Neutral Citation Number: [2021] EW Misc 7 (CC)

Case No: H00GL086

IN THE COUNTY COURT AT BRISTOL
BUSINESS AND PROPERTY WORK

Bristol Civil Justice Centre
2 Redcliff Street, Bristol, BS1 6GR

Date: 30/04/2021

Before :

HHJ PAUL MATTHEWS

- -

IN THE MATTER OF CAPITAL INVESTMENT CENTRE LIMITED
AND
IN THE MATTER OF THE COMPANIES ACT 2006

Between :

SAQIB RASUL	**Claimant**
- and -	
(1) ZUBAIR GINWALLA	**Defendants**
(2) CAPITAL INVESTMENT CENTRE LIMITED	

- -
- -

Nicholas MacLeod-James (instructed by **direct access**) for the **Claimant**
Chloe Shuffrey (instructed by **Astraea Legal**) for the **First Defendant**
The Second Defendant was not present or represented

Hearing date: 20 April 2021

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Approved Judgment

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

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Covid-19 Protocol: This judgment was handed down by the judge remotely by circulation to the parties' representatives by email and release to BAILII on the date shown at 10:30 am.

HHJ Paul Matthews :

Introduction

1. This is my judgment on an application made by the claimant by application notice dated 1 February 2021 for permission to continue a derivative claim on behalf of the second defendant against the first defendant. Such claims are governed by sections 260-264 of the Companies Act 2006, and CPR rules 19.9-19.9F and the Practice Direction to Part 19. Initially, and as required by section 261(2), I considered on paper, and without any material from the defendants, whether it appeared to the court that the application and evidence in support did not disclose a prima facie case for giving permission. It did not so appear, and so on 18 March 2021 I gave directions under section 261(3) for the hearing of the application. I also granted an interim injunction (to hold the *status quo*) over until the hearing took place. The hearing took place on 20 April 2021 remotely, using the MS Teams video-conferencing program.

2. I set out the background to the claim in my written reasons accompanying the directions of 18 March. I repeat here the first four paragraphs of those reasons:

> "1. The claimant issued a claim form in the County Court at Gloucester to make a derivative claim on behalf of Capital Investment Centre Ltd ("the company") against the first defendant. The claimant and the first defendant are equal 50% shareholders, and the only two directors, of the company, the second defendant. The first defendant is the company secretary. The claimant claims that the first defendant is in breach of his director duties under ss 172 and 175 of the Companies Act 2006. The County Court at Gloucester properly transferred the claim to Bristol.
>
> 2. The matter arises because the company carries on business at 177 Barton Street, Gloucester ("the property"), which is also the registered office of the company. The claimant claims that there is some sort of tenancy vested in the company giving it the right to occupy the property, but it is not clear exactly what. No allegation is made of any particular kind of tenancy, *eg* periodic or for a fixed term, and no documents relating to the tenancy are in evidence, except a notice to which I shall come.
>
> 3. A copy of the freehold title as registered at HM Land Registry shows that as at 2 February 2021 the freehold was vested in one Martin Friedman, of Salford. However, the particulars of claim allege that in 2020 the claimant and the first defendant discussed whether the freehold could be purchased by the company. They go on to allege that on 29 September 2020 the first defendant bought the freehold for himself, rather than for the company. On 14 December 2020 the first defendant served a notice under s 25 of the Landlord and Tenant Act 1954, giving notice to end the company's tenancy on 30 June 2021, and opposing the grant of a new tenancy.
>
> 4. On behalf of the company, the claimant seeks a declaration that the first defendant holds the freehold on trust for the company, an account of profits from

the purchase and an order for payment of anything found due, an order that the company be permitted to buy and that the first defendant sell the property, an injunction to restrain the first defendant from dealing with the property other than transferring it to the company, an order that the s 25 notice be withdrawn or treated as withdrawn, damages, interest and costs."

3. At paragraph 52 of the particulars of claim, the claimant gives particulars of the loss and damage said to have been suffered by the company:

> "(1) The loss of the Property freehold and in particular the increase in value since the transfer to the First Defendant and increased development and commercial value.
>
> (2) Loss of Company value.
>
> (3) Rental, service charge and other sums paid by the Company to the First Defendant for the lease, use and occupation of the Property from the date of transfer to the First Defendant.
>
> (4) Loss of goodwill and business profits since the said date of transfer."

The hearing

4. The burden of showing that permission should be granted to continue the claim lies on the claimant. At the hearing for permission I had the particulars of claim, supported by a statement of truth, dated 29 January 2021, the original witness statement from the claimant, dated 1 February 2021, a witness statement in answer from the first defendant dated 8 April 2021, and a second witness statement from the claimant dated 15 April 2021 in reply to that of the first defendant. The company being deadlocked, there was no contribution on its behalf. I heard oral submissions from Mr Nicholas MacLeod-James, counsel on behalf of the claimant, and Ms Chloe Shuffrey, counsel on behalf of the first defendant. Again, the company itself was neither present nor represented.

Evidence

5. The claimant says in the particulars of claim that a charitable organisation occupied the premises from 2012, but by late 2016 was struggling financially. The claimant says he agreed with the charity to take over the ground floor. Then he invited the first defendant to come and share his space. Both of them carried on their respective businesses from separate desks on the ground floor. The company was incorporated on 28 February 2017, and thereafter the company obtained a tenancy of the property. The company was let into possession and paid rent by reference to monthly periods for exclusive occupation. From this the inference, if not displaced by subsequent facts, is that the company had a monthly periodic tenancy at common law: see *Javid v Aqil* [1991] 1 WLR 1007, 1012.

6. The claimant's second witness statement exhibits a letter from the previous landlord's agents dated 14 April 2021. (This is well after this claim was started.) It encloses, and thereby puts in evidence for the first time, a document purporting to be an unsigned draft tenancy agreement for 36 months from 1 March 2017, so expiring on 28

February 2020. This, if genuine, would be within the exception to section 52(1) of the Law of Property Act 1925, contained in section 54(2) of the Act, for leases taking effect in possession at a rack rent for not more than three years. In this case I do not need to decide whether this is a genuine document or not, because it does not matter if the tenancy was a monthly periodic tenancy or for three years. If it was the latter, it would have expired and, the company holding over and paying a monthly rent, a monthly periodic tenancy would have arisen in its place anyway. What does matter however is the order of events. According to the claimant, the charity occupied first, then he took the ground floor, then he shared the ground floor with the first defendant, then the company was incorporated, and finally a tenancy was granted to the company.

7. In his witness statement, the first defendant does not challenge the sequence of events leading up the grant of a tenancy to the company, as set out in the particulars of claim. He agrees that the claimant and he are equal shareholders in, and the only directors of, the company, that the first defendant is the company secretary, and that neither director or shareholder can in practice procure that the company takes action against the other member or director without his consent. The first defendant also agrees that he owes the statutory duties to the company under sections 172 and 175 of the Companies Act 2006. Finally, he agrees that he has served a notice on the company under section 25 of the Landlord and Tenant Act 1954, Part II, dated 14 December 2020 to terminate the lease and the occupation of the company at the property in question.

8. However, the first defendant denies that he has breached any of his duties to the company. He says that he approached the freeholder's agent in his personal capacity "in front of the claimant" telling him of his desire to purchase the property, but never told him that this would be on behalf of the company. After he sold some other property in January 2020, he had money to invest in this property. Between May and September 2020 the first defendant and the freehold owner negotiated a price for the transaction, which was £112,000. According to him, the first defendant says he updated the claimant regularly as to what he was doing, but never suggested that this was for the company's benefit or on behalf of the company. For his part, the claimant never suggested that the company should purchase the property or asked any questions about how it was being purchased, how the purchase would be funded, or offered to contribute to the funding.

9. As I have said, the claimant has made a second witness statement in which he denies the account put forward by the first defendant. However, he does not put forward any minutes, emails, texts or other documentary correspondence to show that the company was ever considering the purchase of the property, or that the claimant ever offered to provide funding for this to happen. It is clear that the factual dispute between the parties as to the purchase of the property by the first defendant cannot be resolved at this stage. I have to proceed on the basis that allegations are made which the claimant will be able to prove at trial. Whether they are true can only be determined after trial of the intended derivative claim.

10. The first defendant's evidence goes on to deal with the company's financial position. The first defendant says that the company has never been in a position to purchase the property. The latest available annual report and (unaudited) financial statements are for the year ended 29 February 2020. They show that in that year the turnover was

£23,857, producing a loss of £2,524. The previous year (ending 29 February 2019) the company made a profit of £2,133 on a turnover of £24,223. The balance sheet showed that the company had a negative equity position of £4,276 in the year ended 2019 and a greater negative equity position of £6,900 in the year ended 2020. So it was then "balance-sheet insolvent". The claimant's second witness statement does not update the position or rebut the first defendant's view. The company's business consists of managing properties for other landlords. Until April 2021, it was managing three properties, but on 1 April 2021 the landlord of two of these indicated that he would no longer use the company's services. The company also receives occupational rents for sub-lettings in the property. The most recent bank statement (exhibited to the first defendant statement) shows a bank balance as at 1 March 2021 of £1,803.70. The first defendant also says that the claimant is not in a position to put up the money needed to buy the property jointly with the first defendant. Indeed (he says) the claimant was not able to pay his personal commitments during the 2020 lockdown.

11. Unsurprisingly, the first defendant says that the relationship between him and the claimant has completely broken down and that they have agreed they will no longer be working together. He says that it "is likely to be wound down". One matter that is not adequately dealt with in the evidence is the question of the value of the property today (and in particular whether it has a greater value than the purchase price) and any development potential there is for the property. I assume that the claimant's concern in relation to this derivative claim stems from a view held by him that the property is worth considerably more than was paid for it, and does have potential for development. But it is strange that this is not dealt with expressly in the evidence.

12. In his witness statement in reply, the claimant challenges the first defendant's assertion that he would be unable to finance a joint purchase of the property, but he does not deal with the evidence of the company's financial position given by the first defendant. Nor does he deal with the breakdown of their relationship, or the likelihood of the company continuing to trade in its present form. That evidence is therefore not challenged. On this application I am not therefore in a position to disbelieve that part of the evidence given by the first defendant, and should take it into account in reaching my decision: see *eg Coyne v DRC Distribution Ltd* [2008] EWCA Civ 488, [58].

The claim

13. The claim as put forward by the claimant on behalf of the company is that the first defendant is in breach of his fiduciary obligations to the company under sections 172 and 175 of the Companies Act 2006, by negotiating for and purchasing for his own account the fee simple estate (freehold interest) in the premises where the company has its registered office and carries on business, and in which it has a leasehold interest. These sections (and others) represent a statutory codification of pre-existing rules, largely the product of decisions of the courts of equity in the preceding 200 years.

14. Section 172 (so far as material) provides that:

> "(1) A director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole, and in doing so have regard (amongst other matters) to–

[…]

(f) the need to act fairly as between members of the company."

15. And section 175 (so far as material) provides that:

"(1) A director of a company must avoid a situation in which he has, or can have, a direct or indirect interest that conflicts, or possibly may conflict, with the interests of the company.

(2) This applies in particular to the exploitation of any property, information or opportunity (and it is immaterial whether the company could take advantage of the property, information or opportunity).

(3) This duty does not apply to a conflict of interest arising in relation to a transaction or arrangement with the company.

(4) This duty is not infringed—

(a) if the situation cannot reasonably be regarded as likely to give rise to a conflict of interest; or

(b) if the matter has been authorised by the directors."

I should say that the evidence did not contain a copy of the Articles of Association of the company, but I was not told that there was any provision in them modifying the rules on conflict of interest, and so for present purposes I assume that there is none: *cf* section 180(4) of the 2006 Act.

16. Section 172 encapsulates the pre-existing duty of directors to act in the best interests of the company: see *eg Re Southern Counties Fresh Foods Ltd* [2008] EWHC 2810 (Ch), [52]. Section 175 encapsulates then pre-existing 'no-profit' and 'no-conflict' rules (though the former was often seen as contained in the latter): see *eg Fairfield Water Ski Club Ltd v Cohoon* [2020] EWHC 290 (Comm) at [51](4), reversed on other grounds, [2021] EWCA Civ 143.

17. The claimant claims that the first defendant has breached his duties in three main ways. **First of all**, he has bought the freehold of the property, which is the registered office of the company, and its sole place of business, without the knowledge of the claimant. He was able to do this because of his position and the information acquired as director of the company. This deprived the company of the opportunity to acquire the property, with its associated development potential. **Secondly**, the first defendant having purchased the reversion on the property has served notice to terminate the company's tenancy. The company has no other place of business and also receives rents and occupation fees from other occupiers of the premises. **Thirdly**, the first defendant has become the landlord of the company but is still a director of the tenant company. This creates an inherent conflict, as well as permitting the first defendant to profit from the company without the company's agreement.

Claimant's authorities

18. In support of these claims, the claimant referred me to a number of authorities bearing on the question of breach of these duties. The first of these was *Bhullar v Bhullar* [2003] EWCA Civ 424. In that case two brothers (Mohan and Sohan) and their respective families were the members of a company whose objects included the acquisition of property for investment. Each brother and his family owned 50% of the shares. But three of the five directors came from Sohan's family, and only two from that of Mohan. In 1998 relations between the two families broke down, and they considered how to divide up the company's assets and business between them.

19. Whilst negotiations were proceeding, one of Sohan's sons, Inderjit, discovered that a property called Whitehall Mill, next door to an existing investment property (Springbank Works) belonging to the company, was on the market. He and his brother bid for and purchased Whitehall Mill in the name of Silvercrest Trading (GB) Ltd ("Silvercrest"), another company which they personally owned and controlled. Inderjit consulted the company's solicitor as to whether there was any reason why he and his brother could not acquire the Mill for their personal benefit, and was told there was none. They did not at that stage disclose the existence of the Mill or their purchase of it to the company or to their fellow directors. In 2001 Mohan and his family presented an unfair prejudice petition against Sohan and his family, making a number of allegations, including a complaint relating to the acquisition of the Mill. The judge declined to grant the primary relief sought under the petition, but did find that the respondents had breached their fiduciary duty to the company in acquiring the mill for their personal benefit. He declared that Silvercrest held the Mill upon trust for the company. The respondents appealed, but their appeal was dismissed.

20. Jonathan Parker LJ (with whom Schiemann and Brooke LJJ agreed) said:

> "41. Like the defendant in *Industrial Development Consultants Ltd v. Cooley*, the appellants in the instant case had, at the material time, one capacity and one capacity only in which they were carrying on business, namely as directors of the Company. In that capacity, they were in a fiduciary relationship with the Company. At the material time, the Company was still trading, albeit that negotiations (ultimately unsuccessful) for a division of its assets and business were on foot. As Inderjit accepted in cross-examination, it would have been 'worthwhile' for the company to have acquired the Property. Although the reasons why it would have been 'worthwhile' were not explored in evidence, it seems obvious that the opportunity to acquire the Property would have been commercially attractive to the Company, given its proximity to Springbank Works. Whether the Company could or would have taken that opportunity, had it been made aware of it, is not to the point: the existence of the opportunity was information which it was relevant for the Company to know, and it follows that the appellants were under a duty to communicate it to the Company. The anxiety which the appellants plainly felt as to the propriety of purchasing the Property through Silvercrest without first disclosing their intentions to their co-directors – anxiety which led Inderjit to seek legal advice from the Company's solicitor – is, in my view, eloquent of the existence of a possible conflict of duty and interest."

21. It will be noted that this case is rather different factually from that one. In that case Mohan's family did not know of the existence of the opportunity, let alone that Sohan's sons had been negotiating for it, before the purchase of the property. In the present case the claimant's case is that he knew of the existence of the opportunity,

and knew that the first defendant was negotiating for and indeed had successfully negotiated for the freehold of their property. His case is that he thought that the first defendant was doing so on behalf of the company rather than in his own personal interest. On the face of it, this has some similarities with a *Pallant v Morgan* [1953] Ch 43 equity, but that case was not referred to before me.

22. The claimant also referred to the decision of the Court of Appeal in *O'Donnell v Shanahan* [2009] 2 BCLC 666, CA. That was another case of an unfair prejudice petition, in which several allegations of unfairly prejudicial conduct were made by the petitioner shareholder and director against the respondents, the other two shareholders and directors of the company. At trial the petitioner failed, and she appealed on one ground only, the respondents' acquisition in 1999 of an investment property (Aria House) through another company in which those two respondents were 50-50 shareholders, allegedly in breach of their duties as directors of the company the subject of the petition. The Court of Appeal allowed the appeal on this ground.

23. Rimer LJ (with whom Waller and Aikins LJJ agreed) said this:

> "52. Subject to the *Aas v. Benham* 'scope of business' point, to which I will come, I would regard this as a plain case in which Mr Shanahan and Mr Leonard had (without the company's informed consent) adopted for their private benefit a business opportunity that came to them in their capacities as directors of the company with the consequence that they would in principle be accountable to the company for any profit derived from it. The prime mover of the two in the Aria House matter as a whole was Mr Shanahan, but neither the judge nor the argument before us drew any distinction between the roles of the two respondents.
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> […]
>
> 54. In my judgment, this was obviously a case in which, once that opportunity arose, the respondents could not properly make use of the information they had so obtained in deciding to take up the opportunity for their own benefit. That was because they had obtained the information in the course of acting as directors of the company; and the opportunity also came to them in such course. As I shall explain, I consider that the opportunity led the respondents straight into a breach of 'no conflict' rule. But quite apart from this, it was one that they ought obviously to have made known to the company. In practice, that meant that they needed to discuss it with Ms O'Donnell. If the company was not interested in taking up the opportunity, its members could consent to its being taken up by the respondents personally. As the respondents did not offer the opportunity to the company, but took it up personally, they engaged in a transaction that rendered them liable to account under the 'no profit' rule.
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> 55. The authorities relating to trustees' and directors' duties to account for profit earned in consequence of a breach of the 'no profit' rule are legion, they all appear to me to point to the same conclusion and none appears to qualify the liability to account by reference to whether the impugned transaction was (in the case of an alleged breach by a director) within or without the scope of the company's business. The principle of accountability by directors in breach of the rule derives from the strict rule affecting trustees, the leading case in the latter field

being *Keech v. Sandford* Sel. Cas. Ch. 61. In that case it had been *impossible* for the trustee to obtain a renewal of the trust's lease for the beneficiary, but the trustee was nevertheless held accountable for then renewing it for himself. It may be thought odd that a strict principle of that nature, which fathered the like principle of accountability applicable to directors, can enable a director to answer a claim under the 'no profit' rule by asserting that the impugned transaction was unimpeachable because it was not the kind of transaction the company ordinarily engaged in. That is to ignore the point that the rationale of the 'no conflict' and 'no profit' rules is to underpin the fiduciary's duty of undivided loyalty to his beneficiary. If an opportunity comes to him in his capacity as a fiduciary, his principal is entitled to know about it. The director cannot be left to make the decision as to whether he is allowed to help himself to its benefit.

[…]

70. The statements of principle in the authorities about directors' fiduciary duties make it clear that any inquiry as to whether the company could, would or might have taken up the opportunity itself is irrelevant; so also, therefore, must be a 'scope of business' inquiry. The point is that the existence of the opportunity is one that it is relevant for the company to know and of which the director has a duty to inform it. It is not for the director to make his own decision that the company will not be interested and to proceed, without more, to appropriate the opportunity for himself. His duty is one of undivided loyalty and this is one manifestation of how that duty is required to be discharged.

71. This was a case in which, in the course of acting as directors on behalf of the company in an estate agency capacity, the respondents obtained information relating to the virtue of Aria House as an investment and were given the opportunity of personally sharing in the opportunity of purchasing it. It may have been improbable that the company could or would want or be able to take up the opportunity itself. But the opportunity was there for the company to consider and, if so advised, to reject and it was no answer to the claimed breach of the 'no profit' rule that property investment was something that the company did not do. Nor, until Mr Sulaiman telephoned Mr Shanahan, did the company do estate agency work. There was no bright line marking off what it did and did not do.

[…]

73. I can take the 'no conflict' rule more shortly. The judge concluded that there was no breach of it and I have explained why. In my judgment, however, there was a breach of it. The respondents became engaged in the Aria House affair in their capacity as directors of the company whose function was, as agent for Mr Sulaiman, to find a purchaser. They found Mr Walsh and brokered a deal under which, on exchange of contracts, £30,000 vendor's commission was payable to the company by Mr Sulaiman.

74. When the Walsh deal fell through, the respondents, still as directors and acting on behalf of the company, were anxious to find a substitute purchaser, one who would ideally simply slip into Mr Walsh's shoes and buy on like terms (with HLR being later used as the purchasing company, with the apparent intention of confusing Mr Sulaiman into believing that the purchaser was the same company

as HLR IoM). The respondents appear to me to have conducted themselves generally in relation to this matter with a marked lack of business scruple and they (and the company) may well have breached various duties owed to Mr Walsh. Mr Clutterbuck made much of that but I do not regard it as at the forefront of relevance on the 'no conflict' point. As it seems to me, the simple point is that once the substitute Holleran arrangement was arrived at, the respondents were faced with the prospect that he was not prepared to agree to the payment of the £100,000 that would enable Mr Sulaiman to pay the company the £30,000 commission or any commission. He was only prepared to agree to the payment to Mr Sulaiman of the net £70,000. That made no difference as far as Mr Sulaiman was concerned. The only loser was the company. Under the substitute deal that the respondents brokered, one in which they were now personal participants, they also agreed with Mr Holleran that the company should no longer have its commission. When contracts were exchanged on 26 May 1999, it did not get any commission. Nor was it to be entitled to any in the future.

75. That feature of the new deal appears to me to have placed the respondents in a conflict between their personal interests (to achieve a purchase in concert with Mr Holleran, who had made his position clear about the commission payment) and the company's interests (to receive a proper reward for brokering the substitute deal). The respondents simply sacrificed the company's interests and preferred their own. The company had not authorised them to do that. As directors their duty was to achieve a proper reward for the company for negotiating a sale of Aria House. In my judgment that feature alone of the substitute deal meant that the respondents were in a state of conflict of interest and duty when, through HRL, they entered into the purchase contract on 26 May 1999. It is nothing to the point that some time after the exchange of contracts they agreed to and did compensate Ms O'Donnell for losing out on her share of a £30,000 commission. That may have redressed the wrong she had so suffered and it is no doubt relevant to the respondents' claim that Ms McDonnell acquiesced in their purchase. It did not, however, retrospectively prevent the acquisition by the respondents (through HRL) of their interest in Aria House from being one entered into breach of the 'no conflict' rule.”

24. Next, the claimant referred to *Gower’s Company Law*, which discusses those two cases in the context of section 175, and then continues as follows:

“18-98. Where does this leave directors? It is easy to explain that it is, and ought to be, irrelevant to the question fiduciary breach whether the company could, or would, exploit the opportunity in question. Those questions are more relevant when the alleged breach is of the good faith duty (s. 171), or even the care and skill duty (s. 174) but the gist of the ‘no conflict’ rule is to compel, so far as possible, unwavering loyalty to the corporate endeavour. Both the duty and its remedies are geared to this end. This, it is suggested, implicitly and inevitably requires the courts to pay some regard to the scope of that endeavour. Instead, the two cases just described (*Bhullar v Bhullar* and *O’Donnell v Shanahan*) adopt a broad approach that, taken only a little further, verges on a funding that any opportunity that is at all interesting financially will be seen of interest to the company. This raises the risks for directors, and increases the chances of pure windfall gains to the company and its shareholders: the trend is towards there

being no safe harbour other than to present every entrepreneurial idea to the board before pursuing it individually, notwithstanding the nature of the corporate business or whether there is a real, sensible prospect of a conflict. This effectively gives the company a right of first refusal on opportunities seen by the directors as worth pursuing. Within the company's scope of business, broadly interpreted, this is precisely the goal of the no-conflict rule, but outside that context the broader rule needs some justification. It raises the fiduciary 'no conflict' rule from pragmatic prophylaxis to something far more draconian. …"

25. Finally, the claimant refers to a lengthy and detailed case note on *O'Donnell v Shanahan* in The Modern Law Review, by Deidre Ahern ((2011) 74 MLR 596). In particular, he relies on this passage (at 602):

> "In a classic application of *Regal (Hastings)*, the fact that the company could not have taken up the opportunity without shareholder finance – which was unlikely to be forthcoming from the petitioner – was treated as irrelevant. This analysis is consistent with other post-*Bhullar* cases such as *Quarter Master UK Ltd (in liq) v Pyke* where it was held that a conflict of interest arose even though the company would not have been in a position to take advantage of the business opportunity as it was going into liquidation."

Keech v Sandford

26. Before turning to consider the present case in detail, I will observe that there is perhaps a question mark as to how far the original trust law rule exemplified in the case of *Keech v Sandford* (1726) Sel Cas t King 61, referred to by the Court of Appeal in *O'Donnell v Shanahan*, could have applied to the situation now under consideration. In *Keech v Sandford*, the trustee had been unable to renew the trust lease for the benefit of his beneficiary (as it was his duty to attempt to do), but was successful in renewing the lease for his own benefit. It was not a case about the acquisition of *other* property for the benefit of the trust, but instead about preserving the *existing* trust property. As a result, subsequent trust cases, such as *Bevan v Webb* [1905] 1 Ch 620, held that, in cases where the acquisition of the reversion by the trustee had nothing to do with the trust itself, in that it did not damage the trust lease or any incident of it, and the opportunity did not come to the trustee *as lessee*, the rule in *Keech v Sandford* did not apply to the acquisition of the reversion.

27. In *Protheroe v Protheroe* [1968] 1 WLR 519, however, the Court of Appeal took a different view. This was a dispute between a separated married couple before the Matrimonial Causes Act 1973, in a case where the husband had acquired the reversion to the lease of the matrimonial home. So the attribution of property rights to the spouses depended on property law alone, and the court had no 'matrimonial' discretion. It is well known that the absence of such a discretion put pressure on the courts in those days, in cases of matrimonial property disputes, to treat otherwise stable property law principles as perhaps more flexible than they really were. No cases were cited to the court in argument, and in particular not the *Bevan v Webb* line of authorities.

28. Lord Denning MR gave an extempore judgment of just over one page, with which the other two judges simply agreed, holding (at 521D-E) that

> "There is a long established rule of equity from *Keech v Sandford*, downwards that if a trustee, who owns the leasehold, gets in the freehold, that freehold belongs to the trust and he cannot take the property for himself."

But *Keech v Sandford* was not such a case, and, with great respect to the late Master of the Rolls, there was no "long established rule of equity" to that effect. Nevertheless, *Protheroe* has been followed since, and must now be taken to represent the law, at least below the Supreme Court.

29. In any event, I am not here concerned with trustees, but instead with directors of companies, and the relevant authorities are *Bhullar v Bhullar* and *O'Donnell v Shanahan*. Strictly speaking, those cases were decided on the pre-existing common law, and I am instead concerned with the provisions of the Companies Act 2006. But there was no suggestion that the law was now in substance different, and the cases say the opposite. Whilst *Gower's Company Law* may be thought to sound a note of warning as to how far the law has now gone, that is a warning better addressed to legislators than to a judge at first instance deciding an actual case. As I understand the current law, if company directors, in that capacity, come across a business opportunity, even if it is not within the scope of the company's business, and even if the company does not have the resources to exploit it, and even if it has expressed the view that it does not want to take up further opportunities, and even if the company is on the verge of being broken up or liquidated, the duty of the directors is to inform the company so that it may make an informed decision as to whether to take it up or refuse it, and perhaps consent to the directors exploiting it for themselves.

Submissions

30. The allegations made in the present case by the claimant against the first defendant are that the first defendant came across such a business opportunity precisely because he was a director of the company occupying the building in relation to which the opportunity arose and therefore in his capacity as a director. This is challenged by the first defendant. There is also a divergence of evidence as to whether (as the first defendant says) the first defendant informed the claimant that he was negotiating to buy the property for himself and the claimant did not object to that and made no suggestion that the company should buy it or that they should buy it jointly, or on the other hand whether (as the claimant says) the claimant was aware of the business opportunity but understood that it was being negotiated by the first defendant on behalf of the company rather than on the first defendant's own behalf, and the company did not consent to the first defendant's taking the latter course.

31. On behalf of the first defendant it is argued that the court should undertake a two-stage enquiry. The first stage arises under section 263(2)(a) of the 2006 Act, and the second stage under section 263(3) of that Act. Those provisions are as follows:

> "(2) Permission [to continue a derivative claim] must be refused if the court is satisfied –
>
> > (a) that a person acting in accordance with section 172 (duty to promote the success of the company) would not seek to continue the claim;
> >
> > […]

> (3) In considering whether to give permission … the court must take into account, in particular –
>
> > (a) whether the member is acting in good faith in seeking to continue the claim;
> >
> > (b) the importance that a person acting in accordance with section 172 (duty to promote the success of the company) would attach to continuing it;
> >
> > […]"

32. The authorities are clear that the words "a person acting in accordance with section 172 … would not seek to continue the claim" in section 263(2)(a) are to be construed as meaning that "section 263(2)(a) will apply only where the court is satisfied that *no* director acting in accordance with section 172 would seek to continue the claim. If some directors would, and others would not, seek to continue the claim the case is one for the application of section 263(3)(b)": per Lewison J in *Iesini v Westrip Holdings* [2010] BCC 420, [86].

33. The first defendant also reminded me that in *Sequana SA v BAT Industries Plc* [2019] EWCA Civ 112, the Court of Appeal held that there comes a point when a company faces insolvency such that the duty of the directors under section 172 to promote the success of the company for the benefit of its members as a whole is replaced by a duty to act in the best interests of creditors. David Richards LJ (with whom Longmore and Henderson LJJ agreed) said:

> "220. Judicial statements should never be treated and construed as if they were statutes but, in my judgment, the formulation used by Sir Andrew Morritt C and Patten LJ in *Bilta v Nazir*, and by judges in other cases, that the duty arises when the directors know or should know that the company is or is likely to become insolvent accurately encapsulates the trigger. In this context, 'likely' means probable, not some lower test such as that adopted by Hoffmann J in construing the statutory test for the making of an administration order: see *Re Harris Simons Construction Ltd* [1989] 1 WLR 368."

34. It was submitted that here the directors knew or should have known that this company was or was likely to become insolvent. So, a person acting in accordance with section 172 would be one under a duty to act in the best interests of *creditors*, rather than members. The first defendant points to the fact that the company was already balance-sheet insolvent, made a loss in the last year for which accounts are available, has very little money in the bank (less than £2000), and is in a very small way of business. He also points to the fact that the company has recently lost two of the three properties which it was managing, and therefore will have a significantly reduced income from now on, unless further business is obtained. It is clear that the management of the company itself is in deadlock. On the first defendant's evidence the claimant and the first defendant have decided to go their separate ways. The claimant does not challenge this. In my judgment, the *Sequana* test is satisfied, in that on the material before me this company already is or will, more likely than not, become insolvent.

35. The merits of the underlying claim are relevant to the assessment carried out by the court, both under section 263(2)(a) and section 263(3)(b), as to whether the

hypothetical director would continue the claim, and what importance would be attached to it. It is clear that it would be wrong for the court to carry out a "mini trial" of the claim: *Fanmailuk.com v Cooper* [2008] BCC 877, [2]. On the other hand, more than a *prima facie* case is needed: *Iesini v Westrip Holdings* [2010] BCC 420, [79]. Lewison J in that case also stated that:

> "85. … There are, of course, a number of factors that a director, acting in accordance with section 172, would consider in reaching his decision. They include: the size of the claim; the strength of the claim; the cost of the proceedings; the company's ability to fund the proceedings; the ability of the potential defendants to satisfy a judgment; the impact on the company if it lost the claim and had to pay not only its own costs but the defendant's as well; any disruption to the company's activities while the claim is pursued; whether the prosecution of the claim would damage the company in other ways (e.g. by losing the services of a valuable employee or alienating a key supplier or customer) and so on. The weighing of all these considerations is essentially a commercial decision, which the court is ill-equipped to take, except in a clear case."

36. Two cases were cited to me as examples where the decision was to refuse permission. *Re Seven Holdings Ltd* [2011] EWHC 1893 (Ch) was the case of a company joint venture between Richard Percy and Gareth Trevor, with equal interests, who fell out. Mr Percy sought to continue a derivative claim against Mr Trevor. The deputy judge, David Donaldson QC, held that

> "15. … the company is not only deadlocked but has run its course, subject only to sale of the two completed units at Austin Avenue. I can see no prospect of the parties agreeing statutory accounts, putting the company once more into breach of the criminal law and exposing it and the two men to further prosecution and fines. It is in short a natural candidate to be wound up on a just-and-equitable petition by either shareholder …"

37. In addition, both investors were net creditors of the company and could each petition to wind it up for that reason. The deputy judge said:

> "20. It is therefore in my view appropriate to consider the comparative merits of leaving all or some of the disputes to be dealt with by a liquidator rather than by litigation in a derivative action, and factor these into the overall decision which the court has to reach under section 263 as regards each of the claims."

38. The deputy judge considered the various heads of claim to be advanced in a derivative claim, and concluded:

> "58. On any realistic view, these claims, even in aggregate, would be comfortably exceeded by the amount due to Mr Trevor on his loan account. There is therefore no need for any positive action by the company. It could simply await suit by Mr Trevor for the balance of his account and set off the claims by way of partial defence, though in practice it is virtually inconceivable that Mr Trevor would seek to recover the balance of his loan account other than in a liquidation, where any cross-claim or set-off would in

> any event be taken into account. In these circumstances, I consider that no director would consider it desirable for the company to prosecute a claim for any of these amounts. Indeed, I can see no possible benefit to the company in adopting such a course."

39. The other case was *Zavahir v Shankleman* [2017] BCC 500. In that case the freehold of a block of 11 flats was sold in 1998 to a company ("YSL") the four shares in which were issued to the owners of four of the flats, who, or whose successors in title, were the claimants (one flat) and the defendants (three flats). At a later date, either in 2013 or in 2014 (both dates are given in the judgment) all the flat owners except the defendants gave notice to YSL to acquire the freehold in a new company ("new-YSL"). That acquisition completed, and the consideration of £224,000 was paid to YSL. However, before completion and the transfer of the freehold to new-YSL, the first defendant as a director of YSL caused it to grant the defendants 999-year leases of their flats for £1 consideration each. The claimants issued and now sought to continue a derivative claim against the defendants for breach of duty in granting 999-year leases for £1 at a time when YSL had no profits for distribution, contrary to section 830 of the Companies Act 2006.

40. The deputy judge, John Baldwin QC, was satisfied that the claimants had "something more than" a *prima facie* case. But he referred to the test in section 263(2)(a), and said:

> "37. … YSL currently has about £20,000 and it has no property to manage, no business to conduct. The claimants' costs to date of the action are about £156,000 and pleadings are not closed, i.e. the action has barely started. A wholly successful outcome will yield £136,500 plus some interest thereon plus, probably, a favourable order for costs. A fairly optimistic estimate of recoverable costs is about 80 per cent of the moneys spent. Once the action is over, if any moneys are left they are likely to be distributed amongst the shareholders, 25 per cent each. If the action fails it will be a complete disaster. If the action settles on a walk-away basis, it again looks like a complete disaster as far as YSL is concerned.
>
> […]
>
> "39. In my judgment, any prudent director carrying out a normal risk/benefit analysis would not seek to continue this claim. In the circumstances of a company such as YSL in the position it finds itself in with few assets and no future prospects, the downsides and costs of losing far outweigh the benefits of winning even if there is factored in a significantly greater chance of winning than losing.
>
> 40. Even if I am wrong in my conclusion that the claimants do not pass the s.263(2) gateway, I think a consideration of the matters in s.263(3) leads to the same conclusion. Given the inherent risks of litigation and the availability of an alternative remedy, I do not think a prudent director would attach great importance to continuing the litigation and with the costs being so high in relation to the potential reward and what might be done with the money, he/she would not be keen to pursue it. These are additional reasons for the court refusing permission to continue."

41. In the present case, the first defendant submitted that the underlying claim lacked any legal merit, that it lacked economic sense, and that the claimant was not acting in good faith. He submitted that no director acting in accordance with section 172 could think it was in the interests of the company (or the creditors) to pursue the claim. Permission should therefore be refused.

42. As to merits, the first defendant submits that the company was and is quite clearly not in a position to buy the property and that therefore he has deprived the company of nothing. He cannot have deprived the company of any increase in value of the property and its increased development and commercial value, since the company never had any prospect of owning it. The company cannot have lost rental, service charge and other sums which it has paid to the first defendant as its landlord since he acquired the freehold, because it would have been liable to pay the sums, whoever the landlord was. The accounts that have been filed do not disclose any value placed on goodwill, so there is nothing to be lost there. Since there was no planning permission for residential use of the upper parts, any income derived from that was unlawful and cannot be the subject of a claim.

43. The first defendant also denies that he used information that came to him as a director to acquire the property. He reminds the court that (even on the claimant's case) his occupation, and therefore his knowledge, of the property pre-dated the incorporation of the company and his directorship. In relation to his becoming landlord of the company by purchasing the freehold reversion, the first defendant refers to the exception in section 175(3) of the 2006 Act for conflicts arising in relation to transactions or arrangements with the company. He says he informed the claimant of the proposed transaction, that is, to purchase the property.

44. In addition, the first defendant says that it makes no economic sense for the company to pursue this claim. The company cannot afford to purchase the property, and, being insolvent, should not take on any more debt. If the company fought the claim and lost it would be disastrous, because the company would be liable for the first defendant's costs. If the company succeeded, it would still have to reimburse the cost of purchase to the first defendant, for which purpose it has no resources, and the first defendant would accordingly proceed to wind up the company. Because the company is insolvent, the interests of the creditors come first and it is not in the interests of the creditors to risk the limited resources it has in this litigation. The company has run its course and its limited business is nearly at an end.

45. Finally, the first defendant submits that the claimant is not acting in good faith in pursuing this claim. He says the claimant is pursuing the claim in his own interests. The appropriate remedy for such a grievance (he says) is a petition under section 994 of the 2006 Act in respect of conduct unfairly prejudicial to him as a shareholder.

Discussion

46. In my view the first defendant misses the point with his arguments that the company has not *lost* anything. The claims sought to be made are claims in respect of alleged breach of fiduciary duty by the first defendant, owed to the company. These do not depend, like claims in tort, on proving *loss* to the company, as they are concerned instead to strip *gains* from the first defendant. The focus is completely different. So in *Bhullar v Bhullar* and *O'Donnell v Shanahan*, the Court of Appeal made clear that it

did not matter that the business opportunity concerned was not within the scope of the company's business, and that the company did not have the resources to exploit it. What mattered was whether the first defendant had exploited an opportunity that he should not have exploited, at the expense of the company. The company should have had the opportunity to consider it and either take it up or refuse it. That is (part of) what undivided loyalty means.

47. Nor do I accept that the terms of section 175(3) excuse the first defendant from any applicable duty to the company under that section by reason of having become the landlord of the company. For that subsection to apply, there must be a transaction or arrangement "with the company". The transaction by virtue of which the first defendant became the company's landlord was not with *the company*: it was with the previous owner of the freehold reversion.

48. On the other hand, the company had already agreed (independently) with the previous owner to pay the rent and service charges, and that involved no breach of duty by the first defendant. Then the landlord sold his rights for value to the first defendant. As I have already said, section 175 encapsulates both the 'no-profit' and the 'no-conflict' rules of the pre-existing caselaw. That caselaw says that the two rules should be considered separately. For the first defendant to acquire and exercise those rights as against the company does not involve any breach of the no-profit rule. The first defendant is not profiting from his position as director, but from his position as landlord. He is not profiting from any property of the company: he is profiting from his own property: *cf Re Gee* [1948] Ch. 284.

49. Nor, at all events unless the opportunity came to the first defendant as a director of the company, is this a breach of the no-conflict rule. If the company had entered into a transaction with the first defendant as freehold owner of the property to obtain a tenancy from him, that would have been a transaction falling within section 175(1) with at least the potential to create a conflict of interest. But it would have been excused by section 175(3). Moreover, by the company's entering into it with knowledge of the situation, it would have been authorised by the company, under section 175(4)(b). Here, the legal framework in both the company and the first defendant found themselves had been established by an earlier transaction between the company and the original owner. That produced no conflict between the company and the first defendant. When the first defendant stepped into the previous freeholder's shoes, he acquired precisely the same rights and liabilities as the previous freeholder had. The legal rights that each enjoys have been established already. Subject to one other point, there is no transaction to produce a conflict or potential conflict.

50. That one other point is the notice to quit and notice under section 25 of the 1954 Act, on which the claimant relies to show that the first defendant had the potential to and did put himself in a position of conflict with the company. But the notice to quit is an incident of the property rights which follow on from the original landlord-tenant relationship (approved by the company). Under that relationship, the landlord is entitled to serve a notice to quit and a section 25 notice. Apart from the conflict argument, there is no suggestion that the notice was ineffective at common law or under section 25.

51. Moreover, in the case of a monthly periodic tenancy (such as the present appears to be), for one of two joint tenants of the tenancy (who are therefore necessarily trustees) to serve a notice to quit to determine the tenancy is not a positive act which can amount to a breach of trust: *Crawley Borough Council v Ure* [1996] QB 13, CA. If a trustee would not commit a breach of trust by giving a notice to quit, I do not see how it can be said to be a breach of the first defendant's fiduciary duty as a director of the company to do the same. At all events, any such claim would be a weak one.

52. As for the section 25 notice, it was held by the Court of Appeal in *Harris v Black* (1983) 46 P & CR 366, where two trustees of land (holding business premises) for themselves were now at loggerheads, and one did not wish to continue as joint tenant with the other, that it was not a breach of trust for one to refuse to join in a counter-notice to a section 25 notice from the landlord. The circumstances here are analogous. If in such circumstances it would not be a breach of duty for the first defendant to refuse to agree to the company's serving a counternotice, I have difficulty in seeing how it could be a breach of duty for the first defendant as landlord to have served the original section 25 notice at all. Again, any such claim would at best be weak.

53. As for the point that the first defendant would be making the company homeless, there is no evidence of any real loss there, except for the occupation rents which the company currently receives from sub-lettings. But it appears that the company can carry on its small remaining business from any office or indeed home address, and if the latter then the cost of its own rent of the premises would be saved.

54. Earlier, I specifically excepted the case where the information about the freehold reversion came to the first defendant *in his capacity as* a director of the company. But in this case so far there is no credible evidence that this was so. The first defendant came to and occupied the property before there was a joint venture with the claimant, and before there was a company of which he was a director. So he would have been aware of the possibility of acquiring the freehold reversion before he became a director. That is a fatal weakness in the case. The letter from the previous owner's agent dated 14 April 2021, to which I referred earlier, says that he assumed that the first defendant was acting as a director of the company. That does not assist the claimant. A further weakness is the lack of any evidence showing that the property is worth more than the first defendant paid for it, or that it has any development potential value.

55. The result is that I cannot say, on the material before me, that there is more than a prima facie case presented. Indeed, now that I have been able to take into account the material put forward by the first defendant, there seems to be rather less than this. This means that I should refuse permission at the outset. But in case I am wrong about this, I will go on to consider the further points raised by the first defendant.

56. First, there is the requirement in section 263(2)(a) of the 2006 Act for the court to refuse permission it is satisfied that no director of the company complying with the duty under section 172 would seek to continue the claim. In order to consider this point, the court must conduct some kind of cost-benefit analysis. Here, if the company loses the case, it will be financially ruinous. If the company wins the case, it will be able to obtain the property, but only by reimbursing the first defendant for what he paid, *ie* £112,000. The company does not have this sort of money, and there is no evidence that the claimant is in any position to lend it. A bank statement shows that he

has only about £40,000 in an account, and there is no evidence that that is actually available to lend to the company. So either the property would have to be sold (leaving it with any profit or loss on the sale) or the first defendant would petition for its winding up. This means that the whole point of this case if pursued will be simply to obtain any profit on resale for the company. Given that there is no evidence before me that the property is worth any more than the first defendant paid for it, this is extremely unattractive as a motive for litigation.

57. More generally, this company is deadlocked, and its business has been considerably reduced. It has no sufficient assets with which to fight legal proceedings. It is going nowhere. Since on the latest figures available it appears to be both balance sheet insolvent and trading at a loss, the section 172 duty is now owed to the creditors rather than to the members. In my judgment, no director of the company having regard to the interests of the creditors would take on the very significant costs risk in fighting this case. Accordingly, no such director would seek to continue this claim. That means I must refuse permission under section 263(2)(a).

58. Even if that were wrong, the court in considering whether to give permission would still have to take into account the importance that a director of the company acting in accordance with section 172 would attach to continuing the claim. In my judgment, it would be a very significant factor to take into account, and, given the weakness of the claim and the significant costs risk, with such serious consequences, it would lead to the same result, namely, a refusal to continue with this claim.

59. In view of the result to which I have already come, it is not necessary for me to deal with the further argument based on lack of good faith by the claimant. I should also say that the claimant originally sought an indemnity for costs from the company. During the argument he changed his ground somewhat, offering to take on the case without an indemnity, and relying on his ability to seek a costs order in his favour if he was successful. Again, in view of the result to which I have come, I need not deal with this.

Conclusion

60. The result is that I dismiss this application for permission to continue the derivative claim. Once this judgment is formally handed down, the interim injunction will have to be discharged. I am grateful to both counsel for their pertinent and interesting arguments. I would be grateful to receive a draft minute of order for approval.