Bankrupts involved in the management of a company—a cautionary tale

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Restructuring & Insolvency analysis: James Dawson, barrister at 3PB, considers the decision in Re C. & M.B. Holdings Ltd; Hamilton and another (Joint Trustees in Bankruptcy of Charles Newell Brown) v Brown and another company, where trustees in bankruptcy sought relief in relation to a company in which the bankrupt owned shares.

Original news

Re C. & M.B. Holdings Ltd; Hamilton and another (Joint Trustees in Bankruptcy of Charles Newell Brown) v Brown and another company [2016] EWHC 191 (Ch), [2016] All ER (D) 103 (Feb)

The Companies Court ruled that the trustees in the bankruptcy of the first respondent's husband were entitled to present a petition to wind up a company in which he had shares because they were to be regarded as 'a member' of the company, for the purposes of section 74 of the Insolvency Act 1986 (IA 1986) and, therefore, as registered within the company's register of members for the relevant period. On the balance of probability, the trustees had established unfair prejudice and grounds for winding up the company, subject to financial issues yet to be determined.

What was the background to the hearing?

Mr and Mrs Brown were equal shareholders in C. & MB. Holdings Ltd (C. & M.B.), and until Mr Brown was made bankrupt, joint directors but, as the court found, it was Mr Brown who was the experienced businessman and who ran C. & M.B. and its subsidiaries. Mr Brown was made bankrupt in May 2014, but continued to be concerned with C. & M.B.'s management after he was made bankrupt, in breach of section 11 of the Company Directors Disqualification Act 1986.

Mr Brown's joint trustees in bankruptcy (trustees) petitioned the court, claiming relief under section 994 of the Companies Act 2006 (CA 2006) and to have the company wound up on the ground that it was just and equitable to do so pursuant to IA 1986, s 122(1)(g). They relied on the fact that Mr Brown had continued to be involved in the management of C. & M.B. after his bankruptcy as well as various other acts of Mr and Mrs Brown.

What were the legal issues the Registrar had to decide?

Because of various difficulties with trial preparation, the Registrar did not decide any issues of solvency or valuation, therefore many of the interesting legal arguments such as whether the trustees had standing to present a winding-up petition if the company was insolvent, and whether relief should be given under CA 2006, s 994 if the shares in it were worthless, were not decided.

The Registrar did decide the following issues:

- whether the trustees had standing to present a winding-up petition when the shares which had belonged to the Mr Brown and vested in them upon his bankruptcy had not been registered in their name for six of the previous 18 months as required by IA 1986, s 124(2)(b)
- whether, applying established legal principles in respect of a CA 2006, s 994 application, the involvement of Mr Brown in C. & M.B. after his bankruptcy was grounds for granting relief
- whether the involvement of Mr Brown in C. & M.B. after his bankruptcy was grounds for just and equitable winding up of the company

What were the main legal arguments put forward?

IA 1986, s 124(2) provides that:

> '...a contributory is not entitled to present a winding-up petition unless...the shares in respect of which he is a contributory, or some of them, either were originally allotted to him, or have been held by him, and registered in his name, for at least 6 months during the 18 months before the commencement of the winding up...'.

In respect of the first issue, it was argued by Mr and Mrs Brown that IA 1986, s 124(2) should be applied as it is written and that the trustees had not had the shares registered in their name for the required time. They argued that registration was an essential qualification for a contributory who desired to present a petition. They drew a contrast with CA 2006, s 994 which expressly includes, as those who can petition, persons to whom shares have been transferred as a matter of law.

The trustees relied upon IA 1986, s 283(4) which provides that the property which vests in a trustee in bankruptcy includes 'any power exercisable by the bankrupt', they argued that they had exercised Mr Brown's power to petition for a winding up and could, therefore, rely upon Mr Brown's registration as a member for the requisite period of six months.

In respect of the other issues under CA 2006, s 994, Mr Brown argued that his involvement with C. & M.B. after his bankruptcy (which he denied, but on which the Registrar found against him) did not cause the trustees financial loss and, importantly, if the trustees were to assert they had suffered prejudice it must be as a member of the company, not as trustees in bankruptcy.

What did the Registrar decide, and why?

On the question of whether the trustees had standing to present the petition, the Registrar appears to have taken his own point under IA 1986, s 250. In a closely reasoned part of his judgment the Registrar decided that:

- IA 1986, ss 74 and 79 operate so that a member whose shares are fully paid up are defined as contributories
- IA 1986, s 250 provides that a person who is not a member of the company, but to whom shares have been transmitted as a matter of law, is to be regarded as a member and references in that part of IA 1986 to a member are to be read accordingly
- a person to whom IA 1986, s 250 applies is, therefore, to be regarded as a contributory within the meaning of IA 1986, s 74 and a member within IA 1986, s 74, even though they have not been registered as a member
- IA 1986, s 250 requires that IA 1986, s 124(2) must be read so that the trustees were regarded as members (since the shares had been transmitted to them as a matter of law) and, further, treated as registered for the period in which they are to be regarded as members. Thus the trustees did have standing to petition

On the issue of standing, the Registrar also agreed with the submissions of the trustees based on IA 1986, s 283(4).

On the question of unfair prejudice and Mr Brown's involvement, the Registrar agreed that any prejudice had to affect the trustees as members, not as trustees in bankruptcy, but also held that prejudice included things other than pure economic loss. He found that Mrs Brown, in permitting Mr Brown to have taken part in C. & M.B.'s management after his bankruptcy, had caused there to be unfair and prejudicial conduct of the company's affairs. Mrs Brown had acted in breach of her duties as a director, since she had shared her powers with someone who was disqualified from acting. The crux of the Registrar's decision was:

> 'Those breaches directly affect the Petitioners' constitutional right to have the Company managed by its directors and not by non-appointed, let alone disqualified directors. It would be unfair and prejudicial to the Petitioners' interests as shareholders to remain locked into a company where this was occurring.'

He did not decide what relief to give, leaving that question to the next part of the trial.

The Registrar went on to hold that the same findings meant that it was just and equitable to wind up the company, but he did not go into great detail as to why.

To what extent is the judgment helpful in clarifying the law in this area?

The judgment lays down little that is new in respect of CA 2006, s 994 applications. It is, however, a useful case for minority shareholders where directors have continued to be involved in running a company after their bankruptcy.

The real importance of the judgment is in determining that trustees in bankruptcy can apply to wind up a company under IA 1986, s 124, even where they have not been registered as shareholders.

What practical lessons can those advising take away from this case?

Bankrupts who continue to be concerned in the management of companies, and who are also shareholders in those companies, risk inviting their trustees to apply to wind up those companies and/or seek relief under CA 2006, s 994. Depending upon the size and resources of the company, that may be a very high price to pay.

James Dawson specialises in insolvency and bankruptcy law, and has 15 years of experience representing insolvency practitioners, companies and individuals in all aspects of bankruptcy and insolvency law. As an insolvency practitioner, James is used to considering the claims of trustees in bankruptcy and liquidators to property and associated matters such as exoneration arguments and restitutionary claims.

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