Hilary Term
[2011] UKSC 16
On appeal from: [2009] EWCA Civ 1399

JUDGMENT

Farstad Supply A/S (Respondent) *v* Enviroco Limited (Appellant)

before

Lord Hope, Deputy President
Lord Rodger
Lord Mance
Lord Collins
Lord Clarke

JUDGMENT GIVEN ON

6 April 2011

Heard on 19 and 20 January 2011

Appellant
George Bompas QC
Poonam Melwani
Saira Paruk
(Instructed by Clyde & Co LLP)

Respondent
Ceri Bryant
Ben Griffiths

(Instructed by HBJ Gateley Wareing)

LORD COLLINS

Introduction

1. It is not often that, as in this case, the question of the construction of a charterparty arises in the Chancery Division. The issue between the parties is whether one of them is an "Affiliate" of the charterer for the purposes of provisions in a charterparty by which both the owner and the charterer agreed to indemnify and hold each other harmless (including in the case of the charterer its "Affiliates") in relation to certain liabilities.

2. The charterparty provides (in clause 1):

> "In this Charter Agreement the following words and expressions shall have the meanings hereby assigned to them except where the context otherwise requires:-
>
> a) 'Affiliate' means any subsidiary of the Charterer … or a company of which the Charterer … [is] a Subsidiary or a company which is another Subsidiary of a company of which the Charterer … is a Subsidiary. For the purposes of this definition 'Subsidiary' shall have the meaning assigned to it in Section 736 of the Companies Act 1985."

3. By clause 1.2 a reference to any statute or statutory provision is to include a reference to any amendment, extension, consolidation or replacement thereof.

4. Although for the purposes of this dispute the relevant provisions are to be found in the Companies Act 1985 (as amended by the Companies Act 1989) identical provisions are re-enacted by the Companies Act 2006, and the issue on this appeal is of some general importance. The statutory definition of "subsidiary" is incorporated by reference in other legislation (e.g. Transport Act 2000, section 65; Enterprise Act 2002, section 223; Energy Act 2004, section 196). Incorporation of the statutory definition in commercial contracts (of which this case is an example) is very common. In this case it has had an unexpected result which has arisen through a combination of two factors. The first factor is that, as will be seen, the statutory definition of subsidiary in important respects uses the term "member" which normally connotes the person on the share register. The

second factor flows from a difference between English and Scots law and practice relating to the holding of shares by way of security: under Scots law and practice the mortgagee is registered as the holder of the shares, by contrast with the position in England, where commonly an equitable charge by way of deposit of the share certificate will constitute the security. As Lord Hope and Lord Rodger explain fully in their judgments, under Scots law the only way in which a fixed security over shares can be taken is by fiduciary transfer of the shares to the creditor (*fiducia cum creditore*). The security is known as a share pledge, under which registration of the creditor as holder of the shares constitutes the security.

5. The unexpected result may be (if the Court of Appeal was right) that, in the somewhat unusual circumstances of this case, a company which would otherwise undoubtedly be the subsidiary of another company ceased to be so when the shares in the former company were charged by the latter company to a Scottish bank. To oversimplify considerably, a major question on the appeal is whether, for the purposes of the statutory provision and the contract, the putative holding company remained a "member" notwithstanding that the shares which it owned were charged to, and registered in the name of, the mortgagee's nominee company.

The facts

6. The charterparty was entered into on February 4, 1994. The owner was Farstad Shipping A/S ("Farstad") and the charterer was then called Aberdeen Service Company (North Sea) Ltd ("Asco UK Ltd" or "the Charterer"). The chartered vessel was the "Far Service" ("the Vessel") and the charter was, initially, for 5 years with an option to extend for up to a further 5 years. The Vessel was to supply and/or assist and/or service offshore installations. The charter in fact continued until at least December 2005.

7. The charterparty contained mutual exceptions and indemnities to lay out a regime allocating risk and responsibility in respect of the main types of liability situations that might arise as between Farstad and the Charterer. In particular Farstad was to defend and hold harmless the Charterers, its Affiliates and Customers, in respect of any loss or damage to the Vessel or to other property of Farstad (clause 33.5).

8. Asco UK Ltd is a wholly owned subsidiary of what is now called ASCO plc, formerly ASCO Group plc ("ASCO"), a major oil and gas logistics company. Enviroco Ltd ("Enviroco") carries on business (inter alia) in the industrial cleaning of ships. Until 1999 it too was a wholly owned subsidiary of ASCO.

9. In November 1999, in connection with a joint venture with Stoneyhill Waste Management Ltd ("Stoneyhill"), the shares in Enviroco were converted into equal numbers of A and B ordinary shares with ASCO retaining the A shares and Stoneyhill holding the B shares. The effect of the amended Articles of Association was that ASCO had the right to appoint a majority of directors. In addition, pursuant to an agreement with Stoneyhill, ASCO was entitled to exercise a majority of the voting rights in Enviroco. The A shares were registered in the name of ASCO and the B shares were registered in the name of Stoneyhill.

10. ASCO and Enviroco are both registered in Scotland, and in May 2000 ASCO executed a Deed of Pledge, governed by Scots law, in favour of the Bank of Scotland ("the Bank"), for itself and as agent and "Security Trustee" for a syndicate of banks, to secure facilities granted or to be granted by some of the banks. By the Deed of Pledge ASCO pledged, charged and assigned to the Bank the A ordinary shares held by it in Enviroco, and agreed to register, or procure the registration of the shares in the name of the Bank or its nominees until the secured liabilities were repaid. The shares were then registered in the name of Bank of Scotland Branch Nominees Ltd ("the Nominee").

11. The Deed of Pledge provided that until the security became enforceable "the full voting and other rights and powers in respect of the Shares" were exercisable by ASCO and that ASCO would be appointed as proxy in relation to the voting of the shares until the security was enforced. No voting rights or other powers were exercised by the Bank or the Nominee, all dividends were paid to ASCO and the security was never enforced.

The proceedings

12. On July 7, 2002 Enviroco was employed to clean the oil tanks of the Vessel. While the tanks were being cleaned by Enviroco's employees, a fire occurred in the engine room causing substantial damage to the Vessel and the death of an Enviroco employee.

13. On March 26, 2007 Farstad issued proceedings in Scotland claiming damages from Enviroco amounting to approximately £2.7 million in respect of losses allegedly suffered by Farstad as a consequence of the incident in 2002. Enviroco sought to rely on the mutual exception and indemnity clauses on the basis that it was an "Affiliate" of Asco UK Ltd because each of them was a subsidiary of ASCO.

14. The principal issue is whether the fact that, in accordance with Scottish practice, the shares in Enviroco were registered in the name of the Bank's nominee company has the result that Enviroco was not a subsidiary of ASCO at the relevant time and therefore not an "Affiliate" for the purposes of the charterparty.

15. In December 2007 Enviroco issued these proceedings in England seeking a declaration that on the true and proper construction of the charterparty Enviroco was an Affiliate of the Charterer.

"Subsidiaries": the statutory definitions

16. There are many situations in which company law takes account of groups of companies: see Gower and Davies, *Principles of Modern Company Law*, 8th ed. 2008, para 9-16. They include financial reporting, the control of transactions between a company and its directors, or of the purchase of a company's own shares. It is plainly important and necessary to define what is meant by a "subsidiary" for these and other purposes. There is a special definition for accounting purposes in section 1162 and schedule 7 of the 2006 Act, previously in section 258 and schedule 10A of the 1985 Act (inserted by the Companies Act 1989). The definition for general purposes is in section 1159 and schedule 6 of the 2006 Act, previously in sections 736 and 736A of the 1985 Act as amended by the Companies Act 1989.

Greene Committee and the Companies Acts 1928 and 1929

17. The Companies Act 1928 was the first to deal with the definition of subsidiary, by amending the Companies Acts 1908 to 1917 prior to their consolidation into the Companies Act 1929. The terms "holding company" and "subsidiary" were defined for the purpose of new accounting provisions in sections 122 to 128 of the 1929 Act, which gave effect to the recommendations of the Company Law Amendment Committee (the Greene Committee), 1926, Cmd 2657. Section 127 of the 1929 Act (re-enacting section 40 of the 1928 Act) provided that a company would be deemed to be a subsidiary company of another company if the latter held shares, directly or through a nominee, and (a) the amount of the shares so held was more than 50% such as to entitle the shareholder to more than 50% of the voting power; or (b) the shareholder had power (other than under security documents) to appoint the majority of the board. Where a company the ordinary business of which included lending held shares in another company as security only, no account was to be taken of the shares so held in determining if that other company was a subsidiary: section 127(2). The provisions made no use of the concept of "member."

Cohen Committee in 1945 and the Companies Acts 1947/1948

18. The Cohen Committee on Company Law Amendment recommended in 1945 (Cmd 6659) a revised definition of holding company and subsidiary, where there existed either (a) control of the subsidiary through the board of directors and ownership (direct or indirect) of shares in the subsidiary, or (b) beneficial ownership (direct or indirect or through subsidiaries) of more than half of the subsidiary's equity share capital. The recommendations also envisaged that, as before, shares held as security only by a company the ordinary business of which included lending would continue to be left out of account. The Committee's focus was on the beneficial ownership of shares and not on the status of membership.

19. The changes made by the Companies Act 1947 (consolidated in the Companies Act 1948) were in terms different from those proposed by the Cohen Committee, and introduced the concept of membership into that part of the definition which related to control of composition of the board. By section 154(1)(a) of the 1948 Act a company was deemed to be a subsidiary of another

> "if, but only if, –
>
> > (a) that other either –
> >
> > (i) is a member of it and controls the composition of its board of directors, or
> >
> > (ii) holds more than half in nominal value of its equity share capital …"

20. Special provision was made to deal with shares held by nominees or by way of security in section 154(3)(b),(c),(d), the broad effect of which was that shares held or powers exercisable were to be treated as held or exercisable by the beneficial owner or by the grantor of the security.

The Jenkins Committee, the Companies Act 1967, and the Companies Act 1985 as originally enacted

21. The Jenkins Committee (Company Law Committee, 1962, Cmnd 1749) recommended that there should be an amended definition of subsidiary "based solely on membership and control" (i.e. the first part of the formula in the 1948

Act) because the definition in the 1948 Act could result in a company being a subsidiary of two other companies, and because non-voting and restricted voting equity shares had become more common with the result that a company might own a majority of shares without controlling the composition of the board: paras 149-150 and 156. But this part of the Jenkins Committee's proposals was not adopted in the Companies Act 1967, with the consequence that the definition in the 1948 Act continued to apply.

22. As originally enacted, section 736(1) of the original 1985 Act was in the same terms as section 154(1) of the 1948 Act, with the provisions dealing with nominees and mortgagees now in section 736(4).

The European Community's Seventh Council Directive on consolidated accounts and the changes to the 1985 Act

23. The Seventh Council Directive on consolidated accounts (83/349/EEC of June 13, 1983) required changes in the subsidiary/holding company definition used for accounting purposes. The Companies Act 1989, which implemented the Directive, introduced a new subsidiary/holding company definition for accounting purposes in sections 258 and 259 and schedule 10A (now section 1162 and schedule 7 of the 2006 Act). Section 258(2) defined the "parent undertaking/subsidiary undertaking" by reference to four alternative criteria, two of which used the concept of membership: section 258(2)(b) ("it is a member of the undertaking and has the right to appoint or remove a majority of its board of directors") and section 258(2)(d) ("it is a member of the undertaking and controls alone, pursuant to an agreement with other shareholders or members, a majority of the voting rights in the undertaking").

24. Section 258(3) provided that an undertaking was to be "treated as a member of another undertaking"

> "(b) if any shares in that other undertaking are held by a person acting on behalf of the undertaking or any of its subsidiary undertakings."

25. Schedule 10A contained provisions explaining and supplementing those in section 258. They included provisions (paras 7 and 8) that "rights held by a person as nominee for another" were to be treated as held by that other and that "rights attached to shares held by way of security" were to be treated as held by the person providing the security.

26. The 1989 Act also amended the subsidiary/holding company definition in section 736, with supplementary provisions in section 736A (now section 1159 and schedule 6 of the 2006 Act). Sections 736 and 736A were similar, but not identical, to section 258 and schedule 10A. In particular, with some minor drafting differences, section 736 contained three of the four criteria in section 258(2) (that is, all except the criterion of dominant influence by virtue of the memorandum or articles or of a control contract: section 258(2)(c), and see also section 258(4) for the criteria of actual dominant interest and unified management). Section 736A contained provisions which were similar to (in the case of nominees) or identical to (in the case of shares held as security) to those in schedule 10A. But one important difference for the purposes of this appeal is that sections 736 and 736A contained no equivalent to section 258(3) deeming an undertaking to be a member if shares in the putative subsidiary were held by a person acting on behalf of the undertaking.

27. So far as material to this appeal, sections 736 and 736A of the 1985 Act provide:

> "**736 'Subsidiary', 'holding company' and 'wholly-owned subsidiary'**
>
> (1) A company is a 'subsidiary' of another company, its 'holding company', if that other company—
>
> > (a) holds a majority of the voting rights in it, or
> >
> > (b) is a member of it and has the right to appoint or remove a majority of its board of directors, or
> >
> > (c) is a member of it and controls alone, pursuant to an agreement with other shareholders or members, a majority of the voting rights in it,
>
> …
>
> (3) In this section 'company' includes any body corporate.
>
> **736A Provisions supplementing s. 736**

(1) The provisions of this section explain expressions used in section 736 and otherwise supplement that section.

(2) In section 736(1)(a) and (c) the references to the voting rights in a company are to the rights conferred on shareholders in respect of their shares … to vote at general meetings of the company on all, or substantially all, matters.

(3) In section 736(1)(b) the reference to the right to appoint or remove a majority of the board of directors is to the right to appoint or remove directors holding a majority of the voting rights at meetings of the board on all, or substantially all, matters; and for the purposes of that provision—

(a) a company shall be treated as having the right to appoint to a directorship if—

(i) a person's appointment to it follows necessarily from his appointment as director of the company, or

(ii) the directorship is held by the company itself; and

(b) a right to appoint or remove which is exercisable only with the consent or concurrence of another person shall be left out of account unless no other person has a right to appoint or, as the case may be, remove in relation to that directorship.

…

(5) Rights held by a person in a fiduciary capacity shall be treated as not held by him.

(6) Rights held by a person as nominee for another shall be treated as held by the other; and rights shall be regarded as held as nominee for another if they are exercisable only on his instructions or with his consent or concurrence.

(7) Rights attached to shares held by way of security shall be treated as held by the person providing the security—

(a) where apart from the right to exercise them for the purpose of preserving the value of the security, or of realising it, the rights are exercisable only in accordance with his instructions;

(b) where the shares are held in connection with the granting of loans as part of normal business activities and apart from the right to exercise them for the purpose of preserving the value of the security, or of realising it, the rights are exercisable only in his interests.

…

(12) In this section "company" includes any body corporate."

The decisions below and the appeal

28. No reliance was placed by Enviroco on section 736(1)(a) or (b), but it was common ground that ASCO "controls alone, pursuant to an agreement with other shareholders or members [i.e. Stoneyhill], a majority of the voting rights in" Enviroco, which would therefore be a subsidiary of ASCO within section 736(1)(c) if ASCO were "a member" of Enviroco.

29. Mr Gabriel Moss QC sitting as a Deputy Judge in the Chancery Division held that: (a) as a matter of contractual interpretation, Enviroco was an Affiliate of the Charterer notwithstanding that ASCO's shares in Enviroco had been pledged to the Bank of Scotland by a method which involved the registration of the shares in the name of the Nominee as a member of Enviroco by way of security; and (b) a company remained a holding company of its subsidiary within the meaning of section 736(1)(b) and 736(1)(c) even after it had given all of its shares as security to a lender and the lender or its nominee had been registered as holder of the shares as part of the perfection, protection or enforcement of its security.

30. The Court of Appeal (Mummery, Longmore and Patten LJJ) allowed an appeal by Farstad and held that the definition provision in clause 1(a) of the charterparty was an unequivocal direction that the statutory definition was to be

applied, and that Enviroco was not a subsidiary of ASCO within sections 736 and 736A of the 1985 Act, because: (1) by providing that the putative holding company is to be a "member" of the subsidiary, both sections 736(1)(b) and (c) require the putative holding company actually to be a "member" of the subsidiary within the definition of "member" of a "company" in section 22 of the 1985 Act, that is, to be registered as a member; (2) that requirement could not be satisfied by virtue of the attribution provisions in sections 736A(6) and 736A(7); and (3) sections 736 and 736A had to have the same meaning when applied to the charterparty so that no different construction was available in the commercial context.

31. Enviroco's arguments on the appeal to this Court are these. It puts at the forefront an argument on policy. It says that the version of section 736 introduced by the 1989 Act was intended to bring the definition of holding company and subsidiary into line with the new definitions of parent undertaking and subsidiary undertaking introduced by section 258. It cannot have been the intention of Parliament, in enacting a new and stricter definition of holding company and subsidiary, to enable easy evasion of the statutory restrictions imposed on holding and subsidiary companies by the use of nominees, or to displace those restrictions by the use of ordinary security arrangements with ordinary lending institutions.

32. From that basis Enviroco goes on to put two separate arguments for the conclusion that Enviroco is a subsidiary of ASCO. The first is that ASCO is a "member" within the meaning of section 736(1)(c). The second is that the attribution provisions of section 736A(6) and (7) have the same effect.

33. The first argument is developed in this way. The reference to "member" in section 736(1)(c) (and in section 736(1)(b)) does not require the putative parent company to be named in the subsidiary's register of members since sections 736 and 736A expressly apply not only to "companies" (companies formed and registered under the Companies Acts) which have a register of members, but also to all other forms of body corporate, whether or not incorporated in Great Britain, and whether or not they have any register of members or equivalent, and so the use of the word "member" in the two subsections could not have been intended to denote or require entry on a register of members. The effect of the original section 736 of the 1985 Act was that the putative parent company was not required to be on the register, and Parliament did not intend, and did not legislate for, any change in that regard in 1989. The reference to "member" is intended to refer to the holding of rights of membership (as distinct from the holding of shares, a concept of no application in the case of bodies corporate without any share capital, such as companies limited by guarantee) rather than actual entry on the register.

34. The second argument is that the attribution provisions in sections 736A(6) and (7) attribute to the putative holding company the membership rights enjoyed by a nominee for the holding company (section 736A(6)) or by a chargee holding shares charged by the putative holding company (section 736A(7)), so that it is the holding company which has those rights and is thereby the member for the purposes of section 736.

The meaning of "member" and the attribution provisions

Members

35. Section 22 of the 1985 Act (now section 112 of the 2006 Act), provides:

> "**Definition of 'member'**
>
> (1) The subscribers of a company's memorandum are deemed to have agreed to become members of the company, and on its registration shall be entered as such in its register of members.
>
> (2) Every other person who agrees to become a member of a company, and whose name is entered in its register of members, is a member of the company."

36. That definition applies to all bodies corporate which are formed and registered under the legislation. Enviroco is a company formed and registered under the 1985 Act.

37. The starting point is that the definition of "member" in what is now section 112 of the 2006 Act (section 22 of the 1985 Act for the purposes of this appeal) reflects a fundamental principle of United Kingdom company law, namely that, except where express provision is made to the contrary, the person on the register of the members is the member to the exclusion of any other person, unless and until the register is rectified: *In re Sussex Brick Company* [1904] 1 Ch 598 (retrospective rectification of register did not invalidate notices).

38. Ever since the Companies Clauses Consolidation Act 1845 and the Companies Act 1862 membership has been determined by entry on the register of members. The companies legislation proceeds on that basis and would be unworkable if that were not so. Among the many provisions relating to members

are these: (1) a member will be bound by alterations in the company's articles, subject to specified exceptions (section 25, 2006 Act); (2) there are elaborate provisions relating to the register of members (sections 113 *et seq*), including a duty to keep an index of members (section 115) and rights to inspect and require copies (sections 116-121), and documents in hard copy form must be sent to a member at his address as shown in the register of members (schedule 5, Part 2); (3) a subsidiary cannot be a member of its holding company (section 136); (4) elaborate provision is made for voting by members, by proxies appointed by members, and by joint holders (sections 281 *et seq*); (5) the company must send its annual accounts and report to every member (section 423); (6) unlawful distributions may be recovered from a member who knows or has reasonable grounds for believing that it is unlawfully made (section 847(2)).

39. For those and other purposes the legislation makes it clear that the member is the person on the register, and where it is necessary to apply the legislation to persons who are not on the register, special provision is made. Thus where the shares are bearer shares, special provision is made to allow the bearer to be deemed to be a member (section 122(3)). So also the right of a member to bring a derivative claim or present an unfair prejudice petition is expressly extended "to a person who is not a member of a company but to whom shares in the company have been transferred or transmitted by operation of law" (sections 260(5) and 994(2)).

40. There is no basis for construing section 736(1)(c) (or section 736(1)(b)), taken alone, in any different sense. There is no equivalent, either in section 736 or section 736A, to the deeming provision in section 258(3)(b) where, for accounting purposes, an undertaking is to be treated as a member of another undertaking if shares in the latter are held on its behalf. The absence of such a provision is indicative, although not decisive, and, as will be seen, the reason for its absence is a matter for conjecture only.

The attribution provisions

41. The second argument is that the effect of attribution provisions in sections 736A(6) and (7) is to attribute to ASCO the membership rights enjoyed by the Nominee. In effect this argument amounts to much the same thing as saying that they are to be read as if section 258(3)(b) were part of section 736A.

42. Section 736A(6) provides that "rights held" by a person as nominee for another "shall be treated as held by the other", and section 736A(7) provides in principle that "rights attached to shares held by way of security shall be treated as

held by the person providing the security". These are in substantially the same terms as schedule 10A, paras 7 and 8, supplementing section 258.

43. Neither of these provisions says anything about membership. They are concerned with rights, not status, and plainly refer back to the voting rights and the right to appoint or remove the board in section 736(1)(a)-(c), and their elaboration in sections 736A(2) and (3), which provide, respectively, that in section 736(1)(a) and (c) the references to voting rights are to rights conferred on shareholders in respect of their shares, and in section 736(1)(b) the reference to appoint or remove a majority of the board is to the right to appoint or remove directors holding a majority of voting rights. Those are the "rights held" or "rights attached to shares". The fact that the similar provisions in schedule 10A, paras 7 and 8 were supplemented by section 258(3) is a strong, but not decisive, additional reason for not construing sections 736A(6) and (7) in the way for which Enviroco contends.

The argument from history

44. Nor is there anything in the history of the legislation to affect these conclusions. It is true that from the 1947 Act until the 1985 Act special attribution provisions dealt with nominees and mortgagees in such a way as to treat the beneficial owner/person providing the security as a member where necessary, but there is no secure basis for using those provisions to interpret the amendments made by the 1989 Act.

45. Enviroco uses the Parliamentary history of the 1989 Act relating to what became sections 258 and 736-736A in two ways, the second much more elaborate than the first. The first argument is that the fact that it was never suggested that the introduction of the requirement of membership in section 736(1) was a change in the law supports an inference that no change was intended. The second argument is based on what happened in the passage of the 1989 Companies Bill through its committee stages in the House of Lords and the House of Commons. In the House of Lords amendments were made in the Bill both to what became section 258 and sections 736 and 736A, which included a provision (draft section 736(5)(d)), which was identical to what became section 258(3) ("undertaking shall be treated as a member of another undertaking … (b) if any shares in that other undertaking are held by a person acting on behalf of the undertaking ..."). Then substantial amendments were introduced at the committee stage in the House of Commons to include provisions which became the attribution provisions in schedule 10A (supplementing section 258) and sections 736A(6) and (7). At that time the deemed membership provision in what became section 736A was deleted, but not the equivalent provision in what became section 258(3). Nevertheless, speaking for the Government, Mr Maude in the House of Commons and Lord Fraser of Carmyllie in the House of Lords said that the definition of subsidiary in what

became sections 258 and 736 overlapped, and that the amendments were designed to ensure that where they overlapped, "they do so perfectly": see Hansard (HC Debates), 22 June 1989, Standing Committee D, col 473 and Hansard (HL Debates), 9 November 1989, col 1020.

46. Enviroco argues that the overall effect is that the draftsman took the view that the membership deeming provision in both the earlier drafts of sections 258 and 736/736A was unnecessary in the light of the attribution provisions in what became schedule 10A, paras 7 and 8 and (in the same terms) section 736A(6), (7), but by oversight it was not deleted from what became section 258(3).

47. It is true that, in the unusual situation of the present case, where ASCO has turned Enviroco into a joint venture company and where it has charged the shares to a Scottish bank, the legislation does lead to a result which is certainly odd and possibly absurd. But there is no relevant ambiguity in section 736 and no clear statement which casts any light on any question of interpretation which arises on this appeal. The ministerial statements fall far short of a case for the application of even the most generous application of *Pepper v Hart* [1993] AC 593.

48. The drafting history (to the extent it may be looked at: cf *Ward v Commissioner of Police of the Metropolis* [2005] UKHL 32, [2006] 1 AC 23, at 27) does not throw any light on the reason for the omission from section 736 or section 736A of a provision equivalent to section 258(3). It does seem likely that there was an error. The ministerial statements do not assist on the question whether the deeming provision was incorrectly omitted from sections 736 and 736A, or incorrectly retained in section 258(3). The more likely explanation is that it was incorrectly omitted from section 736A.

49. There is therefore no clear basis on which "the court must be abundantly sure" that there is a drafting error of the nature which the Court can correct: *Inco Europe Ltd v First Choice Distribution* [2000] 1 WLR 586 at 592. The exercise which Enviroco would require from the Court would be an impermissible form of judicial legislation.

50. Enviroco has made much of the danger of evasion of statutory regulation which could occur if the Court of Appeal's construction were right, and the Deputy Judge and Longmore LJ were troubled by this. The problem of construction has been recognised by textwriters for some time (especially *Gore Browne on Companies*, 44th ed (1986), vol 1, Supplement 45, pp 1.019-1.020, para 1.6.1), but no material was put forward to suggest that advantage had been taken, in the 20 years or so since the provisions were enacted, of what was described by Enviroco as a loophole. If there were such material, or if there had been an error, then the

relevant provisions of the 2006 Act, section 1159 and schedule 6, could be amended by regulation, subject to negative resolution, under the power given to the Secretary of State in section 1160. That would be a legitimate route, by contrast with the exercise, which Enviroco in effect asks this Court to undertake, of judicial re-drafting of sections 736 and 736A.

Contractual construction

51. Nor is there any basis for construing the definition differently because it is incorporated in a contract. The starting point is that if the terms of a statute are incorporated into a contract by reference, the contract has to be read as if the words of the statute are written out in the contract and construed, as a matter of contract, in their contractual context: see *Adamastos Shipping Co Ltd v Anglo-Saxon Petroleum Co Ltd* [1959] AC 133, 152, 184.

52. It is true that it is likely that, if they had addressed their minds to it, the parties would not have envisaged that a subsidiary would cease to be so merely because the shares in it were charged to a Scottish bank. But the Court is in no position to re-write the contract for the parties. Thus if the parties had been alive to the possibility and had been presented with it, it is by no means clear that Farstad would have been willing to exempt from liability a sister company of the Charterer which was only 50% owned by ASCO. This is not a case in which it can be said that applying the wording of section 736 flouts business commonsense: *The Antaios* [1985] AC 191, 201. Nor is it a case in which it could be said that "…something must have gone wrong with the language…": *Investors Compensation Scheme Ltd v West Bromwich Building Society* [1998] 1 WLR 896, 913; *Chartbrook Ltd v Persimmon Homes Ltd* [2009] UKHL 38, [2009] 1 AC 1101, at [15]. Nor is there anything in the factual matrix to suggest that the words of section 736 and 736A have a different meaning or construction in the charterparty from the meaning that they would have in the statutory context.

53. For those reasons I would dismiss the appeal.

LORD HOPE

54. I agree with Lord Collins and Lord Rodger that the appeal must be dismissed. I wish to add only a brief footnote to what Lord Rodger has said about the position in Scots law.

55. The question whether there was any room for a difference of view between English and Scots law as to the effect of the entry of a person on the register of a company as a member was considered in *Elliot v Mackie & Sons Ltd; Elliot v Whyte* 1935 SC 81. In that case the trustees and executors of the deceased founder of a well-known private company had executed transfers of shares in favour of two of their number and a third party to enable them to qualify as directors of the company under the articles. This was because the trustees and executors wished to have an adequate representation on the board of directors of the company. The certificates were endorsed to make it plain that the transfers were purely nominal and done only in order to enable the transferees to qualify as directors, the beneficial interest remaining in the transferors. This initiative was objected to by some of the beneficiaries under the deceased's testamentary settlement. They maintained, among other things, that registration of the transfers was ultra vires of the company because the company's articles provided that shares must be held by a director "in his own name and right", and that the register should be rectified because the transferees' names had without sufficient cause been entered in the register.

56. The argument that registration of the transfers was ultra vires of the company because the shares were not held in the transferees' own right as they had no beneficial interest in them was rejected. It was still the practice in Scotland at that time for notice of trusts to be taken in company registers. But Lord President Clyde did not think that this made the relation between the registered trustee and the company in any way different from that which existed in the case of other shareholders. Applying the law as summarised by Lord President Inglis in *Muir v City of Glasgow Bank* (1878) 6 R 392, 399, he said that the trustee has the full right of property in the shares and consequently incurs personally the full liabilities of a shareholder: 1935 SC 81, 90. He then added these words, at pp 90-91:

> "The matter is one in which it is most undesirable to have different interpretations, north and south of the Border, of an expression in common use in the articles of companies whose affairs are regulated by a legislative system which is intended to apply, generally, to both countries; and, whatever view might have been taken – had the matter arisen rebus integris – I think it is too late to open a question which (in England) authority and practice, and (in Scotland) practice conform to that authority, has closed."

57. The expression in common use to which this passage refers is the provision in the company's articles that the qualification was the holding of a certain number of shares in the director's "own name and right." But the underlying point which determined the issue was the effect of the entry of the transferees' names on the register as members of the company, as to which the law on both sides of the Border is the same. The fact that the certificates on the back of the transfers

disclosed that the transfers were purely nominal was insufficient to prevent shares that were actually held in trust from constituting a director's qualification. As Lord Morison said, at p 92, it was of no concern to the company whether the shareholder was the owner of the shares which he held, or whether third parties were the owners or had interests in them.

58. These statements of the law have never been questioned, and I am in no doubt that the same reasoning must be applied in this case. The transaction which led to the entry of Bank of Scotland Branch Nominees Ltd on the register of members of Enviroco Limited in place of Asco Group plc was the agreement between Asco and the Bank of Scotland which led to the transfer to the Bank by Asco of all its shares in Enviroco in security of its obligations to the Bank. The terms of that agreement were set out in the Deed of Pledge, which makes it plain that as between the parties to it this was a transaction in security. But so far as Enviroco itself and all third parties are concerned, Asco must be taken to have transferred to the Bank absolutely and without any qualification all the rights of membership attached to the shares that were previously vested in Asco. It was deprived of those rights as soon as the entry of its name on the register was replaced by that of Nominees.

59. The problem that the Charterparty's use of the statutory definition of "subsidiary" to define the word "affiliate" has given rise to is due to the fact that Scots law insists that, to create a security over shares, the holder of the security – the mortgagee, in other words – must be entered as a member in the register of shareholders of the company. This requirement can be traced back to the rule expressed in the Latin brocard *traditionibus, non nudis pactis, transferuntur rerum dominia*. Equitable transfers are not recognised in Scots law. A mere agreement will not do. Something more is needed to make the agreement effective in a question with third parties. As a general rule this consists of the taking of possession of the security subjects in a way that is appropriate to their nature and characteristics. Enviroco was a company incorporated in Scotland with its registered office in Aberdeen. The lex situs of its shares was Scotland: *Macmillan Inc v Bishopsgate Investment Trust plc (No 3)* [1996] 1 WLR 387, per Staughton LJ at p 405. So Scots law governed what was required to create a security over them. The Bank was entitled to insist upon the delivery into its hands of an instrument of transfer, so that Nominees could be entered in the register of members of Enviroco in place of Asco.

60. The fact that the way the law of Scotland works as to the granting of rights in security over shares in a Scottish company is different from the way security rights may be created over shares under English law must be taken together with its consequences. However much one might have wished that effect might be given in Scots law to the fact that the entry of the Nominees in the company's register as a member of the company although ex facie absolute was truly in

security only, this is no longer – if it ever was – possible. I have not been able to trace any Scots authority that would support such an argument and, for the reasons referred to in *Elliot v Mackie & Sons*, I think that it would stand no chance of being successful.

LORD RODGER

61. I agree with the judgment of Lord Collins. I add a short comment on the effect of the form of security granted by Asco over its shares in Enviroco.

62. As Lord Collins has explained, the critical question is whether, on 7 July 2002, when the fire occurred on the MV Far Service, Enviroco was a subsidiary of Asco plc ("Asco") in terms of section 736(1)(c) of the Companies Act 1985 ("the 1985 Act"). For subsection (1)(c) to apply, Asco had to be "a member" of Enviroco on that date. Unquestionably, Asco had at one time been a member of Enviroco, but on 11 May 2000 Asco entered into a Deed of Pledge with the Bank of Scotland ("the Bank") in order to secure certain obligations and liabilities of Asco to the Bank and certain other lenders. Although the agreement was described as a "Deed of Pledge", the security which it created did not depend on the transfer of possession of the security subjects. Rather, in terms of clause 2(A), Asco pledged, charged and assigned all its shares in Enviroco to the Bank. By clause 3(A), until the relevant liabilities had been discharged in full, Asco had to register, or procure the registration of, the shares in the name of the Bank or its nominees and it had to procure that the Bank or its nominees remained the registered holder of the shares until the relevant liabilities had been so discharged. In short, the security was to be created by transferring title in the shares to the Bank's nominees. This would give the Bank's nominees a real right in the shares in the event of Asco's insolvency.

63. Asco took the steps required by clause 3(B) of the Deed of Pledge, with the result that on 18 May 2000 the register of members of Enviroco was amended to remove the name of Asco and to add the name of the nominees of the Bank as a member. When this was done, Bank of Scotland Branch Nominees Ltd ("Nominees") appeared on the register as a member, holding the shares which had previously been held by Asco when it was a member. Ex facie the register, therefore, Asco was no longer a member of Enviroco and had been replaced by Nominees. Of course, if and when Asco discharged its relevant liabilities, under clause 11 of the Deed, the Bank was required to transfer or cause its nominees to transfer all of the shares in Enviroco back to Asco. At that point – which had not been reached by 7 July 2002 – Asco would have been restored to the register of members and the register would have been altered to show Asco as holding the

shares in Enviroco. As at 7 July 2002, however, Asco did not appear on the register of members of Enviroco and Nominees did.

64. Prima facie, therefore, Enviroco was not a subsidiary of Asco in terms of section 736(1)(c) of the 1985 Act since Asco was not a member of Enviroco. I respectfully agree with Lord Collins' analysis, at paras 41–43, of section 736A and with his conclusion that nothing in that section expands the expression "member" in section 736(1)(c) or supplements, or in any way affects, the requirement that the parent should be a member of the subsidiary.

65. It follows that the appeal must fail for the reasons which Lord Collins gives, unless it can be said that, since the purpose of Asco's transfer of the shares to Nominees was to make Nominees holder of the shares "in security only", according to Scots law Asco was to be regarded as remaining, in substance, a member of Enviroco for all purposes except giving effect to the security. It is only right to point out that no such argument was advanced by counsel for Enviroco at the hearing of the appeal – rightly, in my view.

66. It is, of course, the case that, under clause 5(A) of the Deed of Pledge, for the most part Asco retained the right to exercise all the powers pertaining to the shares. But the mechanism adopted to achieve this confirms that the powers themselves were actually vested in Nominees. For instance, so far as the voting rights are concerned, the arrangement was that, until the security became enforceable, the Bank was to secure that Nominees appointed Asco to act as its proxy in relation to the voting of the shares. Asco was, in effect, to be constituted a procurator in rem suam for this purpose. This arrangement had to be made precisely because Asco was not a member of Enviroco and so could not vote at general meetings of the company; by contrast, Nominees was a member and so would be entitled to vote in respect of the shares. The arrangement ensured that Asco was able to exercise the right to vote, as agreed in clause 5(A), even though it was not a member of Enviroco.

67. There do not appear to be any Scottish cases which discuss the position of a creditor to whom shares have been transferred in security. But in Gloag and Irvine, *Law of Rights in Security Heritable and Moveable and Cautionary Obligations* (1897), p 505, Mr Irvine pointed out that, by going upon the register, the security-holder renders himself liable in all the obligations of a member of the company in terms of the articles of association. "The security-holder is registered individually, and individually he is liable."

68. The author went on, at p 506, to refer to the well-known decisions of the First Division and of the House of Lords as to the position of trustees who were

members of the City of Glasgow Bank when it went into liquidation, due to the fraud of its directors, in October 1878. The liability of members was unlimited. Under reference to the decision of the House of Lords in *Lumsden v Buchanan* (1865) 4 Macq 950, Lord President Inglis summarised the relevant law in *Muir v City of Glasgow Bank* (1878) 6 R 392, 399:

> "Persons becoming partners of a joint stock company, such as the Western Bank, and being registered as such, cannot escape from the full liabilities of partners either in a question with creditors of the company or in the way of relief to their copartners, by reason of the fact that they hold their stock of the company in trust for others, and are described as trustees in the register of partners and the other books and papers of the company."

(At that time, under Scots law it was permissible in certain cases for entries on the register to describe members as trustees.) The decision of the First Division holding the trustees fully liable as contributories was upheld by the House of Lords: (1879) 6 R (HL) 21. Mr Irvine rightly saw that the same reasoning must apply to a security-holder who is entered on the register of members of a company in respect of the shares transferred to him.

69. The decisions in *Muir* and similar cases arising out of the liquidation of the City of Glasgow Bank brought ruin on many people who had merely held shares as trustees. The decisions therefore indicate with remorseless clarity that anyone who is entered on the register of a company as a member in any capacity is quite simply a member, with all the relevant rights and liabilities. That being so, on July 7 2002 Nominees was in all respects the relevant member of Enviroco holding the shares transferred to it. There is therefore no room for the view that, somehow, under Scots law Asco rather than Nominees should be regarded as the member of Enviroco because Asco had transferred its shares to Nominees in security only.

70. Mr Irvine went on, *Law of Rights in Security*, pp 506-507, to identify a number of corresponding drawbacks for the debtor that result from granting a security which depends on transferring the shares to the security-holder. The present case draws attention to another drawback for certain companies which grant such a security. In all the circumstances the appeal must fail for the reasons given by Lord Collins.

LORD MANCE

71. For the reasons given by Lord Collins, supplemented by those given by Lord Hope and Lord Rodger, I agree that this appeal should be dismissed.

LORD CLARKE

72. I was initially attracted by the appellant's case. On any sensible view of the facts Enviroco was throughout a subsidiary of Asco. However, I have reluctantly concluded that there is no escape from the conclusion stated by Lord Hope at para 58 that, when Asco transferred its shares to Nominees, it must be taken to have transferred them absolutely and without any qualification of all the rights of membership attached to the shares that were previously vested in Asco. It was deprived of those rights as soon as the entry of its name on the register was replaced by that of Nominees. I am persuaded by Lord Hope and Lord Rodger that under Scots law, as Lord Rodger puts it at para 69, anyone who is entered on the register of a company is quite simply a member, with all the relevant rights and liabilities. Moreover, that is so, even where, as here the shares have been transferred to Nominees in security only.

73. I also agree with Lord Collins for the reasons he gives that, try as one might, there is no basis upon which it is legally possible to reach any other conclusion as a matter of construction of sections 736 or 736A of the 1985 Act as amended. While I agree with him that it looks likely that the omission from those sections of a provision equivalent to section 258(3) was an error, I also agree with him that the correction of it would amount to impermissible judicial legislation. As Lord Collins explains at para 50, it could have been done in the 20 years or more since the 1989 Act and it could now be done by regulation.

74. For the reasons given by Lord Collins, Lord Hope and Lord Rodger I too would dismiss the appeal.