Neutral Citation Number: [2018] EWHC 3082 (Comm)

Case No: CL-2016-000566

IN THE HIGH COURT OF JUSTICE
BUSINESS AND PROPERTY COURTS OF ENGLAND AND WALES
QUEEN'S BENCH DIVISION
COMMERCIAL COURT

Royal Courts of Justice
Strand, London, WC2A 2LL

Date: 16/11/2018

Before:

STEPHEN HOFMEYR QC
(Sitting as a Deputy High Court Judge)

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Between:

(1) ROBERT SIMON TERRY **(2) LOUISE TRACEY TERRY** **(3) THE TRUSTEES OF THE RT ACCUMULATION AND MAINTENANCE TRUST** **(4) THE TRUSTEES OF THE RT LIFE INTEREST TRUST**	**Claimants**
- and -	
WATCHSTONE LIMITED	**Defendant**

- -

Mr David Lord QC (instructed by **Blake Morgan LLP**) for the **Claimants**
Mr Simon Hattan and Ms Amy Rogers (instructed by **Herbert Smith Freehills LLP**) for the **Defendant**

Hearing dates: 16, 17, 18, 19 and 23 July 2018

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JUDGMENT

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

STEPHEN HOFMEYR QC (Sitting as a Deputy High Court Judge):

1. On 17 May 2011 the entire shareholding in the Defendant, Watchstone Limited (then named Quindell Limited), was sold to Mission Capital Plc in return for 1,243,427,731 shares in Mission Capital Plc. At the time of the sale, each of the Claimants was a shareholder in Watchstone Limited. By reason of the sale, each of the Claimants became a shareholder in Mission Capital Plc.

2. The primary issue in this case is whether, prior to the sale, the board of directors of Quindell Limited (subsequently Watchstone Limited) agreed that Quindell Limited would be responsible for all tax liabilities and associated costs that the Claimants may incur as a consequence of the sale.

3. This is a rather unusual dispute. It is not a dispute between the individuals alleged to have made the agreement as to what was or was not agreed. The individuals involved all agree that they did make an agreement. The issue arises because, surprisingly, there is no contemporaneous documentary record of any agreement. The absence of any contemporaneous documentary record has led those representing the Defendant to conclude and assert that the inevitable inference to be drawn from this and the other known facts is that no agreement was ever made.

4. Subsidiary issues arise if there was an agreement that Watchstone Limited would be responsible for all tax liabilities and associated costs that the Claimants may incur as a consequence of the sale.

I. Background facts

5. The First Claimant, Mr Terry, is an entrepreneur. After a period as an independent management consultant in the legal, banking and insurance industries, Mr Terry founded a consultancy company. In 1997 he sold the consultancy company and formed The Innovation Group Plc of which he was the Chairman and Chief Executive. The Innovation Group Plc was listed on the London Stock Exchange in June 2000 with a market capitalisation of about £250 million and in the following 18 months made 28 acquisitions across 11 countries. Mr Terry was the largest shareholder at the time of the listing.

6. The way in which the listing was structured resulted in Mr Terry unexpectedly having to pay tax in relation to shares received by employees under a share option scheme. In dealing with the unexpected tax liability, Mr Terry was assisted by Mr Anthony Bowers, a tax specialist partner of Deloitte. Mr Terry left The Innovation Group Plc in late 2003.

7. The Defendant, Watchstone Limited, was incorporated as Quindell Limited in 2000. Mr Terry was its founder. It was set up as an Enterprise Investment Scheme ("EIS") qualifying company in accordance with advice received from Mr Bowers. In its early days it bought and operated a golf course and made golf simulators. It subsequently made technology related investments growing into a reselling and sales outsourcing company with expertise in insurance, telecoms, technology, utilities, leisure and retail.

8. Together with two connected trusts, the Third and Fourth Claimants, Mr Terry invested significant sums of money in the Defendant over a number of years. The source of the money invested in the Defendant by Mr Terry and the trusts was largely the proceeds of the sale of shares in The Innovation Group PLC. By investing the proceeds of the sale

of shares in The Innovation Group Plc into the Defendant, capital gains associated with investments of more than £11 million were rolled over and Enterprise Investment Scheme relief was utilised. Based on advice received from Mr Bowers, Mr Terry believed that, so long as the company into which he invested the rolled over gains remained an EIS qualifying company for over 3 years, and so long as he did not sell the shares for cash, he would not lose the EIS relief.

9. Mr Terry subsequently transferred some of his shares in the Defendant to his wife, Mrs Louise Tracey Terry, the Second Claimant, under tax exemptions for transfers between spouses.

10. The negative experience of being exposed to a large unforeseen tax liability as a result of The Innovation Group Plc share option scheme made Mr Terry cautious about any steps he might take in the future for the benefit of companies with which he was involved. He was concerned to ensure that he would be protected against any negative tax consequences to which such conduct might lead and, on at least two occasions, to the knowledge and with the co-operation of his co-directors, took steps to ensure such protection was in place.

11. As a means of crystallising value in the company, from about the summer of 2009 the Defendant began to look at the possibility of a market flotation. Ubiquity Capital LLP was engaged to assist. The representatives of Ubiquity Capital LLP who assisted the Defendant were Mr Jason Cale and Mr Jimmy Webster. In due course, Ubiquity Capital LLP proposed that the Defendant proceed with a reverse takeover of a public company. Following discussions with a number of public companies, on 18 December 2010, the Defendant signed Heads of Terms with Mission Capital Plc.

12. During all of this time, Mr Terry was concerned to ensure that there was no direct financial risk to him, his wife or the trusts associated with any such flotation.

13. The proposed sale to Mission Capital Plc was initially scheduled to take place in February 2011. In the event, Mission Capital Plc acquired the entire issued share capital of the Defendant in exchange for shares in Mission Capital Plc by a Share Purchase Agreement dated 28 April 2011. Completion was conditional upon admission to trading on the Alternative Investment Market (AIM) of the entire issued and to be issued ordinary share capital of Mission Capital Plc. This was achieved on 17 May 2011, at which juncture Mission Capital Plc became the Defendant's parent company.

14. Upon completion, all but one of the directors in Mission Capital Plc (now known as Watchstone Group Plc) resigned as directors of Mission Capital Plc and were replaced as directors by the individuals who, until completion of the acquisition, had been (and, after the acquisition, continued to be) directors in the Defendant company i.e. Mr Robert Terry, Mr Stephen Scott, Mr Dominic Milton and Mr Anthony Bowers. The only director of Mission Capital Plc who remained on the board of Mission Capital Plc on completion of the acquisition of the shares in the Defendant was Mr Robert Burrow. The departing directors were Mr Giuseppe Ciardi, Mr Christopher Phillips and Mr Philip Goldenberg.

15. In the years after the sale, Mission Capital Plc changed its name to Quindell Portfolio Plc and, still later, to Quindell Plc.

II. The primary issue

16. It is the Claimants' case that, in the run up to the sale, the then board of directors of the Defendant agreed that the Defendant would be responsible for all tax liabilities and associated costs that the Claimants may incur as a consequence of the sale and that it would have no right of recourse. This agreement, the Claimants allege, was made at a meeting of the board of directors in late March or early April 2011.

17. Although the alleged agreement was not recorded in writing at the time, what are alleged by the Claimants to be the majority of its terms were recorded in a document prepared by the Defendant's solicitors entitled "*Memorandum of Terms of Tax Indemnity*", a document which was signed on about 7 February 2013 by the individuals (other than Mr Terry) who were directors of the Defendant in March and April 2011. The Memorandum was signed almost two years after the events it records are said to have taken place. It is the Defendant's case that the Memorandum was signed by the members of the board of directors of the Defendant in error, in the mistaken belief that they had entered into an agreement in late March or early April 2011.

III. The evidence

18. In March and April 2011, the board of directors of the Defendant company comprised Mr Terry, Mr Steve Scott, Mr Dominic Milton and Mr Anthony Bowers. With the exception of Mr Bowers, who sadly passed away in 2014, each of these individuals gave oral evidence at the trial.

19. Oral evidence was also given at the trial by Mr Jimmy Webster of Ubiquity Capital LLP, Mr Robert Burrow, a director of Mission Capital Plc between 2005 and 2015, Mr Christopher Phillips, a director of Mission Capital Plc between 2008 and May 2011, Mr Philip Goldenberg, a director of Mission Capital Plc between 2008 and May 2011, Mr

Andrew Clarke and Mr Paul Arathoon, solicitors and partners in the firm of Charles Russell Speechlys LLP (formerly Speechly Bircham LLP) which advised Mission Capital Plc between December 2010 and May 2011 in relation to the sale, and Mr Thomas Griffiths, a director in the corporate finance department of Stockdale Securities Limited (formerly named Arbuthnot Securities), which, until March 2011, advised Mission Capital Plc in relation to the sale.

20. I have no reason to think that, in giving their evidence at the trial, any of these witnesses were doing anything other than stating carefully their honest belief based on their recollection of what was said and done in late 2010 and early 2011.

21. As regards Mr Burrow, during his oral testimony, it became apparent that he is not only a very careful person, he is also sceptical by disposition. Indeed, he came across more sceptical in his oral evidence than the documents and other evidence suggests he was at the time of the relevant events. The extent of his natural scepticism undermined to a degree my confidence in his testimony.

The Agreement

22. Each of the living directors of the Defendant confirmed in evidence at the trial that an agreement in the terms alleged by the Claimants had indeed been made at a meeting of the Defendant's board of directors in late March or early April 2011, prior to the conclusion of the sale. Sometimes they described the agreement as a "*tax indemnity*". On other occasions they described the agreement simply as an "*indemnity*". Each of them stated that, both prior to and at the meeting, Mr Terry emphasised that neither he nor those connected with him would agree to sell to Mission Capital Plc their shares in the Defendant unless they were fully indemnified for tax and other liabilities and costs that they may incur as a consequence of the sale and transactions undertaken in

contemplation of the sale (excluding capital gains tax arising on the ultimate disposal of the shares) and that this was why the board of directors had agreed to grant the indemnity. They also stated that it was part of the agreement that the Defendant would not seek repayment of any money paid out pursuant to the agreement. The so-called "*tax indemnity*" was granted to the Claimants as shareholders in the Defendant.

23. Each of the living directors was asked in cross-examination why the terms or fact of the agreement had not been recorded contemporaneously in a board minute. Their response was that the agreement was concluded at a time of intense activity in the lead up to the sale when the board was meeting on an almost daily basis and the directors were working up to eighteen hour days, that many decisions which were taken were not recorded in a minute and that, in any event, it had never been the practice of the board of directors to minute every conversation, decision or meeting.

24. These directors were also called upon to explain the absence of any reference to the agreement in the transaction documents in respect of the sale. Mr Milton took the leading role in 2010-2011 in respect of the paperwork required to document the sale and it was he who was accordingly able to provide the most comprehensive answers. He stated that, given the unique nature of the transaction i.e. a reverse takeover, the warranties and disclosures that were given by the Defendant and its shareholders to Mission Capital Plc were not given the same level of scrutiny as they would have been had it been a straight disposal. He said that everyone knew that when the sale was completed the board of the Defendant would be running Mission Capital Plc and nothing in terms of the day to day running of the company's business would have changed. Accordingly, so long as the directors of the Defendant were aware of material

facts, they did not require detailed warranties to be set out. The warranties would do no more than disclose to the directors what they already knew.

25. One of Mr Milton's primary responsibilities in relation to the sale was assisting with the preparation of the Long Form and Working Capital Report originally prepared by Deloitte and ultimately finalised by RSM Tenon on 27 April 2011. The inclusion of a reference to the agreement in the Report was the subject of discussion between him and Mr Bowers. It was Mr Milton's evidence (which I accept) that Mr Bowers advised him that a reference to the agreement did not need to be included as, in the view of Deloitte, it was not a material contingent liability. The board, Mr Milton said, was guided by this advice given by Mr Bowers.

26. With the benefit of hindsight, Mr Milton accepts that the "indemnity" ought to have been referred to in the Disclosure Letter. However, he said that he adopted the same approach to the Disclosure Letter as he had done in relation to the other transaction documents and, relying on the advice of Deloitte, did not make reference to the agreement.

27. A significant amount of evidence at the trial was devoted to the issue whether the existence of the alleged agreement (or the fact that an "indemnity" would be or had been granted by the Defendant to the Claimants) was disclosed to representatives of Mission Capital Plc (and other prospective counterparties) before the sale was concluded. Each of Mr Terry, Mr Scott, Mr Milton and Mr Webster said that it had been disclosed. Mr Burrow said that it had not: "*Nobody mentioned the existence of any indemnity to us. That may have been an oversight. I do not question people's motives.*" Mr Griffiths has no recollection of an indemnity or agreement being disclosed. Mr Arathoon said in evidence that, based on a review in 2018 of the

documents which he was involved in preparing in 2011, none of which mentioned an indemnity, he has reached the conclusion that it was not disclosed. Mr Clarke gave evidence to similar effect. Neither he or Mr Arathoon, it seems, had significant discussions with the directors of the Defendant before the sale was concluded. Mr Goldenberg had one meeting with the Defendant's directors. In his evidence he was very clear that he has a positive recollection that he was not told at any time about an indemnity. Mr Phillips was unable to recollect whether it was or was not disclosed in his discussions with the Defendant's directors.

28. Although I think it likely that the fact that an indemnity would be granted was mentioned during a conference call on 20 December 2010 between representatives of the Defendant and Mission Capital Plc when the tax consequences of the proposed sale were discussed, it is in my view unnecessary for me to decide this issue and I decline to do so.

29. During the trial I was shown the transcripts of telephone conversations which took place between 23 January and 12 March 2013. I was also provided with audio copies of the conversations. Each of the parties sought to derive support for its case from what was said in these conversations. Having read the transcripts and listened to what, based on the transcripts, appear to be the material parts of the conversations, I am not persuaded that anything said in these conversations advances matters materially.

30. There was also a not insignificant quantity of evidence devoted to the question of when the agreement was made, if it was made. I did not find this evidence of assistance. There is no documentary evidence fixing the date of the meeting at which the agreement is alleged to have been made, the directors of the Defendant were meeting on an almost daily basis at the time and none of the directors is able to recollect

precisely when he says the agreement was made. Trying to fix a precise date in these circumstances would be little more than speculation. Nor did I consider that it was necessary (or that it would be helpful) for me to speculate what the position might have been had the sale proceeded on 10 March 2011 in accordance with an initial timetable. I have sought, instead, to concentrate on the facts to which witnesses and the documents are able to speak.

The Memorandum

31. The fact that the agreement had not been recorded in writing in 2011 came to light in early 2013. In the course of the preparation of their tax returns, the Claimants were advised by Deloitte that they were facing very large tax liabilities which had been triggered by the sale. This caused Mr Terry to raise the "indemnity" with the other directors of the Defendant then in office, namely, Mr Stephen Scott, Mr Dominic Milton, Mr Anthony Bowers and Mr Laurence Moorse. However, when a search of the Defendant's records was performed, no record of the agreement was found.

32. As a result of the lack of any documentary record of the agreement, the Defendant sought legal advice. The advice was given by the Defendant's then lawyers, Dorsey & Whitney (Europe) LLP.

33. Having consulted Mr Scott, Mr Milton and Mr Bowers, the Defendant's lawyers advised that a written record of the terms of the agreement should be created before any payment was made pursuant to the agreement. Thereafter, a draft of the Memorandum was prepared by the Defendant's lawyers, discussed with Mr Scott, Mr Milton and Mr Bowers at a meeting on 7 February 2013 and signed by each of them. According to Mr Scott and Mr Milton, the directors were willing to sign the Memorandum because it recorded terms of the agreement they had made in 2011.

34. The Memorandum provided, *inter alia*, as follows:

"**Introduction**

We refer to the sale to Mission Capital plc (now renamed "Quindell Portfolio plc") ("**QPP**") of the entire issued share capital of Quindell Limited ("**Company**") pursuant to an agreement dated 28 April 2011 ("**Sale**") and the discussions leading up to the signing of that agreement.

In particular we refer to discussions had at a meeting of the board of directors of the Company on or around April 20ll ("**April Meeting**"). At the time of that meeting, the directors of the Company were Rob Terry, Steve Scott, Dominic Milton and Tony Bowers.

During that meeting, and at previous meetings of the board, Rob Terry emphasised that neither he nor his connected persons (being Tracey Terry, the RT Accumulation and Maintenance Trust and the RT Life Trust) ("**Substantial Shareholders**") would agree to sell their shares in the Company ("**Shares**") to QPP unless they were fully indemnified for (a) all and any Tax (as defined below) and other liabilities that they may suffer or incur as a consequence of the Sale and transactions undertaken by them in contemplation of the Sale (excluding capital gains tax arising on the ultimate disposal of the Shares (or any replacement roll over securities but including all interest, penalties, fines,) which had been deferred by the operation of roll-over relief to the taxable gain arising on the Sale) ("**Relevant Liabilities**").

Indemnity

At the April Meeting, after discussion, and with Mr Terry abstaining from voting or discussions in relation to the matter, it was resolved that the Company would indemnify the Substantial Shareholders in respect of (a) all Relevant Liabilities (b) all professional and other costs, fees and expenses which a Substantial Shareholder may incur in connection with resisting any Relevant Liability and/or the making of any claim by it against the Company for indemnification (including costs associated with any settlement made between the Substantial Shareholder and the Company in respect of a Relevant Liability) and (c) all and any Tax which may become payable by any Substantial Shareholder as a consequence of the receipt by it of any payment by the Company by way of indemnification or the settlement of any claim for indemnification ("**Indemnity**").

Details of the Indemnity were then communicated to the Substantial Shareholders who duly proceeded to participate in the Sale.

….

For the purposes of the Indemnity it was agreed that "Tax" was to be construed in the widest sense so as to include, without limitation, all forms of taxation, national insurance contributions, all withholdings in the nature of taxation and all penalties, charges and interest relating to any tax for which a Substantial Shareholder may become liable, and that, in calculating the liability of a Substantial Shareholder to Tax, no regard should be had to the existence or otherwise of any losses or reliefs which may be available to that Substantial Shareholder which would otherwise operate to reduce that Substantial Shareholder's liability for Tax for a period of time.

We, the undersigned, being all the directors of the Company at the time of the April Meeting have signed this memorandum by way of confirmation that it represents a true record of the discussions had at that meeting and the terms of the Indemnity by which the Company is bound."

35. The Memorandum was signed by each of Messrs Scott, Bowers and Milton.

36. It was subsequently noted that the signed Memorandum did not record a term to the effect that any payments made pursuant to the agreement would not be repayable. However, each of Mr Scott, Mr Milton and Mr Terry were adamant that such a term had been agreed orally in 2011.

Payment pursuant to the Agreement

37. On 7 February 2013 Mr Terry sent a demand to the Defendant for payment to be made to the Claimants pursuant to the "indemnity". This was followed by a formal demand dated 18 February 2013.

38. On 18 February 2013, the then Finance Director of the Defendant's parent company, Mr Laurence Moorse, sent an email to the then board members of the parent company (Messrs Scott, Moorse, Burrow, Cale, Bowers and Terry), confirming that Mr Terry (on behalf of the Claimants) had made a demand for payment under the "indemnity" of a sum of £3,135,816 and that the payment would be made on the same day to avoid tax penalties being imposed. He concluded the email: "*Should you have any queries, please contact or email me by return*." Mr Cale responded by return. He said that he was happy on the basis of Mr Terry's confirmation that he would co-operate with drawing up appropriate paperwork. Mr Scott confirmed to Mr Moorse both in writing and orally that he did not have any objection to the payment being made. In his view, it was due. None of the other directors responded in writing within the deadline and the payment was duly made.

39. The fact of the payment by the Defendant to the Claimants pursuant to the "indemnity" was noted at the next meeting of the board of directors of the parent company held on 8 March 2013 and the minutes acknowledged that there was no requirement for the Claimants to repay the amounts disbursed. This meeting was attended by Mr Burrow. The minutes of the meeting on 8 March 2013 were reviewed and approved by the board of directors of the parent company at the next board meeting on 5 July 2013. This meeting of the board of directors was also attended by Mr Burrow.

40. The parent company's financial statements for the year ended 31 December 2012 included a reference to the "indemnity" and the directors' Letter of Representation to the company's auditors dated 6 May 2013 confirmed that the "indemnity" was in place at the time of the sale.

Subsequent events

41. After Mr Terry had filed his tax return in early 2013, Her Majesty's Revenue and Customs raised an enquiry in relation to some of the allowances Mr Terry had used. Although some of these were disallowed, they did not affect the amount due under the "indemnity".

42. Sadly, Mr Bowers passed away unexpectedly in late 2014.

43. Receipt by the Claimants in February 2013 of the sum of £3,135,816 led in due course to further capital gains tax liabilities and associated professional fees being incurred by the Claimants. These, together with a small underpayment made in 2013, amounted to £1,025,620.20 in total.

44. In a letter dated 19 July 2016 the Claimants made a demand for payment of this sum which they alleged is due pursuant to the agreement. The Defendant has refused to pay

this sum or any part of it to the Claimants. Further, on the ground that the "indemnity" was never agreed, the Defendant claims (in restitution) the repayment of the sum of £3,135,816.00 paid to the Claimants on 18 February 2013.

IV. Was an agreement made in early 2011?

45. The case advanced by the Claimants is short and simple. They assert that at a meeting of the board of directors of the Defendant held in late March or early April 2011 and, in any event, prior to the sale, it was agreed by all of the directors other than Mr Terry, who did not participate in the decision, that the Defendant would be responsible for all tax and other liabilities and costs that the Claimants may incur as a consequence of the prospective sale (and transactions undertaken in contemplation of the sale) and that, if any payments were made pursuant to the agreement, those payments would not become repayable in the future. The Claimants and each of the individuals who were directors of the Defendant when the agreement was alleged to have been concluded described the agreement as a "*tax indemnity*", or simply an "*indemnity*".

46. The Defendant's response to the claim has developed. In its original Defence, the Defendant put the Claimants to proof as to whether any indemnity was ever in fact granted by the Defendant and, if it was, as to the terms of the indemnity. However, by an amendment made in May 2018, the Defendant changed its case to a denial. The Defendant denies that any legally enforceable indemnity was granted to the Claimants whether in the terms alleged or at all. The Defendant's case is that "*the inevitable inference from the material before the Court … is that Messrs Bowers, Scott and Milton did not grant an indemnity to the Claimants in April 2011 as alleged …*".

47. A number of facts and matters are relied upon as giving rise to the asserted "*inevitable inference*". In summary:

(1) The alleged indemnity was not recorded contemporaneously in a minute of the Defendant's board of directors;

(2) The alleged indemnity was not mentioned to any of the Defendant's or Mission Capital Plc's professional advisers during the transaction negotiations;

(3) There is no reference to the alleged indemnity in the transaction documents, nor in any contemporary emails or meeting attendance notes or board minutes; and

(4) The evidence of the Defendant's directors in relation to the alleged indemnity, as it emerged orally, was more nuanced and less certain than the evidence set out in the witness statements.

48. The Defendant invites me to conclude that, by the time the Defendant began meeting with potential counterparts in late 2010, and certainly by early 2011, any question of an indemnity had "*fallen off the radar*"; that the directors were focussing on ensuring that the Defendant's business, finances, books and records were in an adequate state and that disclosure, due diligence and drafting of transaction documents progressed as rapidly as possible; that the directors were satisfied that capital gains tax roll-over clearance would be granted; that the Claimants were satisfied, based on advice from Mr Bowers, that there was no risk of any EIS gains crystallising upon the sale; and that it was therefore unsurprising that the matter of indemnification was not raised with the Defendant's advisors, with Mission Capital Plc or with Mission Capital Plc's advisors. The Defendant invites me to conclude that, whilst it may well have been that the directors would readily have granted an indemnity prior to the sale, if asked to do so,

the point was not on the radar in April 2011, the question did not arise, and the board did not meet to grant any indemnity.

49. In support of its denial, the Defendant places particular reliance on passages in two judgments of Leggatt J (as he then was): ***Gestamin SGPS SA v Credit Suisse (UK) Limited*** [2013] EWHC 2560 (Comm) at [16] - [22], ***Blue v Ashley*** [2017] EWHC 1928 (Comm) [65] – [70]; and a passage in a judgment of Popplewell J: ***Edgeworth Capital v Aabar Investments*** [2018] EWHC 1627 (Comm) at [34]. It submits that, in weighing the recollections of the Defendant's directors in office in early 2011, more than 8 years after the fact, against the "*deafening silence*" in the contemporary documents, the known or probable facts, and the inherent unlikelihood of what are alleged to be coincidences in the Claimants' account, the "*inevitable inference*" must be that no indemnity was granted.

50. Given the central place these passages were given in the Defendant's submissions, the passages relied upon are set out in full, below.

51. In ***Gestamin SGPS SA v Credit Suisse (UK) Limited***, Leggatt J stated as follows:

> "**Evidence based on recollection**
>
> 15. An obvious difficulty which affects allegations and oral evidence based on recollection of events which occurred several years ago is the unreliability of human memory.
>
> 16. While everyone knows that memory is fallible, I do not believe that the legal system has sufficiently absorbed the lessons of a century of psychological research into the nature of memory and the unreliability of eyewitness testimony. One of the most important lessons of such research is that in everyday life we are not aware of the extent to which our own and other people's memories are unreliable and believe our memories to be more faithful than they are. Two common (and related) errors are to suppose: (1) that the stronger and more vivid is our feeling or experience of recollection, the more likely the recollection is to be accurate; and (2) that the more confident another person is in their recollection, the more likely their recollection is to be accurate.

17. Underlying both these errors is a faulty model of memory as a mental record which is fixed at the time of experience of an event and then fades (more or less slowly) over time. In fact, psychological research has demonstrated that memories are fluid and malleable, being constantly rewritten whenever they are retrieved. This is true even of so-called 'flashbulb' memories, that is memories of experiencing or learning of a particularly shocking or traumatic event. (The very description 'flashbulb' memory is in fact misleading, reflecting as it does the misconception that memory operates like a camera or other device that makes a fixed record of an experience.) External information can intrude into a witness's memory, as can his or her own thoughts and beliefs, and both can cause dramatic changes in recollection. Events can come to be recalled as memories which did not happen at all or which happened to someone else (referred to in the literature as a failure of source memory).

18. Memory is especially unreliable when it comes to recalling past beliefs. Our memories of past beliefs are revised to make them more consistent with our present beliefs. Studies have also shown that memory is particularly vulnerable to interference and alteration when a person is presented with new information or suggestions about an event in circumstances where his or her memory of it is already weak due to the passage of time.

19. The process of civil litigation itself subjects the memories of witnesses to powerful biases. The nature of litigation is such that witnesses often have a stake in a particular version of events. This is obvious where the witness is a party or has a tie of loyalty (such as an employment relationship) to a party to the proceedings. Other, more subtle influences include allegiances created by the process of preparing a witness statement and of coming to court to give evidence for one side in the dispute. A desire to assist, or at least not to prejudice, the party who has called the witness or that party's lawyers, as well as a natural desire to give a good impression in a public forum, can be significant motivating forces.

20. Considerable interference with memory is also introduced in civil litigation by the procedure of preparing for trial. A witness is asked to make a statement, often (as in the present case) when a long time has already elapsed since the relevant events. The statement is usually drafted for the witness by a lawyer who is inevitably conscious of the significance for the issues in the case of what the witness does nor does not say. The statement is made after the witness's memory has been "refreshed" by reading documents. The documents considered often include statements of case and other argumentative material as well as documents which the witness did not see at the time or which came into existence after the events which he or she is being asked to recall. The statement may go through several iterations before it is finalised. Then, usually months later, the witness will be asked to re-read his or her statement and review documents again before giving evidence in court. The effect of this process is to establish in the mind of the witness the matters recorded in his or her own statement and other written material, whether they be true or false, and to cause the witness's memory of events to be based increasingly on this material and later interpretations of it rather than on the original experience of the events.

21. It is not uncommon (and the present case was no exception) for witnesses to be asked in cross-examination if they understand the difference between recollection and reconstruction or whether their evidence is a genuine recollection or a reconstruction of events. Such questions are misguided in at least two ways. First, they erroneously presuppose that there is a clear distinction between recollection and reconstruction, when all remembering of distant events involves reconstructive processes. Second, such questions disregard the fact that such processes are largely unconscious and that the strength, vividness and apparent authenticity of memories is not a reliable measure of their truth.

22. In the light of these considerations, the best approach for a judge to adopt in the trial of a commercial case is, in my view, to place little if any reliance at all on witnesses' recollections of what was said in meetings and conversations, and to base factual findings on inferences drawn from the documentary evidence and known or probable facts. This does not mean that oral testimony serves no useful purpose – though its utility is often disproportionate to its length. But its value lies largely, as I see it, in the opportunity which cross-examination affords to subject the documentary record to critical scrutiny and to gauge the personality, motivations and working practices of a witness, rather than in testimony of what the witness recalls of particular conversations and events. Above all, it is important to avoid the fallacy of supposing that, because a witness has confidence in his or her recollection and is honest, evidence based on that recollection provides any reliable guide to the truth.

23. It is in this way that I have approached the evidence in the present case."

52. In ***Blue v Ashley***, Leggatt J stated as follows:

"**IV. Evidence based on memory**

65. It is rare in modern commercial litigation to encounter a claim, particularly a claim for millions of pounds, based on an agreement which is not only said to have been made purely by word of mouth but of which there is no contemporaneous documentary record of any kind. In the twenty-first century the prevalence of emails, text messages and other forms of electronic communication is such that most agreements or discussions which are of legal significance, even if not embodied in writing, leave some form of electronic footprint. In the present case, however, such a footprint is entirely absent. The only sources of evidence of what was said in the conversation on which Mr Blue's claim is based are the recollections reported by the people who were present in the Horse & Groom on 24 January 2013 and any inferences that can be drawn from what Mr Blue and Mr Ashley later said and did. The evidential difficulty is compounded by the fact that most of the later conversations relied on by Mr Blue were also not recorded or referred to in any contemporaneous document.

66. I have no reason to think that (with the possible exception of Mr Leach when he retreated from what he had said to Mr Blue's solicitors) any of the witnesses were doing anything other than stating their honest belief based

on their recollection of what was said in relevant conversations. But evidence based on recollection of what was said in undocumented conversations which occurred several years ago is problematic. In ***Gestmin SGPS SA v Credit Suisse (UK) Limited*** [2013] EWHC 3560 (Comm), at paras 16-20, I made some observations about the unreliability of human memory which I take the liberty of repeating in view of their particular relevance in this case:

> [Paragraphs 16-20 of ***Gestamin***, set out above, were then quoted.]

67. In the light of these considerations, I expressed the opinion in the ***Gestmin*** case (at para 22) that the best approach for a judge to adopt in the trial of a commercial case is to place little if any reliance on witnesses' recollections of what was said in meetings and conversations, and to base factual findings on inferences drawn from the documentary evidence and known or probable facts.

68. A long list of cases was cited by counsel for Mr Blue showing that my observations in the ***Gestmin*** case about the unreliability of memory evidence have commended themselves to a number of other judges. In some of these cases they were also supported by the evidence of psychologists or psychiatrists who were expert witnesses: see e.g. ***AB v Catholic Child Welfare Society*** [2016] EWHC 3334 (QB), paras 23-24, and related cases. My observations have also been specifically endorsed by two academic psychologists in a published paper: see Howe and Knott, "*The fallibility of memory in judicial processes: Lessons from the past and their modern consequences*" (2015) Memory, 23, 633 at 651-3. In the introduction to that paper the authors also summarised succinctly the scientific reasons why memory does not provide a veridical representation of events as experienced. They explained:

> "… what gets encoded into memory is determined by what a person attends to, what they already have stored in memory, their expectations, needs and emotional state. This information is subsequently integrated (consolidated) with other information that has already been stored in a person's long-term, autobiographical memory. What gets retrieved later from that memory is determined by that same multitude of factors that contributed to encoding as well as what drives the recollection of the event. Specifically, what gets retold about an experience depends on whom one is talking to and what the purpose is of remembering that particular event (e.g., telling a friend, relaying an experience to a therapist, telling the police about an event). Moreover, what gets remembered is reconstructed from the remnants of what was originally stored; that is, what we remember is constructed from whatever remains in memory following any forgetting or interference from new experiences that may have occurred across the interval between storing and retrieving a particular experience. Because the contents of our memories for experiences involve the active manipulation (during encoding), integration with pre-existing information (during consolidation), and reconstruction (during retrieval) of that information, memory is, by definition, fallible at best and unreliable at worst."

69. In addition to the points that I noted in the ***Gestmin*** case, two other findings of psychological research seem to me of assistance in the present case. First, numerous experiments have shown that, when new information is encoded which is related to the self, subsequent memory for that information is improved compared with the encoding of other information. Second, there is a powerful tendency for people to remember past events concerning themselves in a self-enhancing light.

70. Mindful of the weaknesses of evidence based on recollection, I will make such findings as I can about what was said in the conversations on which Mr Blue relies and in particular in the crucial conversation on 24 January 2013 on which his claim is founded."

53. In ***Edgeworth Capital v Aabar Investments***, Popplewell J stated as follows:

"34. The law in relation to the alleged oral agreements is not substantially in dispute. The party asserting the existence of a contract with the other party must show that (i) the terms alleged were agreed (ii) between it and the other party or between third parties through whom it is entitled to rely against the other party (iii) the parties intended the agreed terms to be legally binding (iv) the agreement relied on is supported by consideration and (v) the terms are sufficiently certain and complete. The application of these principles in the context of oral contracts was recently considered by Leggatt J, as he then was, in ***Blue v Ashley*** [2017] EWHC 1928 (Comm) at paragraphs [49]-[64]. I respectfully agree with those observations. I would also associate myself with the views in paragraph [65], which are of particular relevance in this case, that the absence of a contemporaneous written record by those with business experience may count heavily against the existence of an oral contract, because in the twenty-first century the prevalence of emails, text messages and other forms of electronic communication is such that most agreements and discussions which are of legal significance, even if not embodied in writing, leave some form of electronic footprint. Moreover, where parties contemplate that they will instruct lawyers to draft detailed written agreements between them, there is a presumption that they intend the terms of their bargain to be those reflected in such carefully drafted agreements, not those in any prior or contemporaneous oral conversation, even in the absence of a boilerplate entire agreement clause. As Mr Tchenguiz himself put it at one point in his evidence, "the things that are mentioned that are important get documented, the things at the time that are not important do not get documented as such." It is one of the striking features of Edgeworth's case that despite a myriad of written communications between the parties and substantial internal documentation about the transaction over a number of years, there is no record of any articulation of the terms of the alleged Oral Agreements prior to the issue of proceedings."

No contemporary record

54. As to the first and third facts and matters relied upon on behalf of the Defendant as giving rise to the asserted "*inevitable inference*", it is common ground that the alleged indemnity was not recorded contemporaneously in a minute of the Defendant's board of directors. It is also common ground that there is no reference to the alleged indemnity in the transaction documents, or in any contemporary emails or meeting attendance notes or board minutes.

55. These absences were striking and called for cogent explanations. Explanations were provided by each of the living directors and, in particular, by Mr Scott. I have sought to capture the explanations, in summary, at paragraphs [23] to [26] above. Despite the absences being striking, I found the explanations compelling and persuasive.

No disclosure to professional advisers

56. The second of the facts and matters relied upon on behalf of the Defendant as giving rise to the asserted "*inevitable inference*", that the agreement was not mentioned to any of the Defendant's or Mission Capital Plc's professional advisers during the transaction negotiations, is challenged by the Claimants and I have dealt with the challenge at paragraph [27] above. Further, the assertion is, in at least one respect, demonstrably wrong. Both Mr Webster and Mr Cale, the representatives of Ubiquity Capital LLP who were retained to advise on and assist with the transaction, were aware that there would be a "tax indemnity" in place; and it was Mr Webster's recollection that the requirement for an agreement was disclosed to representatives of Mission Capital Plc and other prospective counterparties before the sale was concluded.

57. Even if the agreement was not disclosed to many of the professional advisers involved in advising on the sale, it was clearly disclosed to some. It follows that the fact of the agreement's limited non-disclosure (if it be a fact) does not logically give rise to an inevitable inference that Messrs Bowers, Scott and Milton did not grant an indemnity to the Claimants in April 2011 as the Claimants allege.

Oral evidence less clear than written statements

58. As to the fourth of the facts and matters are relied upon on behalf of the Defendant as giving rise to the asserted "*inevitable inference*", it is correct that the evidence of the directors of the Defendant in early 2011, as it emerged orally, was more nuanced and less certain than the evidence set out in the witness statements. However, in my view this gave their oral evidence greater rather than less credibility. Each of the directors was careful to relate only what he could remember, and it is unsurprising in the circumstances that each had a slightly different perspective in relation to the meeting at which what they referred to as the "*tax indemnity*" (or simply the "*indemnity*") was granted to the Claimants. Some remembered some aspects of the discussion and others remembered other aspects. What did emerge clearly from the evidence of each of them was that, prior to the sale, the directors did agree to provide the Claimants with a "*tax indemnity*" against any negative tax consequences to which the sale would lead and that the agreement was made because of the simple fact that the sale would not have proceeded in the absence of such agreement. Further, whilst the directors expressed the specific terms of the agreement in slightly different ways, their evidence established that there were two aspects to the agreement. First, the Claimants would be fully indemnified for both tax liabilities (excluding capital gains tax arising on the ultimate disposal of their shares) and other liabilities and costs that they may incur as a

consequence of the sale (and transactions undertaken in contemplation of the sale); and, secondly, that the Defendant would not seek repayment of any money paid out pursuant to the agreement.

59. In reaching conclusions on the evidence in this case, I have paid particularly careful attention to the (in truth, uncontroversial) guidance provided by Leggatt J (and Popplewell J) in the passages quoted above. It is beyond doubt that human memory is fallible and may be unreliable; that the process of civil litigation subjects the memories of witnesses to powerful biases – for example, they may have a stake in a particular version of events or be subject to the allegiances created by coming to court to give evidence for one side to a dispute; and that the process of trial preparation tends to fix in the mind of a witness the matters recorded in their witness statements, whether they be true or false. Further, there can be no question that the best approach for a judge to adopt in the trial of a commercial case is to place little reliance on witnesses' recollections of what was said in meetings and conversations, and to base factual findings on inferences drawn from the documentary evidence and known or probable facts. If the learned judges were saying that a judge in a commercial trial cannot reasonably place any reliance on witness recollections of what was said in meetings or discussions, then they were, in my view, going too far. However, in my view, this is not what they were saying.

60. Mindful of the weaknesses of evidence based on recollection, I will make such findings as I can about what, if anything, was agreed in March or April 2011 by Messrs Scott, Milton and Bowers, on behalf of the Defendant, and Mr Terry, on behalf of the Claimants. The absence of any contemporaneous record counts heavily against the recollection of each of them that a "tax indemnity" was granted. However, the absence

of any such record is outweighed by the following facts and matters which, taken together, show with considerable force that a "tax indemnity" was indeed granted by the Defendant to the Claimants in March or April 2011:

(1) There is no dispute between the individuals alleged to have made the agreement. They all recall having made the agreement. This is not a case in which there is a clash of recollections.

(2) As regards the essential ingredients of the agreement, the individuals who made the agreement are all of one mind. The Claimants would be fully indemnified for both tax liabilities (excluding capital gains tax arising on the ultimate disposal of their shares) and other liabilities and costs that they may incur as a consequence of the sale (and transactions undertaken in contemplation of the sale) and the Defendant would not seek repayment of any money paid out pursuant to the agreement.

(3) The question whether an "indemnity" had been granted by the Defendant to the Claimants arose less than two years after it was alleged to have been granted. At the time, the question was investigated carefully by the Defendant's then lawyers, Dorsey & Whitney (Europe) LLP, who concluded, independently, that an "indemnity" had indeed been granted. The investigation led to the drafting of the Memorandum referred to in paragraph 33 above. The Memorandum was signed on 7 February 2013 by all of the Defendant's directors in office in late March / early April 2011. By the Memorandum the directors recorded formally what had been agreed orally nearly two years earlier. At this time and in this context, Mr Burrow never sought to suggest that an "indemnity" had not been granted or that the Memorandum should not be signed.

(4) One of the individuals who was not in doubt in asserting that an “indemnity” had been granted by the Defendant to the Claimants was Mr Bowers, a non-executive director of the Defendant and a former senior tax partner in the accounting firm, Deloitte. It could not be said of Mr Bowers that he was the subject of any significant bias. He had no axe to grind, nor any reason to sign the Memorandum if he was in any doubt as to the existence of the agreement.

(5) Based on the investigations performed by the Defendant’s lawyers and the existence of the signed Memorandum, the Defendant agreed to pay the Claimants £3,135,816 in February 2013. If, at the time, any individual director had been in any doubt as to the existence of the “indemnity” he would have raised the doubt and cautioned against or objected to the making of the payment.

61. Whilst paying careful attention to the warnings against placing reliance on witness recollections, these factors enable me to conclude with confidence that the recollection of these individuals was, in 2013, and is, in 2018, on a balance of probabilities, accurate.

62. On behalf of the Defendant, I was invited to find that, whilst Mr Terry may have made it clear at some stage that he wanted to avoid certain adverse tax consequences for him or his family in concluding the sale, the point “*fell off the radar*” from early 2011 and was not discussed by the Defendant’s board of directors before the sale was completed. There is, however, no evidence to support such a finding. The evidence shows not only that Mr Terry made it clear that he wanted to avoid any adverse consequences for the Claimants if the sale were to be concluded, but also that he was granted an “indemnity” against such consequences. The point did not fall off the radar. As I have found, it was not only on the radar, but addressed expressly.

V. What were the terms of the agreement?

63. The terms of the agreement are for the most part encapsulated in the Memorandum. In summary, the Claimants would be fully indemnified for both tax liabilities (excluding capital gains tax arising on the ultimate disposal of their shares) and other liabilities and costs that they may incur as a consequence of the sale (and transactions undertaken in contemplation of the sale). In the Memorandum, the terms are set out in more formal legal language, as one would expect in a document produced after the event by lawyers.

64. Those who made the agreement were also unanimous in asserting that it was also a term of the agreement that the Defendant would not seek repayment of any money paid out pursuant to the agreement. The agreement to this term is confirmed in two board minutes. I accept this evidence.

VI. Subsidiary issues

65. Subsidiary issues arise if, as I have found, the Claimants were granted an "indemnity" by the Defendant in the manner and terms alleged.

66. In these circumstances, the Defendant submits that the "indemnity" was a "*substantial property transaction*" within the meaning of section 190 of the Companies Act 2006 ("**the Act**"); that such a transaction required shareholder approval; that the transaction was not approved by the shareholders; and that the "indemnity" was, accordingly, both voidable at the instance of the Defendant and duly avoided by the Defendant by letter dated 16 August 2016. The Defendant submits that the "indemnity" was a substantial property transaction because the First Claimant was a director of the Defendant and the other Claimants were "*connected*" to the First Claimant.

67. The Claimants deny each of these submissions. They submit that the "indemnity" was not a non-cash asset of the Defendant and, in any event, that the value of the "indemnity" was not substantial. Further, they submit that the "indemnity" was given to the Claimants in their character as members of the Defendant company and that approval for the "indemnity" from the shareholders was not required pursuant to section 192 of the Act.

The statutory framework

68. Section 190 of the Act provides, *inter alia*, as follows:

> "**Substantial property transactions: requirement of members' approval**
>
> (1) A company may not enter into an arrangement under which–
>
> (a) a director of the company or of its holding company, or a person connected with such a director, acquires or is to acquire from the company (directly or indirectly) a substantial non-cash asset, or
>
> …
>
> unless the arrangement has been approved by a resolution of the members of the company or is conditional on such approval being obtained."

69. By section 191 of the Act, an asset is "*substantial*" for these purposes if its "*value*" (i) exceeds 10% of the company's assets and is more than £5,000 or (ii) exceeds £100,000. Section 191(5) provides that the "*value*" is to be determined as at the time the arrangement is entered into.

70. Section 192 of the Act provides an exception to the requirement of approval under section 190:

> "**Exception for transactions with members or other group companies**
>
> Approval is not required under section 190 (requirement of members' approval for substantial property transactions)-
>
> (a) for a transaction between a company and a person in his character as a member of the company …"

71. As to the consequences of a failure to obtain shareholder approval, section 195 of the Act provides, *inter alia*, as follows:

> "**Property transactions: civil consequences of contravention**
>
> (1) This section applies where a company enters into an arrangement in contravention of section 190 (requirement of members' approval for substantial property transactions).
>
> (2) The arrangement, and any transaction entered into in pursuance of the arrangement (whether by the company or any other person), is voidable at the instance of the company, unless–
>
> (a) restitution of any money or other asset that was the subject matter of the arrangement or transaction is no longer possible,
>
> (b) the company has been indemnified in pursuance of this section by any other persons for the loss or damage suffered by it, or
>
> (c) rights acquired in good faith, for value and without actual notice of the contravention by a person who is not a party to the arrangement or transaction would be affected by the avoidance.
>
> (3) Whether or not the arrangement or any such transaction has been avoided, each of the persons specified in subsection (4) is liable–
>
> (a) to account to the company for any gain that he has made directly or indirectly by the arrangement or transaction, and
>
> (b) (jointly and severally with any other person so liable under this section) to indemnify the company for any loss or damage resulting from the arrangement or transaction.
>
> (4) The persons so liable are–
>
> (a) any director of the company or of its holding company with whom the company entered into the arrangement in contravention of section 190,
>
> (b) any person with whom the company entered into the arrangement in contravention of that section who is connected with a director of the company or of its holding company,
>
> (c) the director of the company or of its holding company with whom any such person is connected, and
>
> (d) any other director of the company who authorised the arrangement or any transaction entered into in pursuance of such an arrangement.
>
> (5) Subsections (3) and (4) are subject to the following two subsections.
>
> (6) In the case of an arrangement entered into by a company in contravention of section 190 with a person connected with a director of the company or of its holding company, that director is not liable by virtue of subsection (4)(c) if he shows that he took all reasonable steps to secure the company's compliance with that section.

(7) In any case–

(a) a person so connected is not liable by virtue of subsection (4)(b), and

(b) a director is not liable by virtue of subsection (4)(d),

if he shows that, at the time the arrangement was entered into, he did not know the relevant circumstances constituting the contravention.

(8) Nothing in this section shall be read as excluding the operation of any other enactment or rule of law by virtue of which the arrangement or transaction may be called in question or any liability to the company may arise."

72. The phrase "*non-cash asset*" is defined at section 1163 of the Act as follows:

"**"Non-cash asset"**

(1) In the Companies Act "non-cash asset" means any property or interest in property, other than cash.

For this purpose "cash" includes foreign currency.

(2) A reference to the transfer or acquisition of a non-cash asset includes-

(a) the creation or extinction of an estate or interest in, or a right over, any property, and

(b) the discharge of a liability of any person, other than a liability for a liquidated sum."

Authority

73. In ***British Racing Drivers' Club Ltd v Hextall Erskine & Co (a firm)*** [1996] 3 All ER 667, at 681, Carnwath J (as he then was) said of section 320 of the Companies Act 1985, the predecessor provision to section 190 of the Act:

"The thinking behind that section is that if directors enter into a substantial commercial transaction with one of their number, there is a danger that their judgment may be distorted by conflicts of interest and loyalties, even in cases of no actual dishonesty. The section is designed to protect a company against such distortions. It enables members to provide a check. Of course, this does not necessarily mean that the members will exercise a better commercial judgment; but it does make it likely the matter will be more widely ventilated, and a more objective decision reached."

74. The provisions of the 1985 Act (like the 2006 Act) govern company law in the whole of the United Kingdom. Section 320 of the 1985 Act (and section 739 of the Act, which

contains the definition of the phrase "*non-cash asset*") were considered by the Outer House of the Court of Sessions in Scotland in ***Micro Leisure Ltd v County Properties (No 1)*** [1999] SC 501. At page 508I to 509F, Lord Hamilton said as follows:

> "In my view it is appropriate to construe sec 320 (as read with sec 739) in a way which gives due recognition to its manifest purpose. That purpose was to protect shareholders against the company being bound without their approval by an arrangement entered into between the company on the one hand and a director or a person connected with him on the other hand by which either party acquired one or more non-cash assets of the requisite value. For present purposes that value was '*not less than £2,000 (but subject to that) exceeds £100,000 or 10 per cent of the company's asset value* ... [identified in a prescribed way] …' (sec 320(2) (as amended)). Thus, the arrangements against which protection is given are those of substantial value relative to the worth of the company.
>
> The concept of a person acquiring an asset from the company (or vice versa) imports, in my view, as a matter of ordinary language that immediately prior to the time of acquisition the asset is in existence - though, given that sec 320 covers arrangements under which a party 'is to acquire' an asset, it may be that it can apply where an asset comes into existence between the making of the arrangement and the acquisition of the asset under it. Section 739(1) defines 'non-cash asset' as meaning any property or interest in property other than cash. That is, as Lord Osborne observed in Lander at 1365L, a comprehensive definition. That definition (when read with sec 320 and leaving aside for the present the effect of sec 739(2)) does not, however, in my view embrace property or an interest in property which is brought into existence only by the 'acquisition' itself. It matters not that the property or interest in property then brought into existence is itself capable of transmission, by assignation or otherwise. In the present case, none of the rights acquired under the agreement existed prior to its execution. None of those rights, in my view, constitutes property or an interest in property acquired by the agreement within the meaning of sec 320(1) as read with sec 739(1).
>
> Section 739(2), however, is clearly designed to extend the concept of acquisition to certain situations in which what is acquired is created contemporaneously with its acquisition. It does not extend to all assets so created. It applies only when what is created is 'an estate or interest in, or a right over, any property'. That formulation imports, in my view, that, prior to the creation of the relative asset, there has existed other property and that the created asset constitutes an estate or interest in that other property or a right over it. The purpose of the extension effected by sec 739(2) is, in my view, to bring within the purview of sec 320 (and also within that of sec 104 of the Act to which the transfer of a non-cash asset appears to refer) the creation (and extinction) of subsidiary estates, interests and rights of substantial value."

75. These provisions of the Companies Act were also considered by the Court of Session (Outer House) in ***Lander v Premier Pict Petroleum Ltd & Anor*** [1998] BCC 248. At page 254A-H of the report, Lord Osborne stated as follows:

> "Turning now to the defence based on s. 320 of the Act of 1985, it appears to me that the question which arises is whether the rights conferred upon the pursuer by cl. 13.3 of the service agreement can properly be regarded as '*non-cash assets*' within the meaning of the section. In that connection, it is plainly necessary to bare (sic) in mind the comprehensive definition of the expression 'non-cash asset' enacted in s. 739(1) of the Act. That expression is there said to mean '*any property or interest in property other than cash …*' It is plain from these provisions, in my opinion, that the concept of property other than cash is of the essence of matter. It was argued here by the defenders that the court was dealing with property in the form of an option. While it is clear that certain kinds of option, which are marketable, may properly be regarded as a property, I do not consider that I am dealing with an option of that kind in the present case. It appears to me that the rights concerned here were rights conferred upon the pursuer by the service agreement, which, according to ordinary principles, was incapable of assignation. Accordingly, I am not persuaded that I am here dealing with an option of a kind which may properly be regarded as property.
>
> I observe from the defenders' averments that the defenders' case is that '*the arrangement contained in the purported agreement concerned a non-cash asset being acquired by the pursuer.*' I read that averment as indicating that the purported agreement of 28 September 1992 concerned the acquisition of a '*non-cash asset*' by the pursuer. It appears to me to be helpful in testing the defenders' argument to examine how subs. (2) of s. 320 might apply to that averment. It of course provides:
>
>> 'For this purpose a non-cash asset is of the requisite value if at the time the arrangement in question is entered into its value is not less that £2,000 but (subject to that) exceeds £100,000 or ten per cent of the company's asset value …'
>
> It is obvious from this provision that the *punctum temporis* for the valuation of the 'non-cash asset' is the time at which the arrangement in question is entered into. In this case that time must be 28 of September 1992. If one considers the situation existing at that time, one is driven to the conclusion that the rights in question, said by the defenders to be a 'non-cash asset' were incapable of valuation at that time. That is because the question of whether any person or any one or more persons acting in concert might acquire control of more than 50 per cent of the equity share capital of first defenders at any time during the term of the pursuer's employment was an uncertain event. Further, upon the assumption that that event might occur, the date of its occurrence was uncertain. It follows that the level of the pursuer's gross salary on the date on which the pursuer might give the appropriate notice would also be uncertain. These uncertainties conspire together to render the rights in question incapable of valuation at that stage, in my opinion. It appears to me that the inference to be drawn from that situation is that

s. 320 was not intended to apply to rights of the kind under the consideration here.

A further difficulty for the defenders appears to me to lie in the nature of the rights in question. They are rights to cash payments, to be made in part directly to the pursuer, in part to his pension fund. In these circumstances, I do not see how they can properly be described as '*property or interest in property other than cash*', within the meaning of s. 739(1). For all of these reasons, I consider that the rights conferred by cl. 13.3 of the service agreement are not 'non-cash assets', within the meaning of s. 320 of the Act. Accordingly, I consider that the defence based upon that section is irrelevant."

76. The purpose and ambit of the predecessor section was considered in England by Andrews J in ***Granada Group Limited v The Law Debenture Pension Trust Corporation Plc*** [2015] WEHC 1499 (Ch):

"36. In order to evaluate these arguments, it is necessary for the Court to have regard to the purpose of s.320 and the mischief that it was designed to prevent. If a company decides to make a cash payment to one or more of its directors, that payment is going to be difficult, if not impossible, to conceal from the shareholders, and the value of what the director receives will be readily apparent on the face of the company's accounts. It is far easier to structure a transaction in which a director obtains an interest in a non-cash asset of the company, such as a property, in a manner in which the director's interest, or its value to him, is not transparent.

37. … the value to be placed on a non-cash asset is often a matter of difficulty, or may be controversial, and the asset may have a particular value to a director which is greater than its open market value. For example, the director may own land adjacent to a strip of land owned by the company whose acquisition would greatly enhance the value of his own land ("a ransom strip"). Yet the company's strip of land may be of little use, and thus of little value, to anyone else. Thus, there is scope for a director acting to his own benefit and to the detriment of the company if he buys the ransom strip, even if he appears to buy it at the open market value.

38. Parliament plainly intended that, where the sums involved were significant, the company should have the protection of a requirement that such arrangements be subject to the prior scrutiny of the general meeting rather than leaving them entirely to the judgment of the directors, at least some of whom will have a conflict of interest. In ***Duckwari plc v Offerventure Ltd (No 2)*** [1999] BCC 11 Nourse LJ at pp 19-20 identified the evident purpose of ss.320 and 322 as being: "*to give shareholders specific protection in respect of arrangements and transactions which will or may benefit directors to the detriment of the company*".

39. In ***British Racing Drivers Club Ltd v Hextall Erskine & Co*** [1996] BCC 727 at p.741A-B, Carnwath J explained that this protection was not confined to instances of deliberate disloyalty:

[See the passage quoted at paragraph 73 above.]

40. S.320 is aimed at "arrangements". That expression is deliberately wide. It obviously includes a transaction in which there are multiple contracts. The company must enter into the "arrangement", but the director need not be a party to it. The section is triggered if the arrangement causes the director, or a connected person, to acquire (or enables him to acquire in the future) one or more non-cash assets of the requisite value from the company. It follows that the non-cash asset in question must be capable of valuation, and that value to the director must be above the requisite value, in this case, £100,000, at the time that the arrangement was entered into.

41. Granada's case on the direct application of s.320(1)(a) to the Directors themselves substantially depends on the extended definition of "*acquisition of a non-cash asset*" in s.739(2). The provisions of the 1985 Act extend to Scotland. In ***Micro Leisure Ltd v County Properties (No 1)*** [1999] SC 501, a decision of the Outer House in Scotland, Lord Hamilton accepted that as a matter of ordinary language, the concept of a person acquiring an asset from the company presupposes that the asset exists prior to its acquisition. The definition of "non-cash asset" does not embrace property or an interest in property that is brought into existence by the "*acquisition*" itself.

42. He then expressed the view, at p.509E, that s.739(2) was clearly designed to extend the concept of "*acquisition*" to certain situations in which what is acquired is created contemporaneously with its acquisition, but it does not extend to all assets so created. It applies only when what is created is "*an estate or interest in, or a right over, any property*." Lord Hamilton said that in his view the purpose of the extension effected by s.739(2) was to bring within the purview of s.320 "*the creation... of subsidiary estates, interests and rights of substantial value*".

43. The judge then went on to give examples of the kinds of rights and interests that would fall within the extended definition, rejecting an argument by counsel in that case that they should be confined to rights which, under Scots law, would be regarded as real rights rather than personal rights. He decided, at p.510B, that the application of a purposive construction to the statutory provisions made it appropriate to recognise that s.739(2) extends beyond subsidiary real rights to "*subsidiary rights which, albeit personal, are capable of materially affecting the exercise by the other party of its proprietorial rights*." On the basis of that analysis, he concluded at p.511A that s.739(2) was not apt to cover contractual rights to share in the profits made from the development of land, because those were in no sense rights over property.

44. I can readily accept that the extended definition under s.739(2) means that the interest that the director acquires (or is to acquire) in the non-cash asset does not have to be a proprietorial interest, but may include some other kind of right over the asset which is susceptible of being valued, such as an option or a licence, and arguably even (though I am more doubtful about this) the benefit of a contractual right to purchase the asset. However, the rights which Granada contends fall within the extended definition are specific examples of the rights that any beneficiary, under any trust, would

have to compel the trustee to administer that trust properly, in the event that the trustee fails to do so. Those are personal rights against the trustee, not rights over the assets of the trust, which only arise when the trust is created, and (whether or not they are susceptible of valuation), in my judgment they do not fall within the meaning of the expression "*rights over any property*".

45. A right over property implies a direct link between the right in question and the property itself, which is why Lord Hamilton spoke of the creation of such a right having a material effect on the other party, (which in context must mean the company) exercising its full proprietorial rights. A charge is a right over property because it inhibits the owner's freedom to deal with that property as he pleases. However, the charge can only be enforced by the person in whom that right is vested. The right of beneficiaries, in certain circumstances, to compel a trustee to exercise his rights, including his rights as chargee, has no impact whatsoever on the chargor's use and enjoyment of his property. It is the charge, and the rights which it creates, which inhibit that use and enjoyment. A right to compel someone other than the owner of the property (in this case a trustee) to exercise a contractual right to require the owner of the property to do something with it, such as sell it and apply the proceeds in a particular way, is not a right over the property itself."

77. In that case, Granada Group Ltd mounted an unsuccessful appeal. The decision of the Court of Appeal is reported at [2017] Bus LR 870. The relevant issue on appeal was whether the word "*interest*" in section 739 of the 1985 Act (part of the phrase "*interest in property*") was broad enough to encompass any economic or financial interest or advantage. The leading judgment was given by Lewison LJ. Whilst recognising that it is necessary for an English lawyer to approach the examples used by Lord Hamilton in the ***Micro Leisure*** case with some care, because the classification in Scots law is not always the same as their classification in English law, he expressly did not disagree with Lord Hamilton's conclusion that section 739(2) of the 1985 Act ("*A reference to the transfer or acquisition of a non-cash asset includes the creation or extinction of an estate or interest in, or a right over, any property and also the discharge of any person's liability, other than a liability for a liquidated sum*") extends to rights that are not proprietary rights, provided they can still be properly described as rights in or over property. He nevertheless dismissed the appellant's contention on the ground that it

focussed too narrowly on the single word "interest", without regard to the context in which it appears:

> "It first appears in section 739(1) of the 1985 Act as part of the phrase "property or an interest in property". In that context it seems to me that an "interest in property" means a proprietary interest. That is why section 739(2) is needed in order to expand the primary definition. If "interest in property" has a meaning as broad as Granada asserts, it is difficult to see why section 739(2) is necessary. Its second appearance is in the phrase "estate or interest in … property". One would expect the same phrase to have the same meaning in both subsections of the same section of an Act of Parliament. As [Counsel for Granada] accepted an "estate" in property means a legal or equitable estate in real property. In my judgment an "interest" in property has the same quality; in particular the quality that it can be defined by reference to proprietary concepts, or at least by concepts that are legally recognisable and enforceable. The reason why the phrase "interest in property" is repeated in section 739(2) is that that subsection extends to the creation or extinction of such an interest. Section 739(2) goes on to include "rights over" property. [Counsel for Granada] rightly accepted that this meant legally enforceable rights. But if "rights over" property means legally enforceable rights, that is a strong pointer to the conclusion that in the same definition an "interest in" property also means one that can be legally enforced. This is consistent with Lord Reid's statement in ***Gartside's*** case [1968] AC 553 that an "interest" must be a right. In short, [Counsel for Granada's] interpretation makes section 739(2) (and indeed part of section 739(1)) redundant.
>
> …
>
> A further objection to [Counsel for Granada's] interpretation is that section 320 was intended (at least in part) to operate prophylactically, so that a company would know in advance what kind of arrangement or transaction needed to be sanctioned in advance by the members in general meeting. A concept as vague as any economic or financial advantage would not, in my judgment, provide a sufficient guide."

78. With a degree of (what I consider to be legitimate) transposition, I have derived the following propositions from these authorities which, to the extent that I am not bound, I find persuasive:

    (1) Section 190 of the Act is designed to protect a company in circumstances where the directors of the company enter into a substantial transaction with one of their number and conflicts of interest arise.

(2) Section 190(1) of the Act concerns the *acquisition* of a substantial non-cash asset. The concept of a person acquiring an asset from a company imports as a matter of ordinary language that, immediately prior to the time of the acquisition, the asset is in existence, although, given that section 190 covers arrangements under which a party '*is to acquire*' an asset, it may be that it can apply where an asset comes into existence between the making of the arrangement and the acquisition of the asset under it;

(3) Section 1163 defines "*non-cash asset*" as meaning any "*property or interest in property, other than cash*."

(a) The concept of property other than cash is of the essence. Accordingly, a non-marketable contractual right would not be properly regarded as "*property*". Similarly, where the rights under the "*arrangement*" are rights to cash payments they cannot properly be described as "*property or interest in property, other than cash*";

(b) The definition does not embrace property or an interest in property that is brought into existence by the acquisition itself. However, the definition – at sub-section (2) – does extend the concept of acquisition to certain situations in which what is acquired is created contemporaneously with its acquisition. It does not extend to all assets so created. It applies only when what is created is "*an estate or interest in, or a right over, any property*". The formulation imports that, prior to the creation of the relative asset, there has existed other property and that the created asset constitutes an estate or interest in that other property or a right over it. The purpose of the extension effected by section 1163(2) of the Act is to bring within the

purview of section 190 the creation of *subsidiary* estates, interests and rights of substantial value;

(c) The phrase "*a right over any property*" implies a direct link between the right in question and the property itself;

(d) The phrase "*interest in property*" is not broad enough to encompass any economic or financial advantage but rather connotes a proprietary interest in property which can be defined by reference to proprietary concepts, or at least by concepts that are legally recognisable and enforceable;

(4) The relevant time for the valuation of the "*non-cash asset*" is the time at which the arrangement in question is concluded.

The issues

79. In order to make good its contention, the Defendant needs to establish the following five matters:

(1) The "indemnity" was a "*non-cash asset*";

(2) As a non-cash asset, it was "*substantial*";

(3) The "indemnity" was *acquired* by the Claimants;

(4) The "indemnity" was granted to Mr Terry (and persons connected with Mr Terry) in his capacity as a director of the Defendant;

(5) The shareholders of the Defendant did not approve the granting of the "indemnity".

80. These are not five entirely discrete enquiries. There is a degree of overlap between some of them. It is nevertheless helpful to consider them separately

81. I will deal with each, in turn. However, before I do so, I will set out what is common ground.

Common ground

82. It is not in dispute that Mr Terry was a director of the Defendant at the time that the indemnity was granted. Nor is it in dispute that Mrs Terry and the Terry family trusts were relevant "*connected*" persons within the meaning of the Act.

83. Nor is it seriously suggested by the Claimants that they took "*all reasonable steps to secure* [the Defendant's] *compliance*" with section 190 of the Act. Nor is it suggested by the Claimants that they "*did not know the relevant circumstances constituting contravention*" within the meaning of section 195(7).

Was the "indemnity" a "non-cash asset"?

84. The first question which arises is whether the "indemnity" was a "*non-cash asset*" within the meaning of the Act.

85. On behalf of the Defendant it is submitted that the definition of "*non-cash asset*" is not limited to real property rights and it includes anything other than cash; that the "indemnity" was a chose in action and, as such, is an intangible property right amounting to "property" within the meaning of section 1163(1) of the Act; that the "indemnity" was a discharge of a person's liability and, as such, amounted to the transfer or acquisition of property or an interest or right in property within the meaning of section 1163(2)(b) of the Act; that the fact that part of the Defendant's liability under

the indemnity was ascertainable at the time of the sale does not mean that the indemnity is tantamount to cash; and that the authorities do not affect this analysis.

86. In my view, the “indemnity” was not a “*non-cash asset*” within the meaning of section 190 of the Act (read together with section 1163 of the Act) because the “indemnity” did not constitute “*property*” or “*interest in property*”. Those words do not include everything other than cash. The rights granted by the “indemnity” were no more than non-marketable contractual rights. They were merely rights to receive cash payments in certain eventualities. I am not persuaded that they can properly be regarded as either “*property*” or “*interest in property*”.

87. It follows that the further questions do not arise. I will nevertheless deal with them for completeness.

Was the “indemnity” an asset acquired by the Claimants?

88. The second question which arises is whether the “indemnity” was an asset *acquired* by the Claimants. Of course, this question only arises if, contrary to my conclusion at paragraph 86 above, the “indemnity” was a “*non-cash asset*” within the meaning of the Act.

89. In my view, the “indemnity” was not an asset that was acquired by the Claimants because it cannot be said of the “indemnity” that it was an asset in existence immediately prior to the time of the acquisition. The rights granted by the “indemnity” were brought into existence by the grant itself. There was no acquisition of pre-existing rights.

Was it a "substantial" non-cash asset?

90. The third question which arises is whether the "indemnity" was a *substantial* non-cash asset. Again, this question arises only if the earlier questions are answered in the affirmative i.e. if the "indemnity" was a non-cash asset that was acquired by the Claimants.

91. The meaning of "*substantial*" is explained in section 191(2) of the Act which is quoted above.

92. The asset value of the Defendant in late March / early April 2011 was about £4.5 million and it follows that 10% of its asset value at that time was about £450,000. As this exceeds £100,000 it is the latter which is the relevant benchmark.

93. It is the Claimants' case that, when the "indemnity" was granted, it was merely an agreement to pay an unidentified sum at an unascertainable date; that it was unknown whether it would ever be called upon; that no value could be attributed to it at the time; and that, accordingly, it was not a substantial non-cash asset.

94. In support of its case the Claimant relies upon an explanation provided to Deloitte by Her Majesty's Revenue and Customs in a letter dated 11 June 2015 to the effect that "*the Indemnity is a possible liability to pay an unidentified sum at an unascertainable date*". The Claimant also relies upon the expert report of Mr Arnold dated 16 March 2018 and the subjective views of the Defendant's directors in office when the "indemnity" was granted.

95. I am unable to accept the Claimants' submission for two reasons.

96. First, in my view it is the objective value of the "indemnity" which is relevant, not the subjective belief of one or more of the Defendant's directors.

97. Second, the objective value of the "indemnity" when it was granted was in my view in excess of £100,000. My conclusion is based upon facts and matters which are common ground:

    (1) even if the sale did not complete, as the experts have concluded, the Claimants' tax liabilities in respect of the transactions which they assert were in contemplation of the sale were in excess of £100,000; and

    (2) if the sale did complete, the Claimants' tax liability was no less than £3.5 million (as the experts have agreed).

98. For these reasons, and on the stated hypothesis, the "indemnity" was a substantial non-cash asset.

Was the "indemnity" granted to Mr Terry in his capacity as a director?

99. On the assumption that the "indemnity" was a substantial non-cash asset acquired by the Claimants, the fourth subsidiary question which arises is whether the "indemnity" was granted to Mr Terry in his capacity as a director. More particularly, the question is whether the "indemnity" was acquired by each of the Claimants in his, her or their "*character as a member*" within the meaning of section 192(a) of the Act.

100. In my view, it is clear the "indemnity" was granted to the Claimants because they were shareholders of and members in the Defendant. Although Mr Terry was a director of the Defendant at the time, none of the other Claimants were. And, as regards Mr Terry himself, the granting of the "indemnity" had nothing to do with the fact that he was a

director. The "indemnity" was acquired by the Claimants because each of them was a shareholder in the Defendant. The "indemnity" related directly to liability each might incur in his, her or its capacity as a member in the Defendant. The "indemnity" was not granted to Mr Terry in his capacity as a director.

101. In answering this question, I have not been assisted by the decision in ***Soden v British & Commonwealth Holdings Plc*** [1998] AC 298. The case of ***Soden*** arose in a different context and concerned different statutory provisions. In the context of insolvency, a distinction is drawn between debts due to general creditors and debts due to people in their character as a member. The latter are unsurprisingly subordinated to the interests of the general creditors. In that case it was held that any damages awarded to a claimant in proceedings against the company, its directors and third parties for negligent misrepresentation inducing it to purchase shares in the company would not fall within the latter category because the claimants' membership was not the foundation of its cause of action. In the instant case, in contrast, the Claimants' membership of the Defendant and the shareholdings they held in the Defendant were the very reason for the "indemnity". It was because the Claimants held shares in the Defendant that they sought and acquired the "indemnity".

Did the shareholders approve the granting of the "indemnity"?

102. The final subsidiary question arises if each of the previous questions is answered in the affirmative. The question is whether the Claimants approved the granting of the "indemnity" in their capacity as shareholders. I can deal with this issue shortly.

103. It was the unchallenged evidence of each of Mr Milton, Mr Scott and Mr Terry that, after Messrs Milton, Scott and Bowers had agreed to grant the "indemnity", a separate vote was taken on behalf of the shareholders represented by them to approve the

granting of the "indemnity". Those representing in excess of 77% of the shares in the Defendant gave their approval in accordance with the requirements of the Defendant's Articles of Association. The Defendant's Articles of Association did not require the assent of all shareholders who have a right to attend and vote at a general meeting of the company. There can therefore be no doubt that the granting of the "indemnity" was approved by a resolution of the members of the Defendant.

Conclusion

104. Based on the conclusions to which I have come, which are set out above, it follows that section 190(1) of the Act was not contravened by the granting to the Claimants of the "indemnity" and that section 195 of the Act is therefore not engaged.

105. It also follows that the counterclaim fails.

VII. What sums, if any, are payable under the agreement?

106. The final matter for me to determine is the sums which are payable under the "indemnity". I do not understand there to be any dispute about the figures. In the circumstances, the further amount which is currently payable under the agreement is £1,025,620.20.

VIII Conclusions

107. For the reasons set out above, the directors of the Defendant in office in late March, early April 2011 (excluding Mr Terry) did agree that the Claimants would be fully indemnified for both tax liabilities (excluding capital gains tax arising on the ultimate disposal of their shares) and other liabilities and costs that they may incur as a

consequence of the sale (and transactions undertaken in contemplation of the sale) and that the Defendant would not seek repayment of any money paid out pursuant to the agreement. Further, the agreement was not an arrangement within the meaning of section 190 of the Act for the following reasons:

(1) The agreement was not a substantial non-cash asset acquired by the Claimants;

(2) The agreement was granted to the Claimants in their capacities as shareholders of the Defendant; and

(3) The agreement was approved by a resolution of the members of the Defendant.

108. It follows that the Claimants' claim succeeds; and that the counterclaim fails.

109. The parties are invited to agree a draft order which incorporates the conclusions which I have reached and which are set out in this judgment.