CORPORATE BRIEFING

The monthly business law briefing

Editorial

This issue includes an article by Howard Morris, Morrison and Foerster on directors' duties and a recent case involving System Building Services Group Limited. There then follows an article on trade marks on the CJEU decision in *SkyKick* by Taylor Wessing. Even though the UK is now no longer in the EU CJEU case law relating to trade marks remains relevant both during the current interim/transitional period and thereafter.

Finally Clare Stothard and Rupal Nathwani of Dentons look at the decision in *Oliver Dean Morley t/a Morley Estates v The Royal Bank of Scotland plc* [2020] EWHC 88 (Ch) and economic duress. Readers who follow the financial press such as the *Financial Times* will have read about the businesses which alleged they were pressed into insolvency by their bank whose distressed businesses unit then did fairly well out of the transaction. However the businesses here did not win and it does illustrate how hard it is to bring these cases. Perhaps the moral of the story is try to avoid large loans from banks if you can avoid it no matter how attractive the deal may appear at first.

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Corporate Law

Directors' Duties Transcend Insolvency

The High Court recently ruled that the general directors' duties prescribed by sections 171-177 of the Companies Act 2006 ("CA 2006") (the "General Duties") continue to apply to directors after their company has entered administration or creditors' voluntary liquidation ("CVL"). This is notwithstanding that after the appointment of an administrator or liquidator, the ability and rights of directors to control the company are legally and practically curtailed. With this decision, the High Court provided clarity on a technical issue, which will have a substantial effect on pre-packs and other disposals of an insolvent company's business and assets.

Directors must be particularly mindful of their duties both before and after their company has entered a formal insolvency process. They should ensure that they have regard to the interests of the company's creditors as a whole both as insolvency becomes likely and after the company has entered an insolvency process. As it follows that insolvency practitioners may look to further scrutinise the actions of directors in an effort to restore value to creditors.

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This alert focuses predominantly on the aspects of the case regarding directors' duties and is relevant to directors, financially distressed companies, creditors and insolvency practitioners.

BACKGROUND FACTS

System Building Services Group Limited (the "Company") entered administration in July 2012 and, subsequently, CVL in July 2013. At the time of insolvency, Mr Mitchie was the sole director and shareholder of the Company. As a director, Mr Mitchie owed the General Duties to the Company. Mr Hunt was acting as the liquidator[1] of the Company (the "Liquidator") and brought claims against Mr Mitchie and Systems Building Services Limited ("SBSL"), a similarly named company to which Mr Mitchie had links. SBSL was incorporated in June 2012 on the advice of Ms Sharma, who became the Company's previous administrator before its CVL. SBSL was set up with a view to purchasing the Company's work in progress once the Company had entered administration. While Mr Mitchie was not initially a director or shareholder of SBSL, at the date of trial he was the sole director and a shareholder of SBSL.

Claims[2]

In brief, the claims the Liquidator brought against Mr Mitchie related to:

1. The purchase of property at an undervalue while the Company was in CVL

Mr Mitchie purchased a two-bedroom house from the Company (the "Property"). Mr Mitchie purchased the Property for £120,000, a marked undervalue to its open market price, while he was the director of the insolvent Company. It was argued that, in purchasing the property, Mr Mitchie was in breach of his General Duties owed to the Company. In particular, his duty to act in a way that would promote the success of the Company (section 172(3) of the CA 2006).

2. Payment to a creditor of the Company while the Company was in administration

Shortly after the Company had entered administration, three payments totalling £19,000 were made to CB Solutions UK Limited ("CB Solutions"), one of the Company's creditors. It was argued that Mr Mitchie caused or allowed these payments to be made; and, in doing so, Mr Mitchie was purported to be in breach of his General Duties and, accordingly, was guilty of misfeasance (section 212 of the Insolvency Act 1986 ("IA 1986")).

3. Payments made to Mr Mitchie by the Company before the Company entered administration

The Company made payments totalling £137,674.59 to Mr Mitchie before the Company entered administration.[3]

THE DECISION

Before deciding whether Mr Mitchie was, in fact, in breach of any of his General Duties, the High Court had to consider whether the General Duties owed by a director continue to apply after a company has entered administration or CVL.

The Reach of Directors' Duties

The High Court held that the General Duties "survive" a company's entry into administration or voluntary liquidation. It held that the General Duties owed by the director to a company and its creditors are "independent of, and parallel to, the duties owed by an administrator or liquidator appointed in respect of the company"[4]. The reasoning behind the decision was that:

1. The General Duties extend beyond directors simply 'exercising' their powers as directors. For example, the duty to avoid a conflict of interest (section 175, CA 2006) does not depend on a director exercising any power conferred by his or her office. It is also evident from section 176, CA 2006 (duty to not accept benefits from third parties) that there are cases where simply 'being' a director triggers a duty. Certain duties are expressly stated to continue apply once a director has vacated his or her office; section 170(2) of the CA 2006 provides that when a director ceases to be a director, the duty to avoid a conflict of interest and the duty to not accept benefits from third parties continue to apply. This provision extends certain duties of directors past the point at which they are able to exercise any powers.
2. Generally, the CA 2006 clearly specifies when provisions should not to apply in administration, compulsory liquidation and CVL. Section 193 of the CA 2006 was used as an example; the section provides that when a company is in administration or is being wound up, the approval of the company's members is not required to effect a substantial property transaction. If it was envisaged that the General Duties should not apply following the commencement of administration or a voluntary winding up, it follows that the CA 2006 would have been drafted to expressly disapply them at such point.
3. The General Duties are based on, and to be interpreted and applied in the same way as, the common law rules and equitable principles that they codify. While on a literal interpretation some of the General Duties are not immediately applicable to a formal insolvency situation, the High Court held that the common law rules and equitable principles on which the General Duties are based are "of sufficient flexibility to extend beyond the company's entry into a formal insolvency process"[5].
4. Section 172(3) of the CA 2006 expressly provides that certain circumstances require directors to consider or act in the interests of creditors of the company. Briefly, in an insolvency context, the precise moment when directors of a company must shift the focus of their duties from the company's members to its creditors will vary in each case, depending on the facts and circumstances. The shift arises when directors "know or should know that the company is or is likely to become insolvent", with the term "likely" meaning "probable"[6] (see our alert detailing when the shift of directors' duties occurs here). Moreover, the Judge stated that there was no pre-CA 2006 (or post-CA 2006) case law to indicate that the General Duties cease when a company enters a formal insolvency process.
5. When a company enters administration or voluntary liquidation, directors are not removed from office. This is made clear in the IA 1986.

The entry of a company into administration or voluntary winding up does not "extinguish" the General Duties that a director owes to a company (and its creditors); rather, the General Duties continue to apply along with any additional duty that is imposed by the IA 1986. The General Duties owed by a director are independent of, and sit alongside, those owed by an insolvency practitioner.

Claims against Mr Mitchie

1. The purchase of property at an undervalue while the Company was in CVL. The Judge found that on the facts it was clear that Mr Mitchie knew that the Property was worth significantly more than the price he paid and it was "plainly not in the interests of the creditors as a whole for Mr Mitchie to purchase the Property off-market at significantly below market value". Further, in looking at the situation subjectively, Mr Mitchie as an "intelligent experienced

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businessman" could not have held the view that the sale of the Property to him at the price he paid, and without any marketing, was in the interests of the creditors as a whole. He would have known that the price the Property was sold for would have a "material impact on the prospect of a distribution to unsecured creditors" [7]. In viewing the situation objectively, an intelligent and honest man acting as director of the Company would not have reasonably believed that the transaction was for the benefit of the creditors either. Mr Mitchie was therefore, found to have acted in breach of his fiduciary duty under section 172(3), CA 2006, one of the General Duties. The Judge ordered that the Property be held on constructive trust for the Company.

2. Payment to a creditor of the Company while the Company was in administration. The High Court found that despite Mr Mitchie's assertions that he did not make such payments to CB Solutions, there was no credible evidence to support them. Mr Mitchie had a long association with CB Solutions, access to the relevant Company accounts, knew about the payments and had incentive to preserve goodwill with CB Solutions for the benefit of the new company SBSL.[8] Absent any reliable evidence as to how and why the payments were made, the Judge held that the claim against Mr Mitchie was proved. Mr Mitchie failed to properly have regard to the interests of the Company's creditors, specifically their right to share the Company's assets on a pari passu basis. He was found to be in breach of his General Duties (sections 172 and 174 of the CA 2006) and accordingly, guilty of misfeasance and ordered to pay £19,000 plus interest to the Company.

In the case of the claims, it was argued for Mr Mitchie that he should be relieved of liability under section 1157 of the CA 2006 on the grounds that he acted honestly and reasonably and ought fairly to be excused. The Judge refused.

COMMENTARY

Often the best placed purchaser for an insolvent company's business and assets is one or more of its directors. They know the business and can move quickly and before market knowledge of the company's failing erodes its position. Administrators and liquidators want a quick sale to maximise value and minimise costs. Creditors, however, can be deeply skeptical of the pre-packaged sales to directors (and sponsors). They are uncomfortable about the old company's business quickly re-emerging, with its debts left behind in the original corporate shell. This case will make it hard for a director to buy the business and/or assets where a better price could be obtained. Insolvency practitioners will be ever more cautious that sales connected to directors of an insolvent company are supported by credible valuations.

Directors of insolvent companies should be careful, particularly when purchasing a company's assets through a pre-pack deal. They should seek to ensure that when purchasing any assets of the insolvent company that (i) they consider the interests of the company's creditors, and (ii) the price of the asset is considered at least 'market value', not below. Where a director is unsure of his or her actions or the purchase of assets from an insolvency practitioner, they should obtain independent advice, as should the insolvency practitioner agreeing the sale. And it follows from this case that insolvency practitioners may seek to scrutinise a director's actions in an attempt to maximise the pool of assets available for creditors.

Lastly, although it was not expressly mentioned in the High Court's decision, it is likely that the General Duties owed by directors would also continue to apply after their company has entered compulsory liquidation.

Case: *Re System Building Services Group Ltd* [2020] EWHC 54 (Ch)

Howard Morris, Morrison and Foerster

Jai Mudhar, London, Trainee Solicitor, contributed to the drafting of this alert.

Endnotes

1. The Company was dissolved in February 2016, before restoration in April 2017, on the application of the second liquidator, Mr Hunt. Mr Hunt was appointed as the second liquidator after the first liquidator, Ms Sharma, was found liable for misfeasance during her role as an officeholder of another company (*Top Brands v Sharma* [2014] EWHC 2753). The present case is one of a number of Ms Sharma's cases that have been re-opened.
2. There was a claim brought against SBSL by the Liquidator. The Company (acting by Ms Sharma) made a number of payments to SBSL. SBSL had purchased the book debts and work in progress of the Company. The claim by the Liquidator was such that certain payments were made for little or no consideration to SBSL and, accordingly, SBSL was unjustly enriched. SBSL was ordered to restore such payments.
3. This sum remained unaccounted for and the Liquidator sought declaratory relief for the outstanding sum, which was argued to be either an outstanding director's loan account or a form of informal, unsecured borrowing. While there was no dishonesty on the part of Mr Mitchie in relation to this claim, after examination the court found that £65,513.28 was unaccounted for and made an order for Mr Mitchie to repay the Company the above sum with interest.
4. *Re System Building Services Group Ltd* [2020] EWHC 54 (Ch) at [60].
5. *Re System Building Services Group Ltd* [2020] EWHC 54 (Ch) at [52].
6. *BTI 2014 LLC v Sequana SA* [2019] EWCA Civ 112 at [222].
7. *Re System Building Services Group Ltd* [2020] EWHC 54 (Ch) at [115].
8. CB Solutions was providing the labour for the Company's work in progress and SBSL was interested in purchasing the work in progress.

Trade Marks

SkyKick: CJEU delivers its much anticipated ruling

Snapshot

The CJEU has delivered its ruling in the high-profile *Sky v SkyKick* case (C-371/18), which concerns the implications of an overly broad specification of goods and services for trade marks. The decision does not have the far-reaching consequences that it could have had. However, trade mark owners will need to consider the now-increased risk of a finding of bad faith when seeking to enforce their marks for goods and services for which they have no reasonable commercial rationale for trying to monopolise.

The CJEU held that:

- A EUTM or national trade mark cannot be declared wholly or partially invalid on the ground that the specification of goods and services in respect of which that trade mark was registered lacks clarity and precision. Lack of clarity and precision should be assessed at the application stage. This differs significantly from the position of the Advocate General (AG) who opined that lack of clarity and precision could be a basis of invalidity (as being contrary to public policy).
- An application for an EUTM or national trade mark made without any intention to use the mark in relation to the goods and services covered by the registration constitutes bad faith if the applicant for registration of that mark had

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