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A collective sigh of relief: *Global Corporate Ltd v Hale* on appeal

KEY POINTS

- Whether a payment is a distribution must be judged on the evidence at the time it is made, and is not affected by a director's subsequent realisation that a dividend was not permitted.
- A director-shareholder cannot make a *quantum meruit* claim for remuneration in return for services provided to a company unless the Articles of Association have been complied with.
- In any event, an unliquidated *quantum meruit* claim would not constitute a defence and set-off to claims brought in a liquidation.

The much awaited Court of Appeal decision in *Global Corporate Ltd v Dirk Stefan Hale* [2018] EWCA Civ 2618 was handed down on 27 November 2018 to a collective sigh of relief in the insolvency world. The umpteen claims which have been put on ice pending the outcome of the appeal can now spring back to life.

BACKGROUND FACTS

Mr Hale was a co-director and shareholder of Powerstation UK Ltd ('the Company'). The Company had been balance sheet insolvent since 2009 and the accounts recorded that it was continuing to trade as a going concern only with the support of the directors. The Company was placed into creditor's voluntary liquidation on 25 November 2015 with an estimate deficiency of £173,594.99.

Mr Hale had worked long hours in the business and, on the advice of an accountant and for reasons of tax efficiency, had received £456 in PAYE and further payments of £1,383 each month. These latter payments were supported by documents entitled 'dividend tax voucher' prepared by the accountants and signed by Mr Hale. They described the payment as an 'interim dividend' and were presented to, and taxed accordingly by, HMRC.

Between 24 January 2014 and 26 October 2015 Mr Hale received a total of £23,511 in 'dividend tax vouchers'.

At the time of these payments, the last annual accounts were for the year ended April 2014. These showed insufficient distributable reserves to justify the payment

of £23,511 as dividends. A question at trial was whether the payments were in fact dividends.

The liquidators assigned their rights to bring unlawful dividend and transaction at an undervalue ("TUV") claims to Global Corporate Ltd, which in turn brought proceedings against Mr Hale for recovery of £23,511:

- as constituting unlawful dividends pursuant to s 847 of the Companies Act 2016 ('CA 2016');
- as a preference pursuant to s 239 of the Insolvency Act 1986 ('IA 1986');
- as a transaction at an undervalue pursuant to s 238 of IA 1986; and
- as constituting misfeasance pursuant to s 212 of IA 1986.

EVIDENCE ON THE NATURE OF THE PAYMENTS

Mr Hale gave evidence initially that he believed that the payments were dividends when paid but that at the end of the financial year the books would be sent to the accountant who, if there were insufficient distributable reserves, 'would reverse those dividends' and re-characterise the payments as PAYE. This re-characterisation had in fact occurred in the years ending 2014 and 2015, but not in respect of the payments totalling £23,511.

Mr Hale appeared as a litigant in person at the trial. Under prolonged questioning from the judge – much criticised by the Court of Appeal – Mr Hale agreed with the judge's suggestion that the declaration of a dividend was only provisional pending the

end of year review by the accountants.

STATUTORY PROVISIONS ON UNLAWFUL DIVIDENDS: A RECAP

Insofar as is relevant, Part 23 is as follows:

'830 Distributions to be made only out of profits available for the purpose

(1) A company may only make a distribution out of profits available for the purpose.

(2) A company's profits available for distribution are its accumulated, realised profits, so far as not previously utilised by distribution or capitalisation, less its accumulated, realised losses, so far as not previously written off in a reduction or reorganisation of capital duly made...

836 Justification of distribution by reference to relevant accounts

(1) Whether a distribution may be made by a company without contravening this Part is determined by reference to the following items as stated in the relevant accounts –

(a) profits, losses, assets and liabilities;

(b) provisions of the following kinds –

(i) where the relevant accounts are

Companies Act accounts, provisions of a kind specified for the purposes of this subsection by regulations under section 396;

(ii) where the relevant accounts are IAS accounts, provisions of any kind;

(c) share capital and reserves (including undistributable reserves).

(2) The relevant accounts are the company's last annual accounts, except that –

(a) where the distribution would be found to contravene this Part by reference to the company's last annual accounts, it may be justified by reference to interim accounts, and

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(b) where the distribution is proposed to be declared during the company's first accounting reference period, or before any accounts have been circulated in respect of that period, it may be justified by reference to initial accounts...

847 Consequences of unlawful distribution

- (1) This section applies where a distribution, or part of one, made by a company to one of its members is made in contravention of this Part.
- (2) If at the time of the distribution the member knows or has reasonable grounds for believing that it is so made, he is liable –
- (a) to repay it (or that part of it, as the case may be) to the company...

DECISION AT FIRST INSTANCE

The s 212 CA 2016 and s 239 IA 1986 claims were dismissed on the principal basis that these did not fall within the terms of the assignment from the liquidators and accordingly Global Corporate Ltd lacked title to sue.

Somewhat controversially, the s 239 IA 1986 claim was dismissed on the basis that the payments were not payments at an undervalue. The judge held that the payments were made in return for services provided by Mr Hale to the Company during the relevant period.

More controversially, the s 847 claim was dismissed on the grounds that the payments did not constitute dividends or distributions at all. The judge held that Mr Hale had taken no valid decision to pay the monies as dividends at the time they were paid; rather the decision was no more than a decision in principle subject to later confirmation.

Perhaps most controversially, the s 212 IA 1986 claim was also dismissed on the grounds that any misfeasance claim could be successfully defended by Mr Hale's *quantum meruit* claim for remuneration.

GROUNDINGS OF APPEAL

Global Corporate Ltd appealed the judge's order dismissing the unlawful dividend claim. This gave rise to two key issues:

- whether the payments were dividends; and
- whether a possible *quantum meruit* claim

by Mr Hale for services provided to the Company could amount to a defence.

No appeal was made against the judge's order dismissing the ss 238, 239 and 212 claims.

COURT OF APPEAL DECISION

The Court of Appeal allowed the appeal and unanimously held that the payments did constitute unlawful dividends for which there was no *quantum meruit* defence. The court essentially corrected two wrong turnings in the law taken at first instance.

Firstly, the judge had asked whether Mr Hale's decision to make dividend payments was: (i) a definitive decision made at the time of the payment; (ii) a provisional decision, subject to the ability to 'un-declare' the dividends after review by the accountants, or (iii) a decision in principle only, with no formal decision taken until review by the accountants.

Outcome (i) would constitute a payment of a dividend. Outcome (ii) was not permitted by the Company's articles and so would mean that no valid decision had been taken. Outcome (iii) would mean that no legally valid decision was taken at the time of payment at all. The judge concluded that no valid decision had been taken and no dividends declared.

The Court of Appeal criticised this analysis. The focus by the judge on the director's intention, rather than on the payments themselves, was wrong. There was no evidence of any service contract entitling Mr Hale to remuneration (which would provide an alternative explanation for the payments). Mr Hale's evidence (until the judge's interventions at least) was that he intended to pay himself qua shareholder. The dividends were declared and taxed as such, and had legal consequences.

Secondly, the Court of Appeal held that Mr Hale had no *quantum meruit* defence and set-off based upon a claim for remuneration for services provided to the Company:

- In *Guinness Plc v Saunders* [1990] 2 AC 663 the House of Lords had held that the law would not imply a contract for remuneration when such could only be agreed to under the articles of association by an appropriate resolution of the board which was lacking.

- A *quantum meruit* claim for remuneration would be an unliquidated claim which Mr Hale would need to prove in the liquidation. Mr Hale would accordingly be liable to repay the dividends and would have to pursue any claim separately.

PRACTICE POINTS

There are perhaps four key practice points flowing from this decision.

Firstly, final or interim dividends declared, labelled and/or taxed as such will be treated as dividends, subject to any successful 're-characterisation' before the time of the company's liquidation.

Secondly, it will be rare for a shareholder-director to successfully raise a *quantum meruit* remuneration claim in defence and set-off of claims arising out of the liquidation. Simply asserting that a director's services were under-remunerated and seeking the difference between the actual remuneration and a commercial sum for those services will no longer cut it.

Thirdly, in a letter relied upon by Mr Hale, the Company's accountants asserted that the practice of paying a low salary together with dividends that would occasionally be reversed in a management adjustment was common in small companies. The Court of Appeal left open the question of the legality of this practice – seemingly an alternative to allocating monies to the director's loan account pending the declaration of a dividend at the end of the year.

Finally, the judge's reasoning on s 238 – that there was no TUV because the payments were made in return for services provided by Mr Hale – was not appealed. In light of the Court of Appeal's reasoning on the *quantum meruit* claim, this surely is now questionable. ■

Further reading

- Shareholder-directors and remuneration by way of dividends: A critique of *Global Corporate Ltd v Hale* (2017) 6 CRI 211
- Challenging employee benefit trusts & disguised remuneration schemes using insolvency proceedings (2018) 4 CRI 121
- LexisPSL Restructuring and Insolvency: Practice note: Recovery of unlawful dividends by an insolvency office-holder