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Case No: 3393 of 2013

IN THE HIGH COURT OF JUSTICE
BUSINESS AND PROPERTY COURTS AT MANCHESTER
INSOLVENCY AND COMPANIES LIST (ChD)

IN THE MATTER OF BROOKMANN HOME LIMITED (IN LIQUIDATION)
AND IN THE MATTER OF THE INSOLVENCY ACT 1986

Date: 29 September 2021

Before :

His Honour Judge Halliwell (sitting as a Judge of the High Court)

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Between :

(1) ELLIOTT HARRY GREEN (as liquidator of Brookmann Home Limited)
(2) BROOKMAN HOME LIMITED

Applicants

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and

(1) CHARLES JOHNSON
(2) MYRON MANN

Respondents

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Mr Steven Fennell (instructed by **Oury Clark Solicitors**) for the **Applicants**
Mr Paul O'Doherty (instructed by **Keystone Law**) for the **First Respondent**
The Second Respondent in person

Hearing dates: 5th, 6th, 7th, 10th, 11th, 12th, 13th, 14th May, 11th June 2021

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APPROVED JUDGMENT

This Judgment was handed down remotely by circulation to the parties' representatives by email. It will also be released for publication on Bailii. The deemed date for hand-down is 29 September 2021.

His Honour Judge Halliwell :

(1) Introduction

1. By these proceedings, the liquidator of Brookmann Home Limited (Company no. 07568206) ("**the Company**") seeks to recover from two directors upwards of £1,225,000, made up of amounts alleged to have been improperly or unlawfully paid to them ("**the Payments**") from the assets of the Company between 23rd May 2011 and 7th January 2013. The Company never traded but, in May 2011, it purchased the shares of another company, Brookmann Home Manchester 1877 Limited (Company no. 00011136) ("**1877**"), under a leveraged transaction in which most of the purchase price was raised from monies advanced to 1877 itself under a factoring agreement in respect of its long established textiles business. It is a feature of the case that 1877 itself went into administration in November 2013.

2. The liquidator of the Company is Mr Elliott Harry Green ("**Mr Green**") and the two directors are Mr Charles Johnson ("**Mr Johnson**") and Mr Myron Mann ("**Mr Mann**"). At the hearing before me, Mr Steven Fennell, of counsel, appeared on behalf of Mr Green and the Company. Mr Paul O'Doherty appeared on behalf of Mr Johnson and Mr Mann attended in person. The hearing was conducted remotely using Microsoft Teams with Mr Mann in Australia.

3. Mr Green contends that the Payments were not authorised under the Company's Articles. He also contends they were made at a time the Company was insolvent without proper regard for the Company's creditors and he contends that they were made at an undervalue within the meaning of *Section 238(2)* of the *Insolvency Act 1986.* To successfully establish his case, he must show that, although the Company never traded and the Payments were essentially made from funds advanced to 1877 under the factoring agreement, they were made from the Company's assets or can somehow be treated as having been made from assets at the Company's free disposal.

4. Messrs Johnson and Mann do not deny the Payments. However, to the extent necessary, they maintain the Payments were authorised by the Company under its Articles. They also deny that the Company was insolvent at any time material to the claim and they contend that, as remuneration for their services to the Company, the Payments cannot properly be characterised as transactions at an undervalue.

5. For the sake of completeness, Mr Green accepts that his misfeasance claim is barred by limitation, under *Section 21(3)* of the *Limitation Act 1980*, in respect of payments made more than six years before the commencement of proceedings. However, relying on *Section 21(1)(b)* and *Burnden Holdings UK Limited v Fielding [2018] UKSC 14*, he submits this does not bar claims against a respondent in receipt of such payments. With this submission, the Respondents do not take issue.

(2) Background

6. Messrs Johnson and Mann have long business experience in connection with the sale and purchase of textiles. Mr Johnson has historically operated from the USA and England, and Mr Mann from Australia. However, each have utilised their international connections and, for several years, they collaborated or carried on business in partnership as Brookmann Global Sourcing Group ('**BGSG**"). This included sourcing products for US retailers from factories in the Far East. Their international connections included Hanung Toys and Textiles Limited ("**Hanung**"), textile manufacturers and suppliers in the India.

7. In early 2011 or thereabouts, Messrs Johnson and Mann became aware of an opportunity to acquire the assets and business of 1877. Although 1877 was, by then, loss making, it had substantial assets and a turnover of more than £30 million. Messrs Johnson and Mann believed that, with their business experience and connections, they would be able to turn the business round.

8. The Company was formed on 17th March 2011 as a vehicle for the acquisition of the assets and business of 1877. It was incorporated with 2,250,000 shares of 1p each. 1,500,000 shares were allotted to Brookmann Holdings Limited ("**Brookmann (IOM)**"), a company registered in the Isle of Man, under the control of Messrs Johnson and Mann. The remaining 750,000 shares were allotted to Hanung. On incorporation, Messrs Johnson and Mann were appointed as the Company's first directors. Two months later, on 9th May 2011, Mr Ashok Kumar Bansal, was also appointed a director on the nomination of Hanung.

9. At this stage, the entirety of the issued share capital in 1877 was vested in Vantona Limited ("**Vantona**"), a company registered in Scotland under Co. no. SC271027. Vantona Limited was itself a subsidiary of Dawson International plc ("**Dawson**"), a company registered in Scotland under Co. no.SC054505.

10. Negotiations for the sale of 1877's assets ensued. Ultimately these evolved into negotiations for a share purchase transaction and, on 17th May 2011, the Company entered into an agreement ("**the SPA**") with Vantona and Dawson for the sale of the shares. The SPA was signed as a deed and provided for Vantona to sell and the Company to purchase all the issued shares in 1877 for an amount equal to the value of 1877's net assets less £2,000,000. The value of 1877's net assets was to be calculated afterwards following the preparation and approval of "Completion Accounts" subject to an initial payment of £4,000,000. Dawson entered into the SPA in order to make warranties and indemnify the Company in respect of its losses. Dawson warranted that the Company had been provided with a materially complete and accurate list of 1877's creditors.

11. By the time the Company entered into the SPA, it appears Mr Mann had drawn up a shareholders' agreement ("**the Shareholders' Agreement**") in anticipation that it would be signed on behalf of the Company's only shareholders, Brookmann (IOM) and Hanung. A copy of the Shareholders' Agreement was admitted in evidence, signed and sealed on behalf of Hanung only. None of the parties to the current proceedings have sought to challenge the Shareholders' Agreement or suggest it was not binding upon Brookmann (IOM) and Hanung as shareholders. However, whilst it may have been based on a standard precedent, it does not appear Mr Mann instructed lawyers in connection with the preparation of the document and is to be interpreted with caution.

12. The transaction was funded from capital introduced by Hanung for its shares in the Company and a loan facility from Leumi ABL Limited ("**Bank Leumi**"), a subsidiary of Bank Leumi (UK) plc. Hanung introduced the sum of £750,000. Bank Leumi's loan facility of up to £4,000,000 was based on a factoring agreement dated 17th May 2011 in respect of 1877's book debts. Although the Company utilised the loan to make the initial payment of £4,000,000, it was not a party to the loan. The parties to the loan were Bank Leumi and 1877. To this extent, 1877 assisted in the purchase of its own shares.

13. Following the SPA, Mr Malcolm Hunt remained in office as 1877's company secretary. On 8th June 2011, he emailed draft completion accounts to Dawson with 1877's net assets quantified in the sum of £6,910.115. Shortly afterwards, however, Mr Hunt was removed from office.

14. Mr David Cooper was Dawson's Group Finance Director. On 8th July 2011, he emailed Messrs Johnson and Mann to advise them that, following an adjustment of £439,946, 1877's net assets amounted to some £6,471,169 leaving an outstanding balance of £471,169. In the expectation that further monies were payable to Vantona, the Company started to make additional payments but completion accounts were never formally agreed. Mr Mann later perceived there were irregularities in 1877's accounts, particularly in relation to the treatment of its main customers, Dunelm Group plc or companies within the Dunelm Group (together "**Dunelm**"). This was at least partly on the basis they had entered into a course of dealing under which Dunelm was entitled to claim credit retrospectively for discounts to the price of its own stock without corresponding accrual provision in 1877's accounts. It instructed Freeth Cartwright LLP ("**Freeth Cartwright**") as its solicitors in the ensuing dispute with Dawson and Vantona. By letters dated 18th April and 16th May 2012, Freeth Cartwright challenged the draft completion accounts and contended that, by virtue of the accounting irregularities, Dawson was in breach of its warranties to the Company and its duty indemnify it in respect of losses.

15. It appears that, in December 2011, Brookmann (IOM)'s shares in the Company were transferred to a Hong Kong company bearing the same name under the control of Messrs Johnson and Mann ("**Brookmann (HK**)"). A draft agreement between Brookmann (IOM), Brookmann (HK) and Messrs Mann and Johnson was admitted in evidence recording the transfer of the shares on 20 December 2011 and providing for Brookmann (HK) to assume the obligations and liabilities of Brookmann (IOM) to Messrs Mann and Johnson. More likely than not, this was signed and completed. By an agreement in writing dated 21st December 2011, Hanung also agreed to sell its shares in the Company to Brookmann (HK). However, there is nothing to suggest this transaction was completed and, following the agreement, Mr Bansal remained in office as a director of the Company. It was not suggested on behalf of any of the parties to these proceedings, that Brookmann (IOM), Brookmann (HK) and Hanung ever entered into a novation.

16. With a view to the withdrawal of their loan facility, in April 2012, Bank Leumi engaged Baker Tilly LLP ("**Baker Tilly**"), accountants, to conduct a financial review of 1877. In their Report dated 22nd June 2012, Baker Tilly noted a deterioration in the level of communication and engagement between 1877 and the Bank. They were critical of the

timeliness and accuracy of the information 1877 had provided to the Bank and were not content to rely on 1877's forecasts for the following year. However, they were also aware that 1877 was seeking alternative finance and indicated that this should be encouraged. They examined 1877's accounting records and management accounts to assess the company's trading performance and management strategy. After adjustments for exceptional items, it was surmised that the company had made a profit of approximately £483,000 in the year ending on 31st March 2012 and its net assets were valued at £4,340,000.

17. As anticipated, 1877 later obtained alternative finance from Aldermore Bank plc ("**Aldermore**"). It did so, in July 2012, subject to a review limit of £2,000,000.

18. On 15th August and 2nd November 2012, Dawson and Vantona respectively went into administration. When they did so, Completion Accounts under the SPA had still not been agreed nor, indeed, had the Company's claim against Dawson for breach of warranty.

19. On 28th May 2013, 1877 entered into a CVA. A Statement of Affairs was produced showing an estimated deficit to creditors of £4,323,266 as at 8th May 2013. In their Proposal dated 8th May 2013, Messrs Johnson and Mann suggested that 1877 had insufficient working capital to meet its continuing requirements. They referred, in particular, to a debit note of approximately £720,000 issued by one of its largest customers which the company had little choice to accept and a further debit note issued by another significant customer in respect of pricing and order discrepancies. These were references to historic issues arising from its trading relationship with Dunelm and Marks & Spencer Group plc ("**Marks & Spencer**"), including Dunelm's claims for discounted stock.

20. On 24th June 2013, the directors approved annual accounts for 1877 in the year ending on 31st March 2012 showing a loss of £353,207 and net assets of £3,501,548 after provision for additional liabilities of £646,960 in relation to anticipated losses under onerous contracts for the sale and purchase of stock. The overall loss of £353,207 was sharply down from the loss of £3,413,655 in the previous year.

21. Nevertheless, the CVA failed and, on 25th November 2013, 1877 went into administration.

22. Meanwhile, on 5th August 2013, the Company was compulsorily wound up on the petition of Premium Credit Limited. The petition debt was £7,805.56. No Statement of Affairs in relation to the Company has been admitted in evidence and its overall indebtedness is unquantified. However, it did not trade and it can reasonably be assumed that 1877 was the Company's main creditor. When the Company went into liquidation, the dispute with Vantona had not yet been resolved and, on 24th January 2014, the administrators of Vantona thus submitted a proof of debt in the sum of £1,277,533.70.

23. On 9th October 2013, Mr Green was appointed liquidator of the Company. However, he elected not to commence these proceedings until July 2018, the best part of five years after the Company went into liquidation. The trial before me took place in May-June 2021, almost eight years after the Company went into liquidation and upwards of ten years after the SPA.

(3) Witnesses

24. I heard evidence from three witnesses, namely Messrs Green, Johnson and Mann. With the passage of time, memories have inevitably faded. At the invitation of counsel, I have borne in mind the observations of Leggatt J in *Gestmin SGPS SA v Credit Suisse (UK) Limited, Credit Suisse Securities (Europe) Limited [2013] EWHC 3560 (Comm)* and Males LJ in *Simetra Global Assets Ltd v Ikon Finance Limited [2019] EWCA Civ 1413* on the central importance of the contemporaneous documentation when evaluating the evidence as a whole. However, in view of the fact that, in the present case, there were significant gaps in the contemporaneous documentation, it has at times been necessary for me to draw inferences from the information available in such documents when considering the evidence of the witnesses and making findings of fact.

25. Mr Green was appointed liquidator of the Company on 9th October 2013, upwards of two months after it was placed in liquidation. He does not have direct knowledge of the management of the Company's affairs prior to his appointment and was critical of the limited co-operation and Company documentation provided to him by the Respondents in connection with the provision of his statutory functions. He was a careful witness who was adroit to confirm the limitations on the information available to him and was unwilling to make concessions about the case advanced by the

Respondents. His evidence was of no more than limited assistance for the purpose of resolving the main factual issues.

26. Initially, Mr Johnson made two comprehensive witness statements with a detailed narrative of the factual background. On the less contentious aspects of the case, the factual account in his first witness statement was in places helpful and illuminating. Unfortunately, however, his oral evidence was unimpressive. Whilst he appeared to have little grasp of the factual detail, this did not preclude him from giving evidence that was, at time, demonstrably incorrect or implausible. I am also mindful that, in support of an application to vacate the trial in October 2020, he deliberately allowed a misleading impression to be created about his whereabouts. Where his evidence is contentious, I have thus treated it with considerable caution, looking for corroboration from other sources and assessing the extent to which it is plausible in the light of the evidence as a whole.

27. By contrast, Mr Mann was an impressive witness who appeared to answer each question in a careful measured way to the best of his recollection. In doing so, he repeatedly demonstrated a willingness to make concessions where required to do so. For the most part his testimony was plausible and consistent with the contemporaneous documentation and I am satisfied I can generally rely on his evidence on the factual issues.

28. Nevertheless, following the liquidation of the Company, Mr Mann failed to take proper steps to preserve the Company's books and records and ensure they were delivered up to Mr Green as liquidator. This is a serious criticism. Whilst Mr Green was able to retrieve documentation from third parties, such as UHY Hacker Young accountants ("**UHY Hacker Young**"), this was incomplete and indubitably impeded Mr Green in the performance of his statutory functions.

(4) The Payments

29. In anticipation that the Company would acquire 1877's assets and conduct the business itself, a bank account was set up in the Company's name ("**the Bank Account**"). Surprising as it may seem, when the transaction was reconstituted as a share purchase agreement, steps were not immediately taken to set up an alternative bank account. Messrs Johnson and Mann were thus content to utilise the Bank Account for 1877's business transactions notwithstanding that the Bank Account was held in the name of

the Company. On this basis, funds transferred to or on behalf of 1877, including funds advanced to 1877 under its facilities with Bank Leumi, were paid into the Bank Account.

30. In their submissions before me, counsel confirmed that all transactions material to the present proceedings were funded in this way and I shall assume this to be the case although there is evidence to suggest that, in due course, 1877 opened at least one additional bank account in its own name. However, in my judgment this is immaterial since the Bank Account was entirely funded from monies paid to or for the benefit of 1877 and the same can be inferred in respect of any additional bank account that might have been opened in the name of 1877 itself. In the absence of any intention to divest 1877 of its beneficial interest, the monies are to be treated as an asset of 1877, not the Company. They were not at the free disposal of the Company. Notwithstanding Mr Fennell's submissions to the contrary, I have reached this conclusion for the following reasons.

31. In *Twinsectra v Yardley [2002] 2AC 164* at *[102]*, Lord Millett confirmed that where a lender parts with money on terms which do not exhaust the beneficial interest, a resulting trust arises in its favour. By analogy and on the same basis, the principle applies where money is credited to a bank account in the name of one party for and on behalf of another. In all such cases, the operative question is whether the parties intended the money to be at the disposal of the recipient, *Twinsectra* at *[74]* and *re Goldcorp Exchange [1995] 1 AC 74, 100.* The principle originates from the observations of Lord Wilberforce in *Barclays Bank v Quistclose [1970] AC 567* at *580* and is now well established.

32. In the present case, almost all the funds credited to the Bank Account were advanced to 1877 under its facilities with the Banks. Until July 2012, the funds were credited or transferred by Bank Leumi. If and to the extent that further monies were subsequently credited to the Bank Account, this was pursuant to the Aldermore facility. 1877's factoring arrangements with Bank Leumi provided for the monies to be credited to 1877's "Receivables Finance Account" and the Bank Account was plainly earmarked for this purpose. The funds were credited to the Bank Account for or on behalf of 1877 only. They were advanced under 1877's loan facilities in consideration of the assignment of its book debts and other obligations owed to it, no doubt in anticipation the monies advanced would be available for the discharge of 1877's business liabilities

and expenses. They were not advanced for the benefit of third parties such as the Company and they were not intended to be at the free disposal of the Company. It can reasonably be inferred that funds were advanced by Aldermore to 1877 on essentially the same basis. It has certainly not been suggested otherwise.

33. There is no evidence it was ever envisaged the Bank Account or, indeed, any other material bank account would be credited with third party monies. Although there are indications in the Shareholders Agreement that Brookmann (IOM) and Hanung may have contemplated that the Company would eventually commence business itself, the Shareholders' Agreement is to be regarded with caution. In any event, the Company never traded and at no point was it contemplated that it would trade in the immediate future. Whilst the Company was at one stage registered for VAT, this was only done for the purpose of enabling it to claim back some expenses in connection with the transaction under which 1877 was acquired. In any event, there is no evidence that money was credited to the Bank Account with the intention that it would be at the free disposal of the Company and it is inherently unlikely that this ever happened.

34. In addition to the funds advanced to 1877 by the Banks, Mr Johnson identified, in his witness statement, payments of £750.86 in respect of travel expenses and £65,951.77 in respect of commission payable to 1877 itself. Since the Company never commenced in business, there can be no good reason for it to have been introduced for the benefit of the Company nor, indeed, to be treated differently from the funds advanced to 1877 under its facilities with the Banks. It is also inherently unlikely it was ever contemplated that monies would be credited to the Bank Account with the intention that they would be held for the benefit of the Company. However, on the hypothesis this is incorrect and there was ever an understanding that this might happen, it would not operate to defeat the resulting trust in favour of 1877 in respect of the monies advanced by the Banks, see *Cooper v PRG Powerhouse Ltd [2008] BCC 588* at *[24]* and *Mundy v Brown [2011] EWHC 377 (Ch) at [27*].

35. At all material times, Messrs Johnson and Mann were directors of 1877 and the Company. However, they could reasonably be expected to make their decisions in respect of 1877 in their capacity as directors of 1877. The share capital of 1877 was held by the Company. However, the Company was not carrying on a business. In any event, on the hypothesis Messrs Johnson and Mann ever purported, in their capacity as directors, to cause it to do so, it would not have been open to them to utilise the Bank

Account for the Company's own purposes consistently with the trusts on which the same was held.

36. Between 29th May 2011 and 7th January 2013, a series of payments ("**the Payments**") were made to Messrs Johnson and Mann or their nominees from the Bank Account or the additional bank account or accounts that was subsequently opened on behalf of the Company. Messrs Johnson and Mann contend that the Payments were made to them as remuneration for services. This includes payments of £150,000 for services provided by them in connection with the acquisition of 1877 ("**the Acquisition Services**") and additional payments for their management services in respect of the business ("**the Management Services**"). In aggregate, it is now alleged that the sum of £539,113 was paid to Mr Johnson and £690,330 was paid to Mr Mann and his nominees.

37. Although the Payments were each made to Messrs Johnson and Mann from 1877's monies and, at least in the case of the Management Services, they were for services provided to 1877 itself, they were subsequently treated in 1877's accounts as having been made so as to discharge third party liabilities. This was apparently done pursuant to advice from 1877's accountants, UHY Hacker Young, in connection with the preparation of 1877's accounts for the year ending on 31st March 2012 to enlarge the assets shown on 1877's balance sheet.

38. The method by which this was achieved can be seen from a document headed "Background Information" which was sent to Mr Green in March 2014 by Mr David Symonds of UHY Hacker Young, 1877's accountants. Whilst the genesis of the document is obscure, it is plainly in the nature of a retrospective rationalisation – not least because the third party ultimately identified - Brookmann (HK) - could have had no involvement in relation to the affairs of 1877 or the Company until December 2011, some six months after the Payments commenced. In this document, Mr Symonds stated that "the entries could have been made direct from 1877 to HK to create a debit balance to 1877 but were routed through [the Company] to increase the debt due to 1877 from that company". Whilst this may have reflected some of the entries in 1877's accounts, it is plain that 1877 did not transfer any monies to the Company in respect of the Payments and, in any event, the same were never at the Company's disposal. The money was paid directly to Messrs Johnson and Mann from the Bank Account or other monies held on 1877's behalf.

(5) The Claim

39. Following the evidence, Mr Fennell refined the Applicants' case. He contends that the Payments were:

    (a) not authorised by the Company's Articles;

    (b) in breach of the Respondents' duties to have proper regard for the interests of the Company's creditors; and

    (c) transactions at an undervalue within the meaning of *Section 238* of the *Insolvency Act 1986*.

(6) Analysis

40. To succeed in establishing their case, it is necessary for the Applicants to establish only one of the grounds on which they rely. However, they must show that the money was at the free disposal of the Company and that Messrs Johnson and Mann made the Payments or purported to make the Payments in their capacity as directors of the Company or at least that they are somehow culpable for a failure to properly exercise their powers as directors of the Company itself. In my judgment, the Applicants' case fails at the outset in each of these respects. I have reached this conclusion for the following reasons.

41. Firstly, the Payments were not made from the Company's assets, they were made from the assets of 1877 (See above). Mr Fennell submits that the monies credited to the Bank Account (and, indeed any other material bank account from which the Payments were made) were not held on trust for 1877 because they were subsequently applied to discharge third party liabilities, such as the Company's liabilities under the SPA, its liabilities for legal fees and the liability of the Company or Brookmann (HK) for the Acquisition or Management Services. However, this confuses the ownership of 1877's assets (including the monies held by or on trust for it) with the application of such assets. If directors choose to authorise payments from a company's assets to meet third party liabilities, it is conceivable they will thereby expose themselves to a claim for breach of their duties as directors if shown they have done so without good reason. However, this does not, in itself, affect the nature of the trusts on which its assets are held prior to disposal.

42. Mr Fennell also submitted that the relationship between 1877 and the Company was one of creditor and debtor, not beneficiary and trustee and this precluded 1877 from contending that the Bank Account was held on trust for 1877. In support of this submission, he relied upon UHY Hacker Young's "Background Information" document. However, this submission is founded on a logical fallacy. UHY Hacker Young's "Background Information" document amounted to a retrospective rationalisation of the transactions but, regardless of the way in which such transactions are characterised, the creditor-debtor relationship was a function of the Payments themselves not the trusts on which the Bank Account was held. If and once 1877's assets were paid or treated as having been paid to or on behalf of the Company or in the discharge of its liabilities, 1877 was then entitled to be treated as a creditor of the Company.

43. Secondly, whilst Messrs Johnson and Mann plainly authorised the Payments – they do not contend otherwise – they were at all material times directors of 1877 and the Company. Since the Payments were made from assets held by or on trust for 1877 and the Management Services were for services provided for 1877, it is implicit that Messrs Johnson and Mann authorised the Payments for such services in their capacity as directors of 1877, not in their capacity as directors of the Company. The Payments for Management Services were payments for services to 1877 in respect of sales, purchases, the management of its business premises, the control and delivery of stock, the employment of staff and 1877's overall management strategy. They were not remuneration for services to the Company and there could be no reason for them to be regarded as such. It matters not whether Messrs Johnson and Mann envisaged that Brookmann (IOM) or Brookmann (HK) would ultimately be responsible for indemnifying 1877 or the Company in respect of the same.

44. Conversely, the Payments for Acquisition Services were not provided for the benefit of 1877; they were for the benefit of the Company and, ultimately, Brookmann (IOM) and Hanung. However, prior to acquisition, there was an understanding between Brookmann (IOM) and Hanung that Brookmann (IOM) would ultimately be responsible for all expenses in connection with the acquisition, including the costs of the Acquisition Services. This is accepted by the Respondents and it is consistent with clause 4.3(e) of the Shareholders Agreement which provided for Brookmann (IOM) to "…arrange adequate funds to complete the Purchase". It can thus be inferred that

Messrs Johnson and Mann authorised the Payments for Acquisition Services in their capacity as directors of all three companies on the understanding that the Payments were being made from the assets of 1877 with the intention that 1877 would ultimately be reimbursed by Brookmann (IOM). However, this leaves no room for submission that the Payments were made from the Company's assets or that they can somehow be characterised as transactions under which the Company freely exercised rights of disposal. Nor, more generally, does it leave room for a claim on behalf of the Company.

45. Relying on the judgment of Newey J in *GHLM Trading Ltd v Maroo [2012] EWHC 61 at [149]*, Mr Fennell submits that it is for the Respondents to justify the Payments not for the Applicants to establish the contrary. However, in that case, Newey J stated, in terms, that this principle applies "once it is shown that a company director has received *company* monies…" (My italics). In the present case, the Applicants have failed to establish that any of the Payments were made with the *Company's* monies.

46. The Applicants' case in relation to the Respondents' duties to have proper regard for the interests of the Company's creditors fails on the same grounds.

47. It is now established that the directors of an insolvent company are under a duty to have proper regard for the interest of the company's creditors, *Jetivia SA v Bilta [2016] AC 1* (Lord Toulson and Lord Hodge at *[123])* once they know or ought to know that the company is or is likely to become insolvent, *BTI 2014 LLC v Sequana SA [2019] BCC 631 (*David Richards LJ at *[220]).* I also accept Mr Fennell's submission that, when considering whether to authorise a transaction on behalf of a company, this requires the directors to consider whether the transaction is in the creditors' interest. However, in the present case, the Payments were not made on behalf of the Company and they were not made with the Company's money.

48. The lack of reality in this part of the Applicants' case is reflected in Paragraph 61(b) of their written Closing Submissions, in which the Payments are challenged on the basis that "…the work done by the Respondents was on any view for the benefit of 1877, not for the benefit of the Company. It was not charged back to 1877 in full". This could only be on the footing that the Payments were made from assets of the Company, not 1877, notwithstanding that they were entirely funded from advances to 1877 itself or monies received by it from its business activities. The logic of the Applicants' case

appears to be that 1877 was not entitled to apply monies advanced to it by Bank Leumi to meet its business expenses or the cost of services provided for it.

49. Similarly, the Applicants' claim under *Section 238* of the *Insolvency Act 1986* is based on the contention that, by making the Payments, the Company itself entered into transactions at an undervalue, defined so as to mean a gift or transaction providing for it to receive no consideration or a consideration for a value significantly less in money or money's worth than the consideration provided by the Company. If, as I have found, the Payments were made with 1877's monies – not the Company's - and the Company had no independent rights of disposition, this precludes a claim based on *Section 238* of the *1986 Act*, see for example, *Mundy v Brown (supra*) at [28]. There is also no room in the present case for a claim based on the proposition that the Company might have promised to procure that the Payments would be made. Whilst the Payments or at least some of them were made from a bank account in the name of the Company, they were made from monies held on trust for 1877 and at its direction. In view of the fact that the Respondents were themselves directors of 1877, it is necessarily to be inferred that they caused the Payments to be made in that capacity not least because the Management Services were provided directly to 1877 and the Acquisition Services were not for the sole benefit of the Company. It follows that the Company was not a party to the material transactions in the sense required by *Section 238(4), re Ovenden Colbert Printers Ltd [2015] BCC 615*.

50. In my judgment, this disposes of the whole of the claim. However, for the sake of completeness, I shall say a little about the way in which I would have determined the case on the hypothesis that the Payments were made by the Company itself from monies at its own free disposal.

51. On this hypothesis, I shall turn first to the question of whether Messrs Johnson and Mann can show that they were entitled to the payments under the Company's constitution. In the present case, the Company had adopted the *Model Articles* with provision, in *Article 19*, for directors to undertake services for the Company for such remuneration as the directors might decide or determine. By *Article 7(1)*, it was provided that, as a general rule, any decision of the directors must be either a majority decision at a meeting or a decision taken in accordance with *Article 8* and, by *Article 8(1*), a decision was deemed to be taken on this basis "when all eligible directors indicate to each other by any means that they share a common view on a matter".

52. Applying these provisions, the Company's eligible directors were Messrs Johnson, Mann and Bansal and this remained the case throughout the time in which the Payments were made. There was, of course, no contract of employment between the Company on the one hand and Messrs Johnson or Mann on the other. Based, however, on the oral testimony of Mr Mann, I am satisfied that all material questions in relation to the provision of their services and their remuneration and expenses for such services, including the amounts to which they would be entitled and how it was to be funded were comprehensively discussed and agreed from an early stage between Messrs Johnson, Mann and Bansal at meetings held face to face between them and by telephone. They were each experienced businessmen, and there were multiple meetings between them. The issues in relation to directors' remuneration and expenses were obviously significant and they involved the payment of very substantial amounts. It is inherently unlikely that such issues were not raised, discussed and agreed at the outset. In view of the scale of Hanung's investment, it would have been surprising had Mr Bansal not sought clarification at an early stage and it would have been equally surprising for Messrs Johnson and Mann to embark on the project and carry out significant amounts of work for a prolonged period of time without first reaching agreement with Mr Bansal about their remuneration and expenses. This is the case notwithstanding their expectations about the ultimate return on their investment. In this respect, it is significant that, in June 2012, Mr Mann travelled to the United Kingdom with his family from Australia to manage 1877 from its business premises and, indeed, continued to do so following approval of the CVA. He did so at considerable personal expense.

53. I am satisfied that Messrs Johnson, Mann and Bansal agreed that Messrs Johnson and Mann would be entitled to the sum of £150,000 as remuneration for the Acquisition Services and, subject to adjustment, £30,000 per month as remuneration for the Management Services. These amounts were to be paid from 1877's funds albeit subject to an understanding 1877 would ultimately be reimbursed by Brookmann (IOM) and, later, Brookmann (HK) at least in relation to the Acquisition Services. On this basis, I am also satisfied that the Payments were made on the understanding that had already been reached by Messrs Johnson, Mann and Bansal and in accordance with the terms of their agreement. To the extent it was thus necessary for them to be approved on

behalf of the Company, they were approved on this basis and Messrs Johnson and Mann can be deemed to have been entitled to the Payments under the Company's constitution.

54. The Applicants' case in relation to the Respondents' putative failure to have proper regard for the interests of the Company's creditors, is based on the proposition that the Company was insolvent when the Payments were made and Messrs Johnson and Mann knew or ought to have known it was or was likely to become insolvent at that stage.

55. It is well established that, for these purposes, insolvency on a cash flow or balance sheet basis suffices, *BTI 2014 LLC v Sequana SA [2019] BCC 631 (*David Richards LJ at *[213]* and *[224]).* Consistently with the judgment of Lord Walker in *BNY Ltd v Eurosail plc [2013] 1 WLR 1408* at *[1],* a company is deemed insolvent on a cash flow basis if unable to pay its debts as they fall due and insolvent on a balance sheet basis if it is proved to the satisfaction of the court that the value of the company's assets is less than its liabilities. Following *BNY (above),* it is also clear that, when applying the cash flow test, only debts that have fallen due or are likely to fall due within the reasonably near future, qualify.

56. Since the Company never traded, it did not incur ordinary business expenses in addition to its liabilities for professional expenses, its liabilities to Vantona under the SPA and its liabilities to 1877 itself. However, upon completion, the capital introduced by Hanung was applied and disposed of as part of the initial payment of £4,000,000 to Vantona. Since none of the Company's other assets was realisable within the immediate future, the Company then had no additional funds and no immediately realisable assets to meet its liabilities within the reasonably near future. This included its liabilities, if any, to Vantona under the SPA and its liabilities for the professional fees of its lawyers in connection with its subsequent dispute with Vantona. If such professional fees were met from the funds advanced to 1877, Messrs Johnson and Mann can be deemed to have authorised payment in their capacity as directors of 1877. The dispute between the Company on the one hand and Vantona and Dawson on the other in relation to the balance of the amounts payable to Vantona under the SPA and Dawson's contractual warranties and indemnities was not resolved before Dawson and Vantona entered into administration. It was ultimately contended on behalf of the Company that there were no outstanding amounts payable to Vantona owing to onerous contracts and rights reserved over stock by its main customer, Dunelm. It is not possible for me to resolve the underlying merits of this dispute on the evidence available.

However, following the SPA, Vantona was at least a contingent creditor until the amounts due to it, if any, were agreed or determined. It is to be recalled that, as early as 8th July 2011, Mr Cooper, of Dawson, emailed Messrs Johnson and Mann to advise them that, following an adjustment of £439,946, 1877's net assets amounted to some £6,471,169 leaving an outstanding balance of £471,169 and, in the expectation further monies would indeed be payable to Vantona, the Company started to make additional payments in advance of the completion accounts.

57. The Company could thus be deemed insolvent on a cash flow basis when each Payment was made if the monies advanced to 1877 by its banks and credited to the relevant bank accounts were not at the free disposal of the Company. Ironically, this would not obviously be the case if, as the Applicants maintain, such monies were indeed available to the Company to meet its own liabilities unless its unresolved indebtedness to Vantona exceeded 1877's banking facilities. By letter dated 4th April 2012, Squire Sanders (UK) LLP asserted, on behalf of Vantona, a claim for as much as £1,192,003.38. I am not satisfied it is open to me to conclude that the Company was indebted to Vantona in an amount approximating this. However, to the extent it is relevant, it could certainly be regarded as a contingent liability.

58. Conversely, however, in the absence of valuation evidence in respect of the Company's shareholding in 1877, I am not satisfied I can safely conclude the Company was insolvent on a balance sheet basis prior to the final Payment on 7th January 2013. Following acquisition, the Company's shareholding in 1877 was essentially its only asset but it would be facile to suggest the same would have become worthless or, indeed worth less than the Company paid for it simply on the basis that 1877 was perceived as to be nearing insolvency.

59. The Company contracted to purchase its shareholding in 1877 for a discount of £2,000,000 on the value of its net assets. At all material times, 1877 was a well established and substantial company with significant business good will. However, it was also making substantial losses. In the period before it was placed in liquidation, it filed accounts for the years ending on 31st December 2009 and 31st March 2012 and an extended 15 month ending on 31st March 2011. On a turnover of £36,292,136, £38,010,739 and £33,536,603 in the periods ending respectively on 31st December 2009, 31st March 2011, and 31st March 2012, it made a gross profit of £6,885,147, £4,731,240 and £4,492,158 translating into operating losses of £1,482,492, £3,060,891

and £1,183,951. Its losses were reflected in diminishing net current assets, down from £7,581,166 on 31st December 2009, to £4,357,528 on 31st March 2011 and £3,980,833 on 31st March 2012. After accounting for fixed assets and provision for additional liabilities in respect of onerous contracts, these amounts were reduced to £7,268,410, £3,854,755 and £3,501,548.

60. However, from the outset, Messrs Johnson and Mann believed they could turn the business round and they were able to persuade Bank Leumi and, ultimately, Aldermore, that there were sound grounds for believing they could do so. Mindful of the 1877's established business goodwill and reputation for the quality of its products – especially knitwear and cashmere- they believed they could extend their operation to North America utilising the connections of Messrs Johnson and Mann. They believed there would be significant scope to reduce the cost of goods utilising their connections in the Far East and reduce overheads and other expenses. They also perceived they could improve stock control and management.

61. It is apparent from Baker Tilly's report, on 22nd June 2012, that Messrs Johnson and Mann initially enjoyed a certain amount of success. Business overheads were reduced and cash flow improved with a shift to suppliers providing consignment stock in exchange for payment at the point stock was drawn down. In their forecast for the year ending on 31st March 2013, their projections for profit before tax amounted to £1,041,000 with EBITDA of £1,202,000.

62. However, in early 2013, it became clear that 1877 was insolvent in the sense that it could no longer realistically expect to pay its debts as and when due. The Respondents maintain that the main reason for this is that its main customer, Dunelm, issued a debit note of £720,000 which 1877 had been left with little choice to accept. They maintain that this was a result of past contractual arrangements with Dunelm – in particular, a dispute in relation to retained stock - and, together with a dispute with another significant customer, Marks & Spencer, it was starved of working capital to meet its continuing commitments. They were thus driven to approach their creditors with a view to entering a Creditors Voluntary Arrangement. Notice of the creditors meeting was given by Notice dated 8th May 2013 and the CVA was approved on 28th May 2013.

63. Again, it is not possible for me to reach any conclusions on the merits of 1877's dispute with both companies. However, I am satisfied that, whilst these would not have been

the only causal factors in the insolvency of 1877, they were of critical significance and, by early 2013 if not before, 1877 was insolvent on a cash flow basis.

64. By this stage, it can also be inferred the Company was insolvent on a balance sheet basis. 1877 was the Company's only asset and, by then, it had little prospect of marketing and disposing of its shareholding in a sum comparable to the amount for which it had originally been acquired. However, the last Payment was made on 7th January 2013, some four months before notice of the creditors meeting was sent to 1877's creditors.

65. In any event, if the Applicants could show the Respondents were at any time under a duty to have regard to the interests of the Company's creditors, it by no means follows that the Respondents committed a breach of such duty by authorising the Payments or that they thereby assumed a liability to the Company or its creditors that equates with the same. The Company's only substantial asset was its shareholding in 1877. As directors of both companies, the Respondents could be expected to exercise reasonable care attending to 1877's affairs, ensuring that the amounts advanced to it by Bank Leumi and Aldermore were generally applied for its benefit. In the present case, this essentially involved utilising these amounts to meet 1877's business commitments. The Payments were made out of monies earmarked as consideration for the Respondents' Acquisition and Management Services from funds originally credited to or for the benefit of 1877. For the Respondents to transfer these monies to the Company or its creditors on their behalf would almost certainly have amounted to a breach of their fiduciary duties to 1877 or its creditors. No doubt, the Respondents could have put themselves into a position in which there was a conflict between their duties to 1877 and the Company. However, I am not satisfied that there was ever a point when the Respondents assumed a duty to the Company itself or its creditors to divert or hold the monies to or for the Company. In the hypothetical event that the Respondents knowingly assumed a duty to hold or divert the monies for the benefit of the Company's creditors on the basis that the Company was insolvent, it is almost inconceivable that the Respondents would have continued to provide the relevant services to 1877 so as to enable the monies to be released for that purpose. If the Company could be showed to have sustained a hypothetical loss, it is unduly simplistic to suggest that this loss is equal to the amount of the Payments.

66. I shall now turn to the Applicants' statutory claim under *Section 238* of the *Insolvency Act 1986*. Since the winding up is deemed to have commenced when the winding up petition was first presented on 21st June 2013, the statutory claim is confined to the preceding two year period under *IA 1986 s240(1)(a).* On this basis, it does not encompass the Payments for the Acquisition Services on 23rd May 2011 but includes all Payments for Management Services save two initial payments of £30,000 on 6th June 2011.

67. *Section 238(4)* includes gifts, transactions on terms providing for a company to receive no consideration and transactions for it to receive "significantly less than the value, in money or money's worth of the consideration provided by the company" itself. On the hypothesis that the Company was a party to the transactions and furnished consideration to the Respondents equal to the value of the Payments, the Company plainly received consideration itself since the services were provided at the Company's request. The Acquisition Services were also of immediate benefit to the Company. No doubt the Management Services were essentially provided to and for 1877, not the Company. However, the Company benefitted from such services as the sole shareholder of 1877.

68. In any event, the Applicants have failed, in my judgment, to establish that the value of the Acquisition and Management Services was significantly less than the value of the Payments, whether assessed intrinsically or with reference to the ultimate value of the services to the Company as purchaser of the shares and subsequently as sole shareholder of 1877. On any analysis, the value of the Payments was considerable. However, 1877 was a substantial company with a turnover of more than £30,000,000 and Messrs Johnson and Mann undertook to perform complex and technical services in connection with the acquisition, which included negotiating the terms of the transaction, reviewing the contractual documentation, assessing the accounting records of 1877 and performing a due diligence. Having done so, they were to provide 1877 with important services which included harnessing their business experience and connections to turn around a business which had started to make significant losses. Moreover, the consideration for their services was carefully discussed, negotiated and agreed by Messrs Johnson, Mann and Bansal.

69. In any event, on the hypothesis that the Applicants were *prima facie* entitled to succeed on their statutory claim under *Section 238*, I am not satisfied it would have been appropriate, in these circumstances, to make an order providing simply for the

Respondents to pay the Applicants an amount equal to the Payments "for restoring the position to what it would have been if the [Company] had not entered into [the transactions]". The statutory jurisdiction in *Section 238(3)* is discretionary and the court's discretion is exercisable in the light of the circumstances as a whole, including, in the present case, the nature and extent of the services for which the Payments were made and the understanding on which they were provided. Conversely, however, there would have been no room for the application of the statutory restriction in *Section 238(5)* since the Company was not itself carrying on a business within the meaning of *Section 238(5).*

70. Having determined all issues of liability in favour of the Respondents, no question arises as to whether Messrs Johnson and Mann should be relieved from liability under *Section 1157* of the *Companies Act 2006,* on the grounds they acted honestly and reasonably.

(7) Disposal

71. The Claims are dismissed on the basis that the Payments were not made from assets over which the Company had free rights of disposal nor were they made on behalf of the Company. Had it been otherwise, the Claims would have failed on the basis that the Payments would be deemed to have been approved by the Company's directors in accordance with the *Model Articles*, they were not made in breach of duty and did not amount to transactions at an undervalue under *Section 238* of the *Insolvency Act 1986.*