & Co had raised in relation to the intercompany position, as I have noted above, was the need to reconcile the amounts shown as debtor (in the Company's books) and creditor (in LFO's books). I conclude that Mr Craig – insofar as he recollects that the Management Charge was an issue raised by the auditors – was confusing this with the reconciliation of the inter-company debt.

138. Equally, however, I find that none of the audit issues raised <u>by Cook & Co</u> prior to the board meeting of 21 November 2011 related to the creditor cut-off issue or accruals issue in relation to the 2010 accounts. As I have explained above, that was an issue which Mr Sutherland himself had spotted, having been alerted by Cook & Co to a similar issue with the 2011 audit.

139. The critical question, therefore, is whether Mr Sutherland raised that issue with the other directors, whether in advance of the board meeting or at it.

140. Notwithstanding Mr Craig's and Mr Davidson's evidence that Mr Sutherland did not do so, for the following reasons I find on the balance of probabilities that at the board meeting on 21 November 2011 (if not also at the breakfast meeting on that date), Mr Sutherland referred to the fact that on the basis of his work (which was ongoing) there appeared to be an overstatement of distributable profits in the 2010 audited accounts and the October management accounts of around £100,000.

141. First, given my finding that Mr Sutherland had himself appreciated the problem before the board meeting, it is inherently likely that he would have brought it to the other directors' attention. Moreover, it is likely that he did so at the board meeting, given that it was the first board meeting for three years and it had been called (as Mr Craig's email of 17 November 2011 indicated) because there were "answers to be given to audit queries" and, to Mr Sutherland's knowledge at least, to consider the declaration of an interim dividend.

142. Second, that conclusion is reinforced by the document which he sent to himself identifying an understatement of liabilities in the 2010 audited accounts in the sum of £100,000. As I have already noted, the most likely inference to be drawn from his action in sending it to himself immediately before meeting with the other directors is that he needed it for the purposes of the meeting later that morning.

143. Third, there had been no written response to Mr Craig's email of 18 November 2011 asking Mr Sutherland to respond by Sunday night on three questions, including as to the outstanding audit points. Mr Craig's evidence was that his questions were answered on the Monday morning by being provided with the October management accounts. That is unlikely, however, as there is nothing in those accounts which addressed the "outstanding audit points". It is inherently more likely that Mr Sutherland answered Mr Craig's queries in person on the Monday morning, there having been no other opportunity to do so.

144. Fourth, the fact that Mr Sutherland believed the amount of the misstatement in the accounts at that stage to be £100,000 is significant, because that alone would not have rendered the Dividend unlawful. Seen in that light, the lack of recollection of the directors of this being mentioned is less significant. The fact that they were given this information is not, for example, inconsistent with Mr Craig's evidence that the main information from Mr Sutherland at the breakfast meeting was that there was sufficient balance on the profit and loss account to pay the Dividend.

145. An important question is whether Mr Sutherland told the other directors that the misstatement was in the precise sum of (or no more than) £100,000, or whether he told them that he believed (or was even confident) that the misstatement was in the sum of £100,000 but that his work had not finished. In trying to square my finding as to Mr Sutherland's knowledge with the accepted fact that neither he nor the other directors were dishonest, I conclude that the latter is more likely. While it meant the directors would have been taking a risk that the misstatement may turn out to be more, they were not approving a dividend in a sum which they knew, on the basis of the financial information they had (ignoring the Management Charge) to be in a sum greater than the Company's distributable profits.

146. Fifth, I am reinforced in this view by the evidence both Mr Davidson and Mr Craig gave as to their reaction when they discovered, within a matter of weeks, that the misstatement in the accounts was in fact much worse, such that the Dividend had certainly been paid at least in part out of capital, and the combined effect of the declaration of the Dividend and the Management Charge was to cause the Company to become insolvent. Notwithstanding the seriousness of this, on learning it, neither of them was prompted to do, or it appears say, anything at all.

147. Mr Davidson's evidence was that he accepted he would have appreciated this from the November management accounts, but that his priority was in trying to get "the transaction" completed, by which he meant the investment by SSCL in LFO, and that he did not give sufficient attention to the payment out of capital. It was put to Mr Craig that the negative position indicated by the November 2011 management accounts would not have concerned him "because you knew that you had an overall solution coming along", to which he responded "exactly". He, too, was referring to the plan to sell the Company and to recapitalise LFO. He acknowledged that the Company itself would need to be recapitalised, but expected that would be done by its new owners.

In short, both men were focussing on the future of LFO, trusting that the Company's new owners would address the need to recapitalise it.

148. Sixth, this provides further support for discounting the fact that neither Mr Craig nor Mr Davidson remembers the issue being raised by Mr Sutherland. Given that they did not do, or say, anything when they found out that the Dividend must have been paid in part out of capital, this is not a case where I can draw an inference in their favour by reason of the fact that, *had* Mr Sutherland told them what I have found he knew, they would be bound to have reacted to it by not approving the Dividend.

149. So far as Mr Lucas is concerned, as I have noted, his evidence was that Mr Sutherland had indeed told the directors at the board meeting of the prior year adjustment to the 2010 accounts. Although I have placed little weight on Mr Lucas' recollection in this respect, it in fact accords with the conclusion I have reached based on the inherent probabilities arising from the other available evidence.

150. Finally, part of the problem in identifying the facts on this issue is that no minutes (other than draft minutes) were ever produced of the board meeting on 21 November 2011 and those draft minutes record no discussion at all as to the propriety of the dividend by reference to the distributable profits disclosed in the October management accounts. That is not a point, however, which counts in favour of the directors, as it was the responsibility of all of them to ensure that proper books and records were maintained: see s.386 of the 2006 Act and *Re Mercury Solutions UK Ltd* [2009] BCC 190, at [17].

151. Turning to the liability of the directors in light of these findings of fact, I consider that each of Mr Craig, Mr Davidson and Mr Lucas failed to comply with the standard required of directors. I stress that there is no question of any of them having acted dishonestly, and I consider separately below whether any of them ought to be excused from liability under s.1157 of the 2006 Act.

152. So far as the recharacterization of the Management Charge is concerned, I have already held (at [115] above) that Mr Craig and Mr Davidson were aware of the facts which rendered the Management Charge in substance a voluntary distribution. I am satisfied that Mr Lucas knew the same. While I accept that they genuinely believed the Company had benefitted from services and goods provided by LFO, and that they genuinely believed that they were entitled to cause the Company to assume a liability to pay for those services and goods, on the basis of the test at [104] above, their knowledge of facts which rendered this a voluntary distribution is sufficient to render them culpable for breach of duty in respect of the Distribution at least to the extent that it exceeded the distributable profits as revealed by the relevant accounts.

153. It is no defence that the precise amount of the Distribution had not been identified at the board meeting (because the Management Charge fluctuated due to continued trading between the two companies). On the contrary, I consider it would be a breach of duty for directors to approve a dividend in an uncertain amount without being sure that however large it might turn out to be, it would be properly made out of distributable profits. Moreover, the directors

knew that it was the purpose of the Management Charge, together with the Dividend, to eliminate the debt due from LFO and they also knew that the relevant accounts stated that debt to be in excess of £900,000.

154. As to their liability to the further extent that the Distribution exceeded the distributable profits that should have been stated in the relevant accounts, on the basis of my finding that Mr Sutherland had brought to their attention the fact that his work to date (as at the time of the board meeting) revealed an increase in liabilities of around £100,000 and that his work was ongoing, I consider that the directors ought not to have gone ahead and approved the Distribution without satisfying themselves that there were in fact sufficient distributable profits for that purpose.

155. Though I think it is inherently likely that Mr Sutherland expressed his belief, even confidence, that the Dividend could nevertheless be paid, it was not sufficient for the other directors to rely on that assurance, once the misstatement in the October management accounts had been raised, without having satisfied themselves that the point had been fully investigated and addressed. I consider that a prudent director acting in accordance with the duty to act in the best interests of the Company would not so have relied, but would have required the work to be completed by Mr Sutherland so that the relevant accounts could be prepared on an accurate basis. Not to do so constituted a failure to take reasonable care that the relevant accounts gave a reasonable view of the profits available for distribution.

156. The most likely explanation for their failure to do so, in the case of Mr Craig and Mr Davidson, given their evidence referred to at [147] above, is that they were focused not on the interests of the Company as a separate entity but on the "overall solution" involving the sale of the Company and recapitalisation of LFO. While understandable, particularly in circumstances where LFO was itself in financial difficulties so that the value of the debt due to the Company from LFO was already in doubt, I consider that this nevertheless constituted a breach of duty. Mr Craig and Mr Davidson were subject to an inherent conflict of interest in connection with the Distribution, given their role as directors of LFO. In acting as they did I consider that they gave undue consideration to the interests of LFO and failed to give proper consideration to those of the Company as a separate economic entity. It was not enough to hope that the Company's new owners (whoever they may be) would address its lack of capital.

157. It is relevant in reaching this conclusion that the Company was known to be in serious financial difficulties, that things were likely to get worse over the next few months (during the quiet trading period), that if the liabilities were understated by even £100,000 the Dividend and Management Charge would have left the Company, even on the numbers as presented to the board meeting, with virtually no net assets and, as it turned out (and as the directors would have found out within a matter of weeks) they left the Company insolvent, with net liabilities of £142,000.

158. While it is unnecessary to investigate the extent to which the directors' conduct amounted to a breach of any of the other statutory duties, it is clear that this at least constituted a failure to act in the interests of creditors at a time when the company was or likely to become (as a result of the Distribution) insolvent.

159. So far as Mr Lucas is concerned, notwithstanding his overall defence that he relied wholly on the other directors who he regarded as having relevant accounting and financial expertise, I do not accept that his lack of financial expertise is an answer to the claim that he too was in breach of duty. As Mr Cook pointed out, a director has an individual responsibility to "inform himself about [the company's] affairs and to join with his co-directors in supervising and controlling them" (*Re Westmid Packing Service Ltd (No.3)* [1998] 2 All ER 124, per Lord Woolf MR at p.130a). Overall responsibility is not delegable, and directors owe "a continuing duty to acquire and maintain a sufficient knowledge and understanding of the company's business to enable them properly to discharge their duties as directors": *Re Barings Plc (No.5)* [1991] 1 BCLC 433, at p.487g and p.489a.

160. On Mr Lucas' own case, he was aware that a prior year adjustment had been made to the 2010 audited accounts, but he was prepared to accept Mr Sutherland's word that the Dividend would be paid out of distributable profits. This did not absolve him, in my judgment, of the duty to maintain sufficient knowledge and understanding of the company's business - specifically that the relevant accounts demonstrated sufficient distributable profits – to enable him to discharge his duty as director in authorising the Distribution.

161. For the above reasons, I conclude that each of Mr Craig, Mr Davidson and Mr Lucas were in breach of their duties as directors in authorising the Distribution to the extent that it exceeded the amount of £428,057, being the amount of distributable profits which should have been stated in the relevant accounts.

<u>Section 1157 of the 2006 Act</u>

162. Section 1157(1) provides that:

> "If in proceedings for negligence, default, breach of duty or breach of trust against–
>
> (a) an officer of a company, or
>
> (b) a person employed by a company as auditor (whether he is or is not an officer of the company),
>
> it appears to the court hearing the case that the officer or person is or may be liable but that he acted honestly and reasonably, and that having regard to all the circumstances of the case (including those connected with his appointment) he ought fairly to be excused, the court may relieve him, either wholly or in part, from his liability on such terms as it thinks fit."

163. On behalf of Mr Craig and Mr Davidson it was submitted that they acted honestly and reasonably in relying on Mr Sutherland's expertise and experience and that, in all the circumstances, they ought to be excused from liability. I do not accept this. Both Mr Craig and Mr Davidson were highly experienced businessmen with a clear understanding of financial statements and the legal and accounting requirements of Part 23 of the 2006 Act. My findings as to their state of knowledge of the understatement of the Company's liabilities in its accounts means that this is not a case where they are entitled to shelter behind the fact that financial matters were delegated to Mr Sutherland.

164. I also take into account the fact that within a matter of weeks it was abundantly clear to both of them that the combined effect of the Dividend and Management Charge was to render the Company insolvent and to create a deficit in the profit and loss account of over £442,000. I do not make any finding that their failure to reverse the transactions when they discovered this fact was a separate breach of duty. Although Mr Cook sought to advance such an argument during the hearing no such alternative case had been pleaded and the question whether it would have been possible, taking into account the potential interest of third parties such as SSCL as an investor in LFO, to have reversed the transaction at that point was not explored in evidence. Nevertheless, the fact that they did nothing – even to investigate that possibility – when they discovered the consequences of the transaction is relevant in considering all the circumstances for the purposes of s.1157.

165. I regard Mr Lucas, however, as being in a different position, for a number of reasons. First, he had no financial or accounting expertise at all and was as a matter of fact much more reliant on Mr Sutherland than the other directors.

166. Second, Mr Craig, Mr Davidson and Mr Sutherland were (as Mr Davidson accepted) the main decision makers on the board and Mr Lucas felt, not unreasonably, that the Company would do whatever they decided. Unlike them, Mr Lucas was not affected by any conflict between promoting the interests of LFO and those of the Company.

167. Third, this is reinforced by the very limited role played by Mr Lucas in relation to the Distribution. He had no warning, before turning up at the board meeting on 21 November 2011, that there was to be even any consideration given to a potential distribution, let alone that the meeting was being convened to authorise one. There was nothing to that effect in the agenda which he received. Unlike the other directors, he had not been sent a copy of the relevant accounts prior to the meeting. He was not invited to the breakfast pre-meeting. As he explained in his evidence, by the time of the board meeting he had been awake for something like 26 hours having unexpectedly been required to work the nightshift at the Company's premises in England before flying to Scotland early on the Monday morning. These factors combined to make Mr Lucas that much more reliant on Mr Craig, Mr Davidson and Mr Sutherland in relation to the business transacted at the meeting.

168. Fourth, Mr Lucas had no further involvement with either the Dividend or the Management Charge after the board meeting. He was not sent either version of the draft minutes and he played no part in approving the amount of the Management Charge or effecting the accounting entries which gave effect to it or the Dividend.

169. While these factors do not mean that Mr Lucas was not in breach of duty as a director, they are sufficient in my judgment to mean that he should be relieved of liability pursuant to s.1157. Accordingly, I do not make any order against Mr Lucas requiring him to compensate the Company in respect of his breach of duty.

Conclusion

170. For the above reasons, I conclude that:

(1) LFO is liable pursuant to s.847 of the 2006 Act to repay the sum of £316,859 in respect of the Distribution;

(2) Mr Craig and Mr Davidson are liable, by reason of breach of duty as directors of the Company in authorising the Distribution, to compensate the Company in the sum of £316,859; and

(3) Mr Lucas, while liable for breach of duty as director in authorising the Distribution, is excused from all such liability pursuant to s.1157 of the 2006 Act.