the petitioner to remain a member.

[16.12] Loch v John Blackwood Ltd [1924] AC 783 (Privy Council)

The engineering business of John Blackwood had, after his death, been formed into a company and run by one of his trustees, McLaren, for the benefit of the three beneficiaries in his estate: McLaren's wife (who was to take one-half), Mrs Loch (one-quarter) and Rodger (since deceased, one-quarter). The business had been run very profitably by McLaren, but (as is described in the judgment) he had run it in a manner which was oppressive to the beneficiaries other than his wife. They accordingly petitioned for the winding up of the company on the ground that it was just and equitable to do so. The Chief Justice of Barbados made an order, which was reversed by the West Indian Court of Appeal but restored by the Privy Council. The remaining facts appear from the judgment.

The opinion of the Privy Council was delivered by LORD SHAW OF DUNFERMLINE: The board of directors now consists of Mr McLaren, his wife Mrs McLaren, who was appointed in 1913, and **(p. 798)** Mr Yearwood. Under this directorate the business of the company appears to have been energetically managed and to have amassed considerable profits.

The arrangement of the capital was this: the total amount was 40,000 in £1 shares; 20,000 of these were allotted to Mrs McLaren; of the remaining 20,000, 10,000 should have gone to Mrs Loch and 10,000 to Mr Rodger. Mrs Loch, however, was allotted 9,999; Mr Rodger, 9,998; and the three shares left over were allotted one to Mr McLaren and one each to Mr Yearwood and Mr King (Mrs McLaren's nominees; the first being Mr McLaren's clerk and the second his solicitor). This was quite a natural and proper arrangement; but, of course, in the event of a division of opinion in the family between what may be called the McLaren interest on the one hand, and the interest of the nephew and niece on the other, the preponderance of voting power lay with the former. It is thus seen that although taking the form of a public company the concern was practically a domestic and family concern. This consideration is important,[52] as also is the preponderance of voting power just alluded to.

In the petition for winding up eight different reasons are assigned therefor. The first is: that the statutory conditions as to general meetings have not been observed; the second that balance-sheets, profit and loss accounts and reports have not been submitted in terms of the articles of the company; and the third is that the conditions under the statute and articles as to audit have not been complied with. All these allegations are true, and it seems naturally to follow from the preponderance already alluded to, that there is at least considerable force in the fifth reason that it is impossible for the petitioners to obtain any relief by calling a general meeting of the company. There are further submissions—namely, that the company and the managing director, Mr McLaren, have refused to submit the value of the shares to arbitration, and that without winding up it is impossible for the petitioners to realise the true value of their shares. But the principal ground of the petitioner is that in the circumstances to be laid before the court it is just and equitable that the company should be ordered to be wound up. This last ground was affirmed by the Court of Common Pleas.

With regard to the first three submissions made in the petition, it was strenuously argued on behalf of the company, which practically means the directorate or the McLaren interest, that however true it might be that owing to the informal way in which the books of the company had been kept it appeared as if both the statute and the articles of association had been violated in various particulars and that no general meetings of the company had been held, and no auditors properly appointed, and it was certain that no balance-sheets, profit and loss accounts and reports had been submitted for the critical years 1919 and 1920, still these were no grounds for winding up. Other applications, it was said, might competently be made to the court to compel the statute and articles to be properly complied with. It may be doubtful whether such a course of conduct lasting in several particulars since its inception until now, would be insufficient as a ground for winding the company up. But their Lordships think it unnecessary to give any separate decision upon such a point.

In their opinion, however, elements of that character in the history of the company, together with the fact that a calling of a meeting of shareholders would lead admittedly to failure and be unavailable as a remedy,

cannot be excluded from the point of view of the court in a consideration of the justice and equity of pronouncing an order for winding up. Such a consideration, in their Lordships' view, ought to proceed upon a sound induction of all the facts of the case, and should not exclude, but should include circumstances which bear upon the problem of continuing or stopping courses of conduct which substantially impair those rights and protections to which shareholders, both under statute and contract, are entitled. It is undoubtedly true that at the foundation of applications for winding up, on the 'just and equitable' rule, there must lie a justifiable lack of confidence in the conduct and management of the company's affairs. But this lack of confidence must be grounded on conduct of the directors, not in regard to their private life or affairs, but in regard to the **(p. 799)** company's business.[53] Furthermore the lack of confidence must spring not from dissatisfaction at being outvoted on the business affairs or on what is called the domestic policy of the company. On the other hand, wherever the lack of confidence is rested on a lack of probity in the conduct of the company's affairs, then the former is justified by the latter, and it is under the statute just and equitable that the company be wound up …

Mr McLaren, for reasons not unnatural, had come to be of opinion that the business owed much of its value and prosperity to himself. But he appears to have proceeded to the further stage of feeling that in these circumstances he could manage the business as if it were his own. Had Mrs Loch and Mr Rodger, or after his death Mr Rodger's executor, obtained a dividend which year by year represented in any reasonable measure a just declaration out of the undoubted profits of the concern, they might no doubt have been content to allow this state of matters to go on; but although on one or two occasions, Mr McLaren paid trifling and fragmentary sums to Mrs Loch, neither she nor the Rodger family have ever obtained any dividend at all. And it is not to be wondered at that in the transaction now about to be mentioned they completely lost confidence in Mr McLaren, and had only too great justification for doing so …

[His Lordship then referred to a decision of the directors to pay McLaren an increased salary and to transfer to him £12,500 War Loan stock, and continued:] No notice was given to the respondents, as shareholders, of this piece of business being contemplated, and no notice was given of what had been done. Four days after this extraordinary transaction, Mr McLaren wrote to Mrs Loch's husband a letter dated 5 May 1920 proposing to her that £10,000 should be given by him as the cumulative value of Mrs Loch's shares and Mr JB Rodger's executor's shares. These shares in all amounted to one-half of the capital of the company—namely, £20,000—and, as already mentioned, it is evident that the true value of assets much exceeded this amount. The proposal was to buy Mrs Loch and the Rodger family out for £10,000. But a further suggestion, which in some ways seems to have been mixed up with the umbrage felt by Mr McLaren in regard to the contents of Mr Rodger's will, was made, and that was that Mrs Loch should be a participant in a scheme whereby the £10,000 to be paid should be distributed—£8,000 to herself and only £2,000 to the Rodgers family.

Their Lordships do not desire to characterise these suggestions in the language which perhaps they fully deserve. The Rodger family, entitled to one-fourth of the holding in the company, nominally £10,000, but in reality of a much higher value, were to be bought off for £2,000, and Mrs Loch was to be the agent in this scheme. No confidence in the directorate could survive such a proposal. To crown all this, as was afterwards discovered, the £10,000 could be comfortably paid by Mr McLaren out of the £12,500 which, four days before, he and his wife and clerk had voted to himself out of the funds of the company. Their Lordships express no surprise at the instant repudiation of Mr McLaren's proposals by Mrs Loch—a repudiation which is creditable to her—and at the application for a winding up of the company being made. Upon the principles already set forth in this judgment that application must succeed. The broad ground is that confidence in its management was, and is, and that most justifiably, at an end …

➢ Notes

1. In *Re RA Noble & Sons (Clothing) Ltd* [1983] BCLC 273, Nourse J held that, so long as the conduct of those in control has been 'the substantial cause' of the destruction of the mutual confidence between the parties, it is

unnecessary to show either that that conduct has been in some way underhand or that the petitioner's own conduct has been above reproach. The Privy Council took a similar view in *Vujnovich v Vujnovich* [1990] BCLC 227.

(p. 800) 2. But note that the court has a discretion under IA 1986 s 125(2) to refuse an order on the 'just and equitable' ground if the petitioner is acting unreasonably in seeking to have the company wound up instead of pursuing some other remedy. In *Re a Company* [1983] 1 WLR 927, Vinelott J held that a petitioner had acted unreasonably in refusing an offer made by the majority members to buy his shares, following a breakdown of confidence, and refused him a winding-up order. That case may be contrasted with *Virdi v Abbey Leisure Ltd* [1990] BCLC 342, CA, where the court exercised its discretion in the petitioner's favour on a similar issue.

It may be just and equitable to wind up a company where one party has simply exercised his or her legal rights, but in an unjust or inequitable way.

[16.13] Ebrahimi v Westbourne Galleries Ltd [1973] AC 360 (House of Lords)

This is probably the most cited case in this area. The company was formed in 1958 to take over a business which Nazar and Ebrahimi had run in partnership for over a decade. At first, the two were equal shareholders and the only directors, but soon afterwards Nazar's son joined the company as a director and shareholder, so that Ebrahimi found himself in a minority position both on the board of directors and at a general meeting. In 1969, after some disagreement between the parties, an ordinary resolution was passed under s 184 of the Act of 1948 [CA 2006 s 168], removing Ebrahimi as director. Ebrahimi sought relief under s 210, or, alternatively, s 222(f) of the 1948 Act [respectively CA 2006 s 994 and IA 1986 s 122(1)(g)]. Plowman J declined to make an order under s 210 because (inter alia) Ebrahimi's complaint was in his capacity as director rather than as member (see 'Members' personal rights', pp 250ff); but he did make a winding-up order. The Court of Appeal reversed the latter ruling, holding that the exercise by a majority of its constitutional and statutory rights, unless shown to be *mala fide*, was not a ground for 'just and equitable' relief under s 222(f). The House of Lords restored the decision of the trial judge.

> LORD WILBERFORCE: My Lords, the petition was brought under s 222(f) of the Companies Act 1948 [IA 1986 s 122(1)(g)], which enables a winding-up order to be made if 'the court is of the opinion that it is just and equitable that the company should be wound up'. This power has existed in our company law in unaltered form since the first major Act, the Companies Act 1862. For some fifty years, following a pronouncement by Lord Cottenham LC in 1849, the words 'just and equitable' were interpreted so as only to include matters ejusdem generis as the preceding clauses of the section, but there is now ample authority for discarding this limitation. There are two other restrictive interpretations which I mention to reject. First, there has been a tendency to create categories or headings under which cases must be brought if the clause is to apply. This is wrong. Illustrations may be used, but general words should remain general and not be reduced to the sum of particular instances. Secondly, it has been suggested, and urged upon us, that (assuming the petitioner is a shareholder and not a creditor) the words must be confined to such circumstances as affect him in his capacity as shareholder. I see no warrant for this either. No doubt, in order to present a petition, he must qualify as a shareholder, but I see no reason for preventing him from relying upon any circumstances of justice or equity which affect him in his relations with the company, or, in a case such as the present, with the other shareholders.
>
> One other signpost is significant. The same words 'just and equitable' appear in the Partnership Act 1890, s 35, as a ground for dissolution of a partnership and no doubt the considerations which they reflect formed part of the common law of partnership before its codification. The importance of this is to provide a bridge between cases under s 222(f) of the Act of 1948 and the principles of equity developed in relation to partnerships.
>
> **(p. 801)** The winding-up order was made following a doctrine which has developed in the courts since the beginning of this century. As presented by the appellant, and in substance accepted by the learned judge, this was that in a case such as this the members of the company are in substance partners, or quasi-partners, and that a winding up may be ordered if such facts are shown as could justify a dissolution of partnership between them. The common use of the words 'just and equitable' in the company and

partnership law supports this approach. Your Lordships were invited by the respondents' counsel to restate the principle on which this provision ought to be used; it has not previously been considered by this House. The main line of his submission was to suggest that too great a use of the partnership analogy had been made; that a limited company, however small, essentially differs from a partnership; that in the case of a company, the rights of its members are governed by the articles of association which have contractual force; that the court has no power or at least ought not to dispense parties from observing their contracts; that, in particular, when one member has been excluded from the directorate, or management, under powers expressly conferred by the Companies Act and the articles, an order for winding up, whether on the partnership analogy or under the just and equitable provision, should not be made. Alternatively, it was argued that before the making of such an order could be considered the petitioner must show and prove that the exclusion was not made bona fide in the interests of the company.

[His Lordship discussed a number of earlier cases and continued:] My Lords, in my opinion these authorities represent a sound and rational development of the law which should be endorsed. The foundation of it all lies in the words 'just and equitable' and, if there is any respect in which some of the cases may be open to criticism, it is that the courts may sometimes have been too timorous in giving them full force. The words are a recognition of the fact that a limited company is more than a mere legal entity, with a personality in law of its own: that there is room in company law for recognition of the fact that behind it, or amongst it, there are individuals, with rights, expectations and obligations inter se which are not necessarily submerged in the company structure. That structure is defined by the Companies Act and by the articles of association by which shareholders agree to be bound. In most companies and in most contexts, this definition is sufficient and exhaustive, equally so whether the company is large or small. The 'just and equitable' provision does not, as the respondents suggest, entitle one party to disregard the obligation he assumed by entering a company, nor the court to dispense him from it. It does, as equity always does, enable the court to subject the exercise of legal rights to equitable considerations, considerations, that is, of a personal character arising between one individual and another, which may make it unjust, or inequitable, to insist on legal rights, or to exercise them in a particular way.

It would be impossible, and wholly undesirable, to define the circumstances in which these considerations may arise. Certainly the fact that a company is a small one, or a private company, is not enough. There are very many of these where the association is a purely commercial one, of which it can safely be said that the basis of association is adequately and exhaustively laid down in the articles. The superimposition of equitable considerations requires something more, which typically may include one, or probably more, of the following elements: (i) an association formed or continued on the basis of a personal relationship, involving mutual confidence—this element will often be found where a pre-existing partnership has been converted into a limited company; (ii) an agreement, or understanding, that all, or some (for there may be 'sleeping' members), of the shareholders shall participate in the conduct of the business; (iii) restriction upon the transfer of the members' interest in the company—so that if confidence is lost, or one member is removed from management, he cannot take out his stake and go elsewhere.

It is these, and analogous, factors which may bring into play the just and equitable clause, and they do so directly, through the force of the words themselves. To refer, as so many of the cases do, to 'quasi-partnerships' or 'in substance partnerships' may be convenient but may also be confusing. It may be convenient because it is the law of partnership which has developed the conceptions of probity, good faith and mutual confidence, and the remedies where these are absent, which become relevant once such factors as I have mentioned are found to exist: the words 'just and equitable' sum these up in the law of partnership itself. And in many, but not necessarily all, cases there **(p. 802)** has been a pre-existing partnership the obligations of which it is reasonable to suppose continue to underlie the new company structure. But the expressions may be confusing if they obscure, or deny, the fact that the parties (possibly former partners) are now co-members in a company, who have accepted, in law, new obligations. A company, however small, however domestic, is a company, not a partnership or even a quasi-partnership and it is through the just and equitable clause that obligations, common to partnership relations, may come in.

My Lords, this is an expulsion case, and I must briefly justify the application in such cases of the just and

equitable clause. The question is, as always, whether it is equitable to allow one (or two) to make use of his legal rights to the prejudice of his associate(s). The law of companies recognises the right, in many ways, to remove a director from the board. Section 184 of the Companies Act 1948 [CA 2006 s 168] confers this right upon the company in general meeting whatever the articles may say. Some articles may prescribe other methods: for example, a governing director may have the power to remove (compare *Re Wondoflex Textiles Pty Ltd*).[54] And quite apart from removal powers, there are normally provisions for retirement of directors by rotation so that their re-election can be opposed and defeated by a majority, or even by a casting vote. In all these ways a particular director-member may find himself no longer a director, through removal, or non-re-election: this situation he must normally accept, unless he undertakes the burden of proving fraud or mala fides. The just and equitable provision nevertheless comes to his assistance if he can point to, and prove, some special underlying obligation of his fellow member(s) in good faith, or confidence, that so long as the business continues he shall be entitled to management participation, an obligation so basic that, if broken, the conclusion must be that the association must be dissolved …

I come to the facts of this case. It is apparent enough that a potential basis for a winding-up order under the just and equitable clause existed. The appellant after a long association in partnership, during which he had an equal share in the management, joined in the formation of the company. The inference must be indisputable that he, and Mr Nazar, did so on the basis that the character of the association would, as a matter of personal relation and good faith, remain the same. He was removed from his directorship under a power valid in law. Did he establish a case which, if he had remained in a partnership with a term providing for expulsion, would have justified an order for dissolution? This was the essential question for the judge. Plowman J dealt with the issue in a brief paragraph in which he said: 'while no doubt the petitioner was lawfully removed, in the sense that he ceased in law to be a director, it does not follow that in removing him the respondents did not do him a wrong. In my judgment, they did do him a wrong, in the sense that it was an abuse of power and a breach of the good faith which partners owe to each other to exclude one of them from all participation in the business upon which they have embarked on the basis that all should participate in its management. The main justification put forward for removing him was that he was perpetually complaining, but the faults were not all on one side and, in my judgment, this is not sufficient justification. For these reasons, in my judgment, the petitioner, therefore, has made out a case for a winding-up order.' Reading this in the context of the judgment as a whole, which had dealt with the specific complaints of one side against the other, I take it as a finding that the respondents were not entitled, in justice and equity, to make use of their legal powers of expulsion and that … the only just and equitable course was to dissolve the association …

LORD CROSS OF CHELSEA delivered a concurring opinion.

VISCOUNT DILHORNE, LORD PEARSON and LORD SALMON concurred.

➢ Notes

1. The *Ebrahimi* case **[16.13]** makes it clear that it may be just and equitable to wind up a company even though the controllers have acted within their strict legal rights.

(p. 803) 2. The *Ebrahimi* case also makes it clear that it may be just and equitable to wind up a company when the complaint relates to behaviour that is contrary to the settled and accepted course of conduct between the parties, whether or not reinforced by contract or by the articles.

3. Many of the previous cases, especially the earlier ones, in which a winding-up order was made on the 'just and equitable' ground, might now be more appropriately made the subject of proceedings under CA 2006 s 994 (discussed at 'Unfairly prejudicial conduct of the company's affairs', pp 681ff). On the other hand, there are modern quasi-partnership cases where the courts refuse to find prejudicial conduct (under CA 1985 s 459, the predecessor of CA 2006 s 994), but will order a just and equitable winding up: for example, *Re RA Noble (Clothing) Ltd* [1983] BCLC 273.

4. *Hawkes v Cuddy* [2009] EWCA Civ 291, makes it clear that the winding-up and unfair prejudice jurisdictions overlap but are not identical.

➢ Question

In *Re Yenidje Tobacco Co Ltd* [1916] 2 Ch 426, CA, the Court of Appeal held that it was just and equitable to wind up a quasi-partnership company where there were sufficiently serious breaches of mutual understanding. The company had been formed by two tobacco manufacturers, Rothman and Weinberg, in order to amalgamate their businesses. They were the only members, with equal voting rights, and the only directors. The parties had been in a state of continuous quarrel for some time. Rothman had brought an action against Weinberg alleging fraud; they had spent over £1,000 (a substantial sum at the time) in litigation over the validity of the dismissal of a factory manager; had argued over the terms of employment of a traveller; and had been communicating with each other only through the secretary of the company. In this situation (despite the fact that the company was making larger profits than ever before), the court granted a winding-up order on Weinberg's petition. Would this case now be dealt with under CA 2006 s 994? What are the advantages and disadvantages of each option?

The courts' discretion to order a compulsory winding up

Once the petitioner has established the right to bring a petition, and proved the grounds alleged, the court has to decide whether or not to make the order to wind up the company. Normally their decision will follow from proof of the elements of the claim, but it is worth noting that:

(i) On a member's or contributory's petition, the court has a statutory discretion to refuse the petition if some other remedy is available to the petitioners *and* it seems that the petitioners are acting unreasonably in seeking to have the company wound up rather than relying on that other remedy (IA 1986 s 125(2)). The court is frequently asked to exercise this discretion where minority shareholders seek an order on the grounds of 'unfair prejudice' (CA 2006 s 994, see 'Unfairly prejudicial conduct of the company's affairs', pp 681ff) and, alternatively, a winding up on the 'just and equitable' ground.
(ii) The court has an inherent jurisdiction to refuse a winding-up order brought for extraneous or improper purposes. In *Re Surrey Garden Village Trust Ltd* [1995] 1 WLR 974, Ch, Plowman J said '… I go further and say that in my judgment it is oppressive and an abuse of the process of the court for shareholders to make use of a winding-up petition for the purpose of seeking to facilitate the achievement of a purely sectional and extraneous object which … has no relevance to the interests of the members as such …'. Similarly, in *Re JE Cade & Sons Ltd* [1992] BCLC 213, a minority member (p. 804) owned the freehold of a farm which had been occupied under licence by the company for some years. He sought a winding-up order on the 'just and equitable' ground or, alternatively, relief under CA 1985 s 459 (CA 2006 s 994); but the court struck out his petition because his real object in bringing the proceedings was not to protect his interests as a member but to secure possession of the farm.
(iii) Finally, the court has an inherent jurisdiction to strike out a petition for winding up which is bound to fail, as an abuse of the process of the court, and it may grant an injunction to restrain the presentation of such a petition (see *Charles Forte Investments Ltd v Amanda* [1964] Ch 240, CA, where Amanda was attempting to use the winding-up procedure as a means of putting pressure on the directors to register certain share transfers).

By invoking these statutory and inherent jurisdictions to have petitions dismissed, a company may avoid the unfavourable publicity that a winding-up petition inevitably attracts.

The functions, powers and duties of the liquidator

The basic duty of the liquidator is to wind up the company's affairs, collect in and realise the company's assets and undertaking, and make the appropriate distributions to the creditors and, if there is a surplus, to the

shareholders.

The rules governing the functions, powers and duties of a liquidator are partly set out in IA 1986 and IR 1986, and partly established by the case law. The Act now makes it obligatory for a liquidator to be a qualified insolvency practitioner (s 230(3)). In a compulsory liquidation, the liquidator is also an officer of the court.

A liquidator acts in the name of the company (which continues to have a separate corporate personality) and not in his own name (except where he is exercising certain special statutory powers), although sometimes, exceptionally, an order of the court is sought vesting all or part of the company's property in the liquidator's name (IA 1986 s 145). This might be necessary, for example, to deal with the local assets of a foreign company which had already been dissolved in its home jurisdiction. Although a liquidator acts in the company's name and not in his own name, he can sometimes incur personal liability, for example where he institutes proceedings and the costs exceed the amount of the company's assets: *Re Wilson Lovatt & Sons Ltd* [1977] 1 All ER 274.

A liquidator owes his duties to the company, not to individual creditors or contributories (*Knowles v Scott* [1891] 1 Ch 717). He may be personally liable for breach of duty, and sued in misfeasance proceedings under IA 1986 s 212, if he:

(i) fails to comply with the strict statutory terms of his office (eg in wrongly admitting a claim by an alleged creditor: *Re Home and Colonial Insurance Co Ltd* [1930] 1 Ch 102; or in distributing the company's assets properly among the persons entitled: *Pulsford v Devenish* [1903] 2 Ch 625);
(ii) performs his functions negligently (*Re Windsor Steam Coal Co (1901) Ltd* [1928] Ch 609); or
(iii) breaches his fiduciary duties to the company by taking secret profits or placing himself in positions of conflict.

Certain statutory powers of a liquidator are conferred by IA 1986 ss 165ff and Sch 4. These, or rather the circumstances in which they may be exercised, vary slightly depending on the type of winding up. Other powers (eg to make calls upon the contributories) are given by the Act in the first place to the court but are then delegated to the liquidator by the rules, pursuant to s 160.

(p. 805) The conduct of the liquidation

The way in which a liquidation is conducted can be described in general terms, but there are differences in detail between compulsory and voluntary liquidations, and between a members' and a creditors' voluntary winding up, which can be discovered only from a study of the 1986 Act and the Insolvency Rules.

The Act confers a wide range of powers on a liquidator.[55] There is an extensive list of specific powers set out in Sch 4, for example the power to bring and defend proceedings, to carry on the company's business and to borrow and to charge the company's property as security. By ss 178ff a liquidator is empowered to 'disclaim' what are described as 'unprofitable contracts' and 'onerous property'—in other words, to wash his hands of any responsibility under the contract or any interest in the property. A common example is a lease of property which is let at a rental higher than the current market rate. Anyone who suffers loss as a result of a disclaimer can prove for it as a debt in the winding up, but will usually be an unsecured creditor with all the disadvantages that entails. Other powers (which are also given to an administrator) include the power to examine directors and other persons on oath in order to gain information about the company's affairs (s 236, see 'Investigating and reporting the affairs of the company', pp 822ff): recall that the person being examined cannot refuse to give answers even where they are incriminating (see 'Inspections and the privilege against self-incrimination', p 737).

'Commencement' of winding up

For many statutory purposes,[56] a winding up takes effect from its 'commencement', which may involve some backdating. IA 1986 s 86 provides that a voluntary winding up is deemed to commence at the time of the passing of the resolution for winding up. In the case of a compulsory winding up, the liquidation is deemed to commence at the time of the presentation of the petition (and not the making of the order itself), but if the company is already in voluntary liquidation when the petition is presented, the relevant time is when the winding-up resolution was passed (s 129).

These provisions have important consequences because from the date of commencement:

(i) dispositions of property by the company (in a compulsory winding up) are avoided, unless the court otherwise orders (s 127);[57]
(ii) attachments, distress and execution (in a compulsory winding up) which have not been completed are void (s 128);[58]
(iii) transfers of shares are avoided (ss 88 and 127);
(iv) transactions entered into within prescribed periods before that date may be invalidated as having been 'at an undervalue' or 'preferences' (ss 238–241: see *Re MC Bacon Ltd* **[16.15]**);
(p. 806) **(v)** a floating charge created within 12 months (or, in some cases, two years) of that date may be invalidated (s 245; see *Re Parkes Garage* **[11.16]**, and *Re Yeovil Glove* **[12.17]**).

By contrast, some categories of creditor are given preferential rights in regard to debts incurred within prescribed periods before the date of the *order* (ss 175 and 386 and sch 6) (see 'Application of assets by the liquidator', pp 820ff). Also see *Re Globespan Airways Ltd (in Liquidation)* [2012] EWCA Civ 1159, CA.

It is not easy to reconcile these 'backdating' provisions with those of CA 2006 s 1079, which aims to protect third parties without actual notice until 15 days after the 'official notification' in the *Gazette* of the making of a winding-up order or, in a voluntary liquidation, of the appointment of a liquidator (see Publication in the *Gazette*', pp 716ff). It is plain that the full implications of this statutory misfit (which are the result of implementing the First EU Company Law Directive) have not been fully thought through by the legislators.

The liquidator's ability to 'claw back' property—unwinding transactions

The effect of the statutory provisions referred to in points (i), (ii), (iv) and (v) in the previous section, is to allow the liquidator to 'claw back' property which has been transferred away by the company, and to avoid some transactions which it has entered into in the period immediately preceding the winding up, thus increasing the assets available for distribution to the creditors generally.

IA 1986 dramatically extended the scope of these provisions by comparison with the previous law. The existing provisions do not depend upon proof of fraud and dishonesty, but simply require that there be '*transactions at an undervalue*' (s 238), or '*preferences*' (s 239). The rules also operate more strictly where the other party to the transaction is a person 'connected with' the company (eg a director or a substantial shareholder, or a close relative of such a person, or another company in the same group: for the full definition, see ss 249 and 435). Where a connected person is involved, the time limits may be extended (ss 240(1)(a) and 245(3)(a)), the onus of proof may be reversed (ss 239(6) and 249(2)), or a possible defence disallowed (s 245(4)). It goes without saying that a very careful reading of the Act is necessary to discover exactly which rules are applicable in a particular case.

The liquidator's ability to require wrongdoers to make personal contributions to the assets of the company

IA 1986 (in addition to imposing criminal liability for various forms of misconduct which may be revealed in the course of a winding up) contains a number of provisions under which the directors of a company in liquidation, and in some cases others, may be made liable to account, pay compensation or contribute to the assets of the company in the hands of the liquidator:

(i) IA 1986 s 212 (commonly called the 'misfeasance' section) provides a summary remedy[59] for establishing accountability or assessing damages against delinquent officers (excluding administrators[60]). This is a purely procedural provision, which creates no new liabilities but provides a simpler mechanism for the recovery of property or compensation in a winding up. It does, however, give the court a discretion to require such compensation to be paid in full or in part, 'as the court thinks just', and does not specify conditions for the exercise of this discretion (s 212(3)).[61]
(p. 807) **(ii)** If, in the course of a winding up, it is found that any business of the company has been carried on with intent to defraud creditors or for any other fraudulent purpose ('*fraudulent trading*'), the court may order those who were knowingly parties to this misconduct to contribute to the company's assets (s 213). For the purposes of this provision, actual dishonesty must be proved (*Re Patrick and Lyon Ltd* [1933] Ch

786). The sum to be contributed is now to be assessed on a compensatory basis only, with no punitive element: *Morphitis v Bernasconi* [2002] EWCA Civ 289, [2003] Ch 552, CA.[62]

(iii) A director, former director or 'shadow director' of a company in liquidation may be ordered to contribute personally to the assets in the hands of the liquidator if there have been circumstances constituting '*wrongful trading*' (a phrase used in the side-note, but not the text, of the Act): s 214. The complex provisions of this section need careful study.

Prerequisites for liability are that (i) the person has been a director (or 'shadow director') and (ii) the company has gone into insolvent liquidation. The person must have known, or should have concluded, that there was no reasonable prospect that the company would avoid going into insolvent liquidation. However, he can avoid liability if the court is satisfied that he 'took every step with a view to minimising the potential loss to the company's creditors' that he ought to have taken. Only the liquidator has standing to bring proceedings.

Although described as 'wrongful trading', as noted earlier, the possible scope of this section is very wide indeed. It can cover passive inactivity just as much as positive wrongdoing; there need be no actual 'trading', but conduct such as allowing the payment of unjustified remuneration or dividends could be caught; and as s 214(4) makes clear, and, as the *Produce Marketing* case **[16.16]** confirms, the director's behaviour is to be judged by objective as well as subjective standards.

It has also been held, as a matter of law, that CA 2006 s 1157 (which empowers a court to relieve a director from liability for breach of duty where he has acted honestly and reasonably and ought fairly to be excused) is not available to a director in s 214 proceedings, although the logic of that analysis appears questionable.[63] On the other hand, s 214(1) itself allows the court to declare that the person is 'liable to make such contribution (if any) to the company's assets as the court thinks proper', so the court can exercise a discretion in any event.

Although the statutory charge of *fraudulent* trading (s 213) remains on the books, the introduction in 1986 of the concept of 'wrongful' trading, which can lead to the same consequences with a much lighter burden of proof, means that s 213 is only rarely invoked. It is invoked, however, if the objective is to attach liability to defendants who are not subject to s 214, which has a much narrower remit than s 213 (eg over the past decade, the liquidators of BCCI have made significant use of s 213). For a recent example, see *Bilta (UK) Ltd (In Liquidation) v Nazir* [2012] EWHC 2163 (Ch), in which s 213 was held to be of extra-territorial effect.

Money that is ordered to be paid under ss 213 and 214 (and, similarly, ss 238 and 239) goes into the general assets of the company in the hands of the liquidator. It is not awardable directly to those affected by the fraudulent or wrongful trading. This avoids the danger that a particular creditor might bring pressure on the directors of a company that was close to insolvency in order to induce them to pay him off out of their own pockets and so gain an advantage over the other creditors. On the other hand, sums recovered under s 212 are the product of a chose in action vested in the company prior to liquidation. Accordingly they are **(p. 808)** 'assets of the company', which are capable of being caught by the provisions of an appropriately drafted charge (*Re Anglo-Austrian Printing & Publishing Union* [1895] 2 Ch 891), or of being assigned by the company or its liquidator (*Re Oasis Merchandising Services Ltd* [1998] Ch 170).

Finally, CDDA 1986 authorises the court to make a disqualification order ('Directors' disqualification', pp 294ff) against anyone held liable for fraudulent or wrongful trading.

Re-use of company names and the 'phoenix syndrome'

The Cork Committee, on whose recommendation the concept of wrongful trading was introduced, were concerned also with another situation, popularly referred to as the 'phoenix syndrome'. This occurs where a person who had been trading through the medium of a company allows it to go into insolvent liquidation and then forms a new company, sometimes with a similar name, and carries on trading much as before. He might even use assets in the new business which he had bought at a knock-down price in the liquidation of the old company, so that the old company's creditors subsidise his fresh start. The Committee (Cmnd 8558, 1982, para 1827) recommended that such a person should be personally liable for the second company's debts if it went into insolvent liquidation within three years.

However, instead of this targeted liability, the Insolvency Act simply focuses on the re-use of the name of a defunct company by a person who was one of its directors. Criminal and civil liability follow: the behaviour is made a criminal offence (s 216) which, in *R v Cole* [1998] 2 BCLC 234, CA, was held to be one of strict liability.[64] In addition, the director, without the need of any court order, is made personally liable, without limitation, for the debts of the new business, whether or not it becomes insolvent (s 217). The conditions for liability are stringently drawn, the criminal and civil consequences are severe and liability is automatic: the court has no discretion to absolve the defendant (*Ricketts v Ad Valorem Factors Ltd* [2003] EWCA Civ 1706, [2004] BCC 164). The provisions seem to be used increasingly frequently.

Insolvency and corporate groups

Another problem discussed by the Cork Committee was that of 'group trading'—the 'runt of the litter' situation criticised by Templeman LJ in *Re Southard & Co Ltd* (Note 4 following *Adams v Cape Industries plc* **[2.19]**, p 73). Is it in keeping with commercial morality that a parent company can allow one of its subsidiaries to decline into insolvency while the rest of the group prospers? *A fortiori*, for the debts owed by the subsidiary to other members of the group to rank equally with those of outside creditors—or even, if secured, ahead of them? The Committee recommended (para 1963) that the law should be changed so that inter-company indebtedness could in some circumstances be postponed to the claim of outside creditors. But, it hesitated to follow the bolder reforms made in New Zealand and Ireland, which empower the court to order one company in a group to pay the debt of another in the insolvent winding up of the latter.

IA 1986 contains no special provisions relating to insolvent groups, although it may have met these problems in part by its 'wrongful trading' provisions (which might extend to a parent company as a 'shadow director') and by its measures to extend the circumstances in which floating charges given to 'connected persons' can be invalidated (companies within the same group are 'connected persons').

The cases which follow illustrate the operation in practice of some of the provisions of IA 1986 that are discussed previously.

(p. 809) ***Avoidance of property dispositions: IA 1986 s 127.***

[16.14] Re Gray's Inn Construction Co Ltd [1980] 1 WLR 711 (Court of Appeal)

The company, which carried on a building business, was ordered to be wound up by the court. Between the time when the petition was presented and the date of the order its bank had allowed it to continue to operate its account. During this period it had traded unprofitably. The Court of Appeal held that both the amounts credited to the company's account and those debited to it constituted 'dispositions' of the company's property (although now see the Note following) and, in the exercise of its discretion under IA 1986 s 127, declined to validate most of these banking transactions. In the course of his judgment, Buckley LJ enunciated some principles for the guidance of courts in relation to the jurisdiction under s 127.

> BUCKLEY LJ: It is a basic concept of our law governing the liquidation of insolvent estates, whether in bankruptcy or under the Companies Acts, that the free assets of the insolvent at the commencement of the liquidation shall be distributed rateably amongst the insolvent's unsecured creditors as at that date … In a company's compulsory winding up [this] is achieved by section 227 [of CA 1948, equivalent to IA 1986 s 127]. There may be occasions, however, when it would be beneficial, not only for the company but also for its unsecured creditors, that the company should be enabled to dispose of some of its property during the period after the petition has been presented but before a winding-up order has been made. An obvious example is if the company has an opportunity by acting speedily to dispose of some piece of property at an exceptionally good price. Many applications for validation under the section relate to specific transactions of this kind or analogous kinds. It may sometimes be beneficial to the company and its creditors that the company should be enabled to complete a particular contract or project, or to continue to carry on its business generally in its ordinary course with a view to a sale of the business as a going concern. In any such case the court has power under section 227 of the Companies Act 1948 to validate the particular transaction, or the completion of the particular contract or project, or the continuance of the company's

business in its ordinary course, as the case may be. In considering whether to make a validating order the court must always, in my opinion, do its best to ensure that the interests of the unsecured creditors will not be prejudiced. Where the application relates to a specific transaction this may be susceptible of positive proof. In a case of completion of a contract or project the proof may perhaps be less positive but nevertheless be cogent enough to satisfy the court that in the interests of the creditors the company should be enabled to proceed, or at any rate that proceeding in the manner proposed would not prejudice them in any respect. The desirability of the company being enabled to carry on its business generally is likely to be more speculative and will be likely to depend on whether a sale of the business as a going concern will probably be more beneficial than a break-up realisation of the company's assets. In each case, I think, the court must necessarily carry out a balancing exercise … Each case must depend upon its own particular facts.

Since the policy of the law is to procure so far as practicable rateable payments of the unsecured creditors' claims, it is, in my opinion, clear that the court should not validate any transaction or series of transactions which might result in one or more pre-liquidation creditors being paid in full at the expense of other creditors, who will only receive a dividend, in the absence of special circumstances making such a course desirable in the interests of the unsecured creditors as a body. If, for example, it were in the interests of the creditors generally that the company's business should be carried on, and this could only be achieved by paying for goods already supplied to the company when the petition is presented but not yet paid for, the court might think fit in the exercise of its discretion to validate payment for those goods …

It may not always be feasible, or desirable, that a validating order should be sought before the transaction in question is carried out. The parties may be unaware at the time when the transaction is entered into that a petition has been presented; or the need for speedy action may be such as to preclude an anticipatory application; or the beneficial character of the transaction may be so obvious **(p. 810)** that there is no real prospect of a liquidator seeking to set it aside, so that an application to the court would waste time, money and effort. But in any case in which the transaction is carried out without an anticipatory validating order the disponee is at risk of the court declining to validate the transaction. It follows, in my view, that the parties when entering into the transaction, if they are aware that it is liable to be invalidated by the section, should have in mind the sort of considerations which would influence the court's decision.

A disposition carried out in good faith in the ordinary course of business at a time when the parties are unaware that a petition has been presented may, it seems, normally be validated by the court … unless there is any ground for thinking that the transaction may involve an attempt to prefer the disponee, in which case the transaction would probably not be validated. In a number of cases reference has been made to the relevance of the policy of ensuring rateable distribution of the assets …

But although that policy might disincline the court to ratify any transaction which involved preferring a pre-liquidation creditor, it has no relevance to a transaction which is entirely post-liquidation, as for instance a sale of an asset at its full market value after presentation of a petition. Such a transaction involves no dissipation of the company's assets, for it does not reduce the value of those assets. It cannot harm the creditors and there would seem to be no reason why the court should not in the exercise of its discretion validate it. A fortiori, the court would be inclined to validate a transaction which would increase, or has increased, the value of the company's assets, or which would preserve, or has preserved, the value of the company's assets from harm which would result from the company's business being paralysed …

GOFF LJ and SIR DAVID CAIRNS concurred.

➢ Note

The transactions which were challenged in this case were payments into and out of the company's bank account, and the court held, or accepted concessions made by counsel, that all such payments were 'dispositions' by the company within s 127. But later cases have shown that this is not always true. In *Re Barn Crown Ltd* [1994] 2