OUTER HOUSE, COURT OF SESSION

[2019] CSOH 61

CA109/18

NOTE OF LADY WOLFFE

In the cause

RONALD WHITELAW SOMERVILLE

Pursuer

against

1051 GWR LIMITED

Defender

Pursuer: McIlvride QC; Harper MacLeod LLP
Defender: Barne QC; TC Young LLP

8 August 2019

Background

Nature of action

[1] The pursuer in this action sues on behalf of GCOS Limited ("the Company") pursuant to an interlocutor granted by Lord Doherty in terms of section 266 of the Companies' Act 2006 ("the 2006 Act"). The pursuer and David Maguire ("David Maguire") are the directors and shareholders (in equal amounts) of the issued capital of the Company. The Company acquired the tenant's interest under a long lease in certain commercial premises at 1051 Great Western Road, Glasgow ("the Premises"). It proposed to sublet the Premises as a means to generate rental income.

[2] This is one of several actions between the pursuer and David Maguire, or between entities with which one or other of those individuals is said to be associated. By this action the pursuer seeks reduction of a lease (or, more properly, a sub-lease) of the Premises granted by the Company to the defender in June 2015 ("the Lease"). It is not necessary to record the protracted path by which the Lease came to be granted. Had notice to quit been given when it was first possible to do so, the Lease would have terminated in mid-September 2015. Notwithstanding the short-term rolling nature of the Lease, by reason of the deadlock between the pursuer and David Maguire *qua* directors of the Company it has not been terminated.

[3] The defender resists reduction. At a two-day debate, it sought to have the pursuer's action dismissed as irrelevant on the basis of a number of arguments set out in its note of argument. The pursuer moved the court to allow his whole averments to go to proof.

The pursuer's pleadings

[4] The Summons has been subject to multiple adjustments. The averments, which are prolix and unstructured, may be divided into three broad categories. There are averments about the unsuccessful negotiations for the pursuer and David Maguire to disentangle their business and property interests. There are averments about the many offers made by David Maguire to let the premises on various terms and which the pursuer rejected because he did not believe them to be in the best interests of the Company. Falling within the third category of averments are those anent David Maguire's conduct linking him in a variety of ways to the defender. The legal basis for reduction (reading short the pursuer's first plea-in-law) is that the defender acquired the Lease in "bad faith and in the knowledge that it had

obtained that interest as a result of David Maguire having acted in breach of his fiduciary duties to the Company…" and "the benefit" of which the defender is not entitled to retain.

Averments of conduct of David Maguire founded upon

[5] For ease of reference, the factual averments extracted from the pursuer's pleadings, and which may potentially be relevant to the legal ground of the action, include the following:-

1) In about the first part of 2015, David Maguire first proposed that the Premises be let to him.

2) Over an extended period of time David Maguire provided undisclosed support for the defender, the purpose of which was to secure a binding legal relationship between the Company and the defender, in the form of a lease (of varying terms) of the Premises in its favour.

3) David Maguire thereafter promoted the former head chef of the Premises and his family as being interested in taking a short-term rolling lease. The rent payable of £4,333 per month (after a one-month rent-free period) proposed lease was "below market rent", but the Company's selling agents advised in favour of this proposal as a means to keep the Premises heated while a full marketing campaign was taken on.

4) It was "on this basis" that the pursuer and David Maguire agreed that the Company should accept the offer and they entered into the Lease with a term of three months' duration. If neither party terminated the Lease, then it would continue until terminated by either party upon giving three months'

notice. The pursuer was not then aware of David Maguire's involvement in or support of the defender.

5) While the basis for the pursuer's "below market rent" averment is not entirely clear, there is a later passage (added in the fourth round of adjustments in a different article of condescendence (article 2)), to the effect that in or around May 2015 David Maguire had proposed the lease of the Premises to a new company to be formed by him on an annual rent of £80,000 (albeit with an initial three-month rent-free period and a further three-month period at a restricted rent), with an option in favour of the tenant to purchase the Company's interest in the Premises within a five-year period at the sum of £80,000. Further, there is reference in article 3 (made by the third round of adjustments) to a different offer in May 2015 to let the Premises for a 36-month period at an annual average payment of £80,167. However, David Maguire "persuaded the pursuer" that a short-term let was preferable.

6) From about late 2015 the pursuer has repeatedly proposed that notice be given to terminate the Lease "in order that the Company can let the Premises at its true market rent". David Maguire declined to agree, or he made any agreement conditional on his having a right to better any offer received by £1, which the pursuer would not agree to.

7) The pursuer repeatedly refused these offers as not in the best interests of the Company.

8) By about late 2015 or early 2016 the business relationship between the pursuer and David Maguire broke down. As a consequence, they intended

to divide their "joint property interests" between them, with a view to severing their business relationship. It was anticipated that the pursuer would acquire the Company. This has not been achieved.

9) David Maguire eventually disclosed, when pressed, that he provided "advice" to the defender but he was not a shareholder or director of it.

10) After enquiry by the pursuer it was ascertained that David Maguire, or possibly his son (who shares the same name), acquired four domain names that might reasonably be associated with the Premises (eg a combination of the letters standing for the abbreviation of the street (Great Western Road, "gwr" etc) and the street number (1051)). The domain names were registered in July and August 2015.

11) One of these domain names is, in fact, used by the defender to advertise its restaurant.

12) From early 2016 the pursuer suspected that David Maguire had a financial interest in the defender or its business, but David Maguire consistently denied this.

13) David Maguire has been the designated premises manager of the Premises (under the relevant liquor licencing regime) since 7 April 2015.

14) From about late 2015 David Maguire has been holding himself out to customers and to restaurant critics as the owner and manager of the defender's restaurant and he is frequently in attendance at the Premises.

15) David Maguire procured the incorporation of the defender.

16) David Maguire arranged for the opening of the defender's bank account.

17) David Maguire introduced the defender to its solicitors.

18) David Maguire provided a personal guarantee on behalf of the defender (guaranteeing its liability to an entity known as 5 PM Limited).

19) At a board meeting of the Company in June 2016 David Maguire is said to have stated, that if the Premises were marketed he would not exclude himself, but would take "full advantage" of the situation and, further, that the pursuer was "stuck with me as your tenant for life" (emphasis added).

20) Throughout the period from late 2016 the pursuer has proposed that the Company find a new tenant of the Premises at a rent "reflecting the Premises' market value" or that the rent payable by the defender be increased. David Maguire has refused to agree to these proposals.

21) In an email dated 11 September 2018, it is averred that David Maguire indicated that he intended to procure that the rent payable by the defender would "not go into the [Company's] account in the meantime" (ie pending severance of the pursuer's and David Maguire's business interests).

22) Thereafter, the defender ceased paying rent. As at 22 February 2019, the rent due by the defender was three months in arrears.

[6] There are other matters referred to in the pleadings which may be relevant:

23) Prior to grant of the Lease, the Company had carried on a restaurant business at the Premises "through the medium of MBIC Limited which held a lease of the Premises".

24) The Company has traded as a restaurant in the Premises prior to June 2015.

25) The pursuer wishes to ascertain the true market value of the Premises, to be established via a marketing exercise. Since late 2015 the pursuer has repeatedly proposed giving notice to the defender to terminate the Lease in

order that the Company can let the Premises at its true market rent, but David Maguire has refused to agree to this unless he is allowed to match any offer the Company might receive.

26) Prior to the raising of this action, the pursuer refrained from causing the Company to seek to reduce the Lease by reason of David Maguire's "repeated statements" that he was willing to enter into an agreement regulating their joint interests, and the pursuer's belief that such agreement was imminent rendered an action of reduction unnecessary.

The legal characterisation of David Maguire's conduct and the legal duties founded upon

[7] The pursuer avers that David Maguire "has at all material times been a shadow director and the controlling mind" of the defender, and separately a *de facto* director of it. As a fall-back, it is averred that if David Maguire is not a shadow or *de facto* director, he intended to become one and "intended at that time to have, a personal interest in the financial success of the defender".

[8] The pursuer founds on the following legal duties (as set out in the first three sentences of Article 4 of Condescendence), namely, that:

1) *qua* director David Maguire owed a fiduciary duty to the Company, including a duty to avoid placing himself in a position of a conflict (or potential conflict) of interest;
2) in procuring that the Company entered into a Lease at an undervalue with the defender, David Maguire breached his duty to promote the success of the Company; and

3) David Maguire placed himself in a position where his interests conflicted or might conflict with the interests of the Company.

[9] In relation to the defender's knowledge, it is said to have been aware of having obtained the benefit of the Lease with the Company as a consequence of David Maguire's breach of fiduciary duty. The defender is said to be fixed with David Maguire's knowledge by virtue of David Maguire being a shadow director, a *de facto* director *or* "*the* person authorised by it to negotiate and agree the terms of the Lease". The defender is averred to have acquired the Lease in bad faith and was not, in those circumstances, entitled to retain the "benefit" of the Lease.

Parties Notes of Arguments, Bundle of Authorities

[10] I have had regard to the note of arguments and chronologies produced by each party, to their Joint Statement of Agreed Legal Principles, which I need not repeat, and to the cases produced in the Joint List of Authorities.

[11] The defender summarises the pursuer's position as follows: that the Lease was entered into as a result of David Maguire acting in breach of his fiduciary duties to the Company and that the defender is impressed with the knowledge of the breach of duty by David Maguire and consequently is in bad faith.

[12] The pursuer's case was argued to be irrelevant on a number of bases. Senior Counsel for the defender, Mr Barne QC, presented his submissions in a number of chapters which differed from (but were understood to cover those in) the defender's note of argument (and of which he was not the author), as follows: (1) the pursuer's averments of breach of fiduciary duty on the part of David Maguire were irrelevant ("the section 175(3) argument"); (2) for the purposes of the remedy of reduction and the averments of bad faith,

the material time was the entry into the Lease and, as a consequence, the averments of David Maguire's subsequent refusals to terminate the Lease were irrelevant ("the material time issue"); (3) the averments of bad faith were lacking in specification ("the attribution of knowledge issue"); (4) there was no basis on which reduction could be granted, largely because the pursuer had no averments that *restitutio in integrum* was possible ("the reduction issue"); and (5) the pursuer failed to address the issue of *mora*, taciturnity and acquiescence ("the *mora* issue").

Discussion

The defender's arguments anent alleged breach of fiduciary duty

Does the pursuer have relevant averments to establish breach of fiduciary duty by David Maguire?

[13] While the defender had several distinct arguments as to why the pursuer's pleadings of breach of duty were irrelevant, the principal argument was advanced in reliance on the terms of section 175(3) of the 2006 Act. I deal with ancillary criticisms (e.g. insufficient averments that the Lease was at an "undervalue"), below.

[14] It may first assist to understand the averred factual foundation of the pursuer's case. At the heart of the pursuer's case is an allegation of breach of fiduciary duty on the part of David Maguire and of which it said the defender was aware at the material time. It is not uncommon for a case of breach of fiduciary duty to be constructed on the basis of conduct on the part of the allegedly defaulting director which was unknown to the pursuer at the material time. There are such features in the present case: the factors identified in subparagraph (2), (9), (10), (15) to (17) of paragraph [5], above, all describe clandestine conduct on the part of David Maguire. Furthermore, all of those factors concerned David Maguire's actions in furtherance of the interests of the defender and to the detriment of the

Company's interests. The detriment to the Company arises in two distinct ways. First, the Lease entered into was ostensibly at a lower rent than the other offers made (recorded at para [5(4)]): a rent of £80,000 per annum (being the figure referred to in the two offers) produces an average rent of £6,667 *per* month whereas the rent passing under the Lease has been £4,333 *per* month since its inception. While the defender argues that it is not possible to compare the rents arising under a short lease (like the Lease) and a longer lease (as envisioned in the offers), that is a matter for proof. Secondly, on the pursuer's case the Company is effectively trapped in a Lease which, by reason of the subsequent deadlock between the pursuer and David Maguire, it is unable to terminate. Its efforts to increase the rent are similarly thwarted. In my view, it is no answer to argue, as the defender does, that the Lease was entered into on the "advice" of professionals. Placed in its factual context, the "advice" was clearly in support of a short-term let to enable a full marketing campaign of the Premises. The averments about the two offers (each at a rent of c £80,000 *per annum*) are capable of providing further support for the pursuer's case that the company's intention at the time was that any let of the Premises in June 2015 was to be short-term and that the Lease is a transaction at an undervalue.

[15] Furthermore, the factors recorded in sub paragraphs (2), (3) and(7) of paragraph [5], above, about David Maguire's ambitions to secure a lease of the Premises, are capable of supporting a case that David Maguire, aware of his ability to thwart any attempt by the Company to terminate the Lease in September 2015, procured the Lease as a vehicle to achieve what he wanted, which was occupation of the Premises. The clandestine features already referred to are capable of adding weight to such a case, as do the averments of the defender's own statement (recorded in paragraph [5(19)]) that *he* would take full advantage of the situation (ie the *impasse* between him and the pursuer). Indeed, that averment is

telling in two respects: the implication is that his intention is to take full "advantage" of the situation (the use of "advantage" is capable of constituting an acknowledgement that the effect of the impasse is detrimental to the interests of the Company); and it is *his*, ie David Maguire's, intention to do so. That part of David Maguire's statement is capable of supporting a case that his actings evidence a concerted (and, possibly, continuing) intent to act in a manner that is in conflict with the obligation he owes *qua* director to the Company and that none of this was disclosed at the material time.

[16] Under reference to section 175(3) of the 2006 Act, Mr Barne submitted that the pursuer had not identified a relevant breach of duty. He argued (i) that chapter 2 of Part 10A of the 2006 Act ("chapter 2") was a complete code of the fiduciary duties which replaced any common law duties, but (ii) that the effect of section 175(3) of the 2006 Act was to exclude any liability on the part of the defender as the Lease concerned a transaction with the Company. After the pursuer's reply, which included Mr McIlvride QC's reference to the discussion (at paras 66 to 68) of the Court of Appeal in *Burns* v *Financial Conduct Authority* [2017] EWCA Civ 2140 ("*Burns")*, in his second speech Mr Barne's position became more fluid on the issues of whether chapter 2 constituted a "complete" code of director's fiduciary duties, whether it displaced all common law duties and as to the precise scope of the carve out in section 175(3). As I understand Mr Barne's final position, it was that section 175(3) of the 2006 Act excluded from the scope of the duty imposed in section 175(1) any transaction with the company (ie "the literal reading", as described by the Court in *Burns*).

[17] In considering that submission, I start by noting that chapter 2 begins with section 170 which, under the rubric "scope and nature of general duties", provides *inter alia* that the "general duties" specified in sections 171 to 177 "are based on certain common law rules and equitable principles as they apply in relation to directors and have effect <u>in place of</u>

those rules and principles as regards the duties owed to a company by a director" (emphasis added). While this is not the occasion to explore the question of whether the code in chapter 2 is "complete" such as to preclude any duty outwith its scope arising under the common law (a suggestion made in passing in submissions), it is clear that chapter 2 expresses in statutory form a general or core code of fiduciary duties imposed on all company directors as a matter of law: section 170(1). It is precisely on that basis that the defender invokes the exclusion (if that is what it is) in section 175(3) of the 2006 Act. He was able to do so, because the chapter 2 duties apply as a matter of law. For that reason, the defender's contention that the pursuer does not expressly aver any of those duties has no force. In any event, as I have him noted, Mr McIlvride had, in fact, referred to and relied on section 177 in the 2006 Act in the course of his oral submissions. Again, Mr Barne took no objection, in my view rightly, to the pursuer's reliance on one of the statutory duties in chapter 2.

[18] Turning to section 175(3), on which Mr Barne relies, it is noted that in the absence of full argument, the English Court of Appeal in *Burns* refrained (at paras 67 to 68) from expressing a concluded view on the question of whether the exclusion in section 175(3) was confined to transactions between the company and the director concerned (as was argued before the tribunal on behalf of the applicant director in that case) or whether the literal meaning was to be preferred (extending the exclusion of the scope of the duty in section 175(1) to any transaction with the company).

[19] Chapter 2, headed "General Duties of Directors", of the 2006 Act articulates a core body of duties which apply as a matter of law to all company directors including "shadow directors (see sections 170(5) read together with the definition of "shadow" director in section 251) and *de facto* directors (see section 250, which defines "director" as including

"any person occupying the position of director, by whatever name called"). In relation to section 170(5), there was no suggestion that the common law duties corresponding to sections 175(1) or 177(1) did not apply to shadow directors. Turning to section 175, this expresses in statutory form the long–established common law duty of directors to avoid a situation of actual or potential conflict between his or her interests and those of the company, and which was articulated in forceful and unequivocal terms by Lord Chancellor Cranworth in *Aberdeen Railway Co* v *Blaikie Brothers* (1854) 1 Macq 461; 17 D(HL) 20 (at pages 471 and 473), and affirmed by Lord President Hamilton in *Commonwealth Oil & Gas* v *Baxter* 2010 SC 156 (at paras 73 and 74). The stringency of the duty is repeated in section 175(1): "A director of a company must avoid … a position of conflict of interest" (emphasis added). In the light of the mandatory character of the rule in both its common law and statutory form, any statutory exception should, for obvious reasons, be construed consistently with the scope of that duty and its interrelationship with the other core duties.

[20] Having regard to chapter 2 as a statutory code of the general duties of directors, each duty should not be considered in isolation from the others but, where necessary, should be construed consistently with, and complementing, the other duties. In part, this is to ensure that the statutory duties are at least co-extensive with the like duties imposed on company directors under the former common law rules. Accordingly, an interpretation which may result in a lacuna of the protection of companies the code is intended to confer, at least invites further scrutiny as to whether that interpretation is the correct one.

[21] In their oral submissions Senior Counsel both referred to section 177. In relation to the subject-matter of section 177, it has long been the case that in certain circumstances directors may enter into a contract or property transaction with the company of which they are a director ("self-dealing") so long as they declare their interest in the proposed

transaction or arrangement. Consistent with breadth of the common law duty section 177 replaces, the statutory duty to inform the company extends to any interest "in any way, directly or indirectly" in a proposed transaction. The purpose of imposing a duty on a director to inform the company of his or her interest was to enable the company either to approve or refuse approval of the proposed transaction. Where the director's interest comes to light after conclusion of the transaction in which he has an interest, the company may ratify the transaction or, alternatively, it may take action to remedy breach of the director's duties to disclose his interest.

[22] It respectfully seems to me that section 175(3) is designed to disapply the otherwise mandatory duty in section 175(1) to enable this kind of permitted self-dealing (and disclosure of which is the subject-matter of section 177). (Other forms of self-dealing, including substantial property dealings, loans etc attract special rules, none of which is said to apply here.) *Prima facie,* therefore, section 175(3) is concerned with transactions involving directors and it does not extend to transactions with non-director third parties. Read consistently with what is disclosable in section 177(1), section 175(3) is not in my view confined to transactions between the director and the company. The passive voice in section 175(3) is intentional. To read section 175(3) as confined to transactions between the company and the director, as I understood Mr McIlvride's submission at one point to be, would introduce a conflict between this subsection and the wider scope of section 177(1). The conflict would arise because a transaction in which the director has an indirect interest (as contended here, via David Maguire's averred involvement *qua* director (in some form) of the defender), would be disclosable under section 177 but prohibited under section 175(1). I agree with the approach of the Court of Appeal in *Burns* that section 175(3) is not to be read so restrictively and that the literal interpretation is to be preferred. Given the

interrelationship between section 175(3) and 177, the consequence of that conclusion reflects the outcome in *Burns*. While in *Burns* the Court of Appeal accepted that the applicant's conduct did not fall within section 175(3), that conclusion was of no avail to the director concerned. It is evident in the Court of Appeal's discussion of this issue that it regarded the section 171 and 177 duties as closely connected (see, eg, from para 71ff). It traced the common law cases articulating these duties, which are now found in the core chapter 2 duties, and found that, to the extent that the applicant fell outwith section 175(1), because she was within the exception in section 175(3), she was caught by section 177: see the discussion at paragraphs 71 to 76, especially the conclusion at paragraph 76 in *Burns*. In contrast to *Burns*, in this case there was no subsidiary argument as to the nature of the "interest" that was disclosable under section 177. While neither of these provisions is specifically averred in either parties' pleadings, both parties accepted in oral submissions that the chapter 2 duties applied and both referred to these specific provisions in their submissions. Counsel simply differed as to the scope of the exception in section 175(3). In the light of that common approach and the fact that the chapter 2 duties apply as a matter of law, it matters not – at least in a case in the commercial court – that there is no express reference to these provisions in parties' averments. Both Senior Counsel fully understood the duties that were potentially engaged.

[23] For completeness, I should record that the consequence of a breach of the duty in section 177 was left relatively unexplored in submissions, but I note Lord Drummond Young's helpful discussion of this issue in *Dryburgh* v *Scott Media Tax Ltd* [2014] CSIH 45; SC 651 (at para 26). In particular, he noted that the obligation of a director to avoid placing himself in a position of a conflict of interest with a company was a continuing duty, as was that to inform the company if such a conflict of interest arose. The purpose of imposing a

duty on a director to inform the company was to enable the company either to authorise that breach or to take action to remedy it. The failure in that duty was a separate breach of fiduciary duty. It was on the basis of breach of that duty that the court in *Dryburgh* held that director's *failure* to consider that obligation to inform was attributed to the company, with the result that that state of (attributed) ignorance constituted an error in the mind of, or attributable to, the company and such as to postpone the start of prescription under section 6(4)(a)(ii) of the Prescription and Limitation (Scotland) Act 1973. There was no suggestion in parties' submissions that reduction was inapt as a means to remedy any breach of one of the core duties, including that in section 177.

[24] For the reasons explained in the next section of this Note, I do not accept the premise that the material time is confined to the period culminating in the grant of the Lease. As noted above, at paragraphs [14] and [15], in substance, the pursuer's case includes (i) the continuing effect of the deadlock, for which there are sufficient pleadings to infer that this is to the detriment of the Company (the inability to terminate what was intended to be a short-term let at less than market rate), and to the obvious benefit of the defender, (ii) taken together with averments that are capable of a instructing a case that David Maguire brought about that situation, and (iii) that he has continued that state of affairs during the period in which he has (on the averments) unambiguously aligned himself with the business and interests of the defender. This is, in my view, a case capable of falling within one of the chapter 2 duties, whether that be the duty to promote the interests of the Company, to avoid a conflict of interest or the related duty to disclose such conflicts under section 177.

[25] Accordingly, the factors in the pursuer's averments are capable of supporting the necessary inference to establish a breach on the part of David Maguire of the duty to disclose his interest in the Lease (assuming there are relevant averments to characterise his

actings as having the requisite qualities *qua* director of the defender), and which on the pursuer's approach was the vehicle by which the interests of the Company are adversely affected to the advantage of the defender.

The material time issue

[26] The defender contends that the material time is the entry into the Lease and that any averments of conduct thereafter are "necessarily irrelevant". Having regard to the particular features just described, I do not accept that submission. The adverse consequences of the Company being unable to terminate a lease which is (on the pursuer's approach) detrimental to its interests are of a *continuing* nature. The matters recorded in subparagraphs (21) and (22) of paragraph [5], above, are capable of demonstrating both the *ongoing* nature of the detriment as a consequence of David Maguire's involvement in the defender ('he intended to procure' that the rent due to the Company would be diverted away from the Company's account), and that the detriment has become more acute (because rent arrears accrue). Accordingly, I do not accept that the "material time" is confined to the period leading up to or culminating in the entry into the Lease. The question of "material time" is a question of fact or, at least, can (as here) be highly fact-sensitive. The subsequent conduct is capable of casting prior conduct in a particular light, potentially supportive of the pursuer's case.

The attribution of knowledge issue

[27] The defender argues that the pursuer's averments of bad faith are lacking in specification. Part of the defender's argument, as I understood it, was that the only means by which David Maguire's knowledge could be attributed to the defender, such as to put it

into bad faith, was predicated on establishing that David Maguire was a shadow or *de facto* director or (put shortly) the controlling mind of the defender. As parties approached it, this was the means (if established) for attribution of David Maguire's knowledge to the defender. On the question of attribution of knowledge, the parties referred to passages in *Dryburgh, supra* (at paras 22 and 23) and *El Ajou* v *Dollar Land Holdings plc* [1994] 2 All ER 685 (at 696A). The discussion in the latter case was inapposite to the facts in this case, concerned as it was with the attribution of knowledge in large, highly structured companies. The phrase "directing mind and will" of the company is referred to with approval in *Dryburgh* as a possible basis to attribute the state of mind of an individual to a corporate body. As I understood Mr Barne's submission, it was not to contest the applicability of that formulation as a matter of law, so much as to argue that the pleadings were not capable of satisfying that test. This involved a reprise of his argument as to the "material time", ie because he wished to exclude consideration of any conduct which post-dated the grant of the Lease (eg as in para[5(21)]) being invoked. I have already explained why, on the whole pleadings, I regard the issue of the material time as encompassing conduct after the Lease was entered into and that, on these averments, this is quintessentially a question of fact and for which proof is essential. It could not be said *ab ante* that the pursuer's averments in this issue were necessarily irrelevant in the usual *Jamieson* v *Jamieson*-sense.

[28] Many of the other factors, neutral in themselves (eg such as David Maguire's acquisition of domain names referable to the Premises and the use of one of these by the defender (para [5(10)] or David Maguire's provision of advice (para [5(9)]), acquire a different complexion when viewed in combination with more colourable factors, and are capable of instructing attribution of David Maguire's knowledge of these matters to the defender.

[29] The defender's argument did not address factors (19), (20) and (21) recorded in paragraph [5], above. In my view these are small, but significant, passages from the pursuer's pleadings. At a board meeting of the Company, it is averred that David Maguire stated in terms that the pursuer will be "stuck with me as your tenant for life". That statement is capable of supporting an inference that David Maguire presented himself or his interests as indistinguishable from those of the defender. The significance is in the use of "me" (ie David Maguire) in combination with "your tenant" (ie the defender). The statement, especially if viewed in the context of David Maguire's conduct, suggests a complete identity between his interests and those of the defender, and where the result of David Maguire's conduct (including his part on securing the grant of the Lease and subsequent refusal to agree to the Company terminating it) has been to the Company's financial disadvantage. The statement recorded in that averment is consistent with the other averments about a deadlock which has subsisted between the pursuer and David Maguire and from which there are averments to infer that the defender has benefitted for more than three years. Of equal significance are (i) the statement that David Maguire would "procure" that the rent payable by the defender would no longer be paid into the Company's account (para [5(21)]), and (ii) the fact that that statement was thereafter carried into effect (para [5(22)]). These factors are capable of supporting a number of inferences, eg that David Maguire controlled the defender's payments and bank account (for which the factors in para [5(16) and (14)] provide additional support), that David Maguire exercised sufficient sway over the defender to procure that it breached the principal obligation of a tenant to pay rent. In my view, these averments are in themselves capable of instructing a case that David Maguire exercised very significant control over the defender or was acting as a director in respect of it.

[30] In relation to David Maguire's status *vis-à-vis* the defender, ie as a shadow or *de facto* director of it, or as its controlling mind or authorised agent, I start by noting that a less rigid approach is supported by the more recent cases than hitherto to the drawing of hard boundaries between the status as a shadow or a *de facto* director. In other words, it is no longer correct *as a matter of law* to treat the actings as a shadow or *de facto* director as mutually exclusive: see the helpful and considered discussion of Arden LJ (as she then was) in *Smithton* v *Naggar* [2014] EWCA Civ 939; [2015] 1 WLR 189 ("*Smithton*") at paragraphs 20 to 45), and which must be understood as superseding the approach in older cases such as that of Millet J in *Re Hydrodam (Corby) Ltd* [1994] BCLC 180 at 182-183e, relied upon by the defender. I gratefully adopt Arden LJ's analysis, especially her observations in *Smithton* that

> "the real issue in some contexts will be whether the acts demonstrate the assumption of acts as a director" (at para 28);

and that the court

> "must look at the cumulative effect of the activities relied on. The court should look at all of the circumstances 'in the round' (per Jonathan Parker J in *Secretary of State for Trade and Industry* v *Jones* [1999] BCC 336)" (at para 40).

Applying those observations to the averments in this case, David Maguire's actings are consistent with his having assumed the status of a director: he promoted the defender from the start; he secured the Lease in its favour; he held (and holds) himself out to others as the owner of the business the defender runs from the Premises; he has procured the defender's apparent breach of the fundamental obligation of a tenant to pay rent, seemingly with impunity, because, by reason of the deadlock between the pursuer and David Maguire, David Maguire is able to thwart any action by the Company to terminate the Lease (or, by inference, to sue for breach). Approaching the matter in the round, I am persuaded that the pursuer has sufficient averments to instruct David Maguire acting in the capacity of a

director of the defender, and whose knowledge may be attributed to the defender for the purpose of the bad faith argument.

The reduction and the mora issues

[31] The same point underpins the defender's last two arguments, the reduction issue and the *mora* issue, namely, that essentially the onus was on the pursuer to make averments in respect of these issues. In short, it was argued that, as a matter of relevancy, it was incumbent upon the pursuer to aver that if reduction were granted,

(i) that there has been no ratification by the Company;

(ii) that *restitutio in integrum* is possible; and

(iii) that the rights of *bona fide* third parties would not be affected.

It was also said in relation to the *mora* issue that the defender having raised the issue of delay, (in the form of a plea of *mora*, taciturnity and acquiescence), the pursuer's case was irrelevant if it did not make any averments in response.

[32] As I understood Mr Barne's submission, he accepted that (i) was concerned with internal ratification and there was nothing in relation to that in this case. He did refer to the Company's acceptance of the payment of rent (up until late 2018) as indicative of ratification. The pursuer required to aver when it knew what it knew and why it was accepting rent. The same point was made about the requirement (ii) for *restitutio*. Brief reference was made to *Spence* v *Crawford* 1939 SC (HL) 52 ("*Spence*"). Separately, Mr Barne argued that given the delay in raising the proceedings, it was incumbent on the pursuer to plead when he became aware of the facts to establish a conflict of interest. Where a plea of *mora* was raised, it was incumbent upon the other party to respond. The pursuer had not done so.

[33] I begin by observing that reduction is an equitable remedy. It provides the context in which the doctrine of *restitutio in integrum* may arise. The purpose of the doctrine is to put parties, so far as possible, into the position which they occupied before the impugned transaction. *Spence* was a case of a director's action for reduction of a contract of his shares to a fellow director. This was resisted *inter alia* on the basis that the pursuer could not make *restitutio* (eg because the company's capital had been increased and the shares returned (consequent upon reduction) would no longer have the same controlling interest; that the defender had relieved the party seeking reduction of obligations to the company's bankers, which would be hard to reverse without financial detriment to the defender etc). The House of Lords found that reduction should be granted, that the factors did not preclude reduction and that a remedy could be fashioned which respected the doctrine of *restitutio.*

[34] In my view, the case of *Spence* is a classic illustration of the equitable character of reduction and which affords sufficient scope for the exercise by the court of its discretion in respect of the remedies to follow, if the ground on which reduction proceeds is established. As I understand the defender's position, the requirements of *restitutio* were presented as effectively an absolute requirement. If the party against whom reduction is sought cannot be restored precisely to his position *ab ante*, the remedy of reduction must be refused. Notwithstanding the issues said to preclude *restitutio* in *Spence*, in that case the House of Lords confirmed that reduction was appropriate. It achieved the equivalent of *restitutio* by upholding reduction of the contract for the sale of the shares and by requiring the party seeking reduction to pay compensation (taking into account certain factors). That case provides an example of the court exercising its discretion pragmatically and flexibly to fashion a remedy to achieve a sufficiently restorative state of affairs reflective of, but not exactly replicating, parties' positions prior to the entry into of the impugned deed. The

issues in *Spence* arose after proof and on its facts it is *a fortiori* the circumstances in the instant case. While the defender takes a plea of *mora*, he does not in fact advance any specific matter as preclusive of *restitutio*. The reduction issue is presented purely as an argument that the pleading onus rests on the pursuer.

[35] In my view the rigidity inherent in the defender's argument is not consistent with the case-law generally, or with the observations in, or outcome of, *Spence*, or, indeed with the well-recognised equitable character of reduction and the doctrine of *restitutio* (as illustrated in *Spence*). Of the remedy of reduction and the doctrine of *restitutio*, Lord Wright in *Spence* observed (at p76):

> "The principles governing that form of relief are the same in Scotland as in England. The remedy is equitable. Its application is discretionary, and, where the remedy is applied, it must be moulded in accordance with the exigencies of the particular case." (Emphasis added.)

After citing with approval the observations of Lord Blackburn in *Erlanger* v *New Sombrero Phosphate Co* (1878) 3 App Case 1218, Lord Wright continued:

> Lord Blackburn is careful not to seek to tie the hands of the Court by attempting to form any rigid rules. The Court must fix its eyes on the goal doing 'what is practically just'. How that goal may be reached must depend on the circumstances of the case. But the Court will be more drastic in exercising its discretionary powers in a case of fraud than in the case of innocent misrepresentation..... There is no doubt good reason for the distinction. A case of innocent misrepresentation may be regarded rather as one of misfortune than one of moral obliquity. There is no deceit or intention to defraud. The Court will be less ready to pull a transaction to pieces where the defendant is innocent, whereas in the case of fraud the Court will exercise its jurisdiction to the full in order, if possible, to prevent the defendant from enjoying the benefit of his fraud at the expense of the innocent plaintiff." (Emphasis added.)

In respect of restitution, Lord Wright observed: "But restoration is essential to the idea of restitution." After instancing case of fraud, Lord Wright continued (at pp 77-78):

> "Though the defendant has been fraudulent, he must not be robbed nor must the plaintiff be unjustly enriched, as he would be if they both got that what he had parted with and kept what he had received in return. The purpose of the relief is not punishment, but compensation. The rule is stated as requiring the restoration of

> both parties to the *status quo ante*. But it is generally the defendant who complains that restitution is impossible. But the Court can go a long way in awarding restitution if the substantial identity of the subject-matter of the contract remains." (Emphasis added.)

Lord Wright examined in detail a number of examples from the case-law illustrating the court's flexibility in the application of the *restitutio* doctrine. He concluded (at p 78):

> "Certainly in the case of fraud the Court will do its best to unravel the complexities of any particular case, which may in some cases involve adjustments on both sides."

[36] Early in his speech in *Spence* Lord Thankerton observed (at para 70) that the doctrine of *restitutio* "is not to be applied too literally". Thereafter he undertook an extensive examination of a number of cases, the purpose of which was to illustrate the court's flexibility in the application of the doctrine. He noted that these cases showed that "the doctrine (i.e. of *restitutio*) relates to the restoration of the defender to his pre-contract position, and the above statements as to the modifications of the doctrine relate to what the defender is to get". While acknowledging that each case will turn on its own circumstances, Lord Thankerton continued: "I may say broadly that, in my opinion, the defender who, as purchaser, has been guilty of fraudulent misrepresentation is not entitled in bar of restitution to found on dealings with the subject purchased which he has been enabled by his fraud to carry out". He concluded by upholding reduction of the share purchase contract on repayment of the price paid for the shares, coupled with the other party making certain countervailing payments. If, after proof in this case, the court finds the essentials of the pursuer's case established, on the spectrum of obliquity, a breach of fiduciary achieved in a clandestine manner or persisted in over an extended period (*if* these features are found) *may* make the case sufficiently analogous to the case of fraud figured in Lord Wright's discussion in *Spence*. In other words, depending on the facts, the court may feel more inclined to exercise its jurisdiction "to the full" – ie, in the manner envisaged by Lord

Wright and to "mould" its relief "in accordance with the exigencies of the case". Such an exercise can only be done after the facts have been established.

[37] The observations and the outcome in *Spence* are redolent of the court taking a pragmatic approach in the exercise of its discretion in the context of an "equitable jurisdiction" (as Lord Wright described it). It is a fact-rich or fact-sensitive exercise (eg because how *restitutio* is achieved "must depend on the circumstances of the case"), which militates against this being capable of resolution at debate as a matter of relevancy. As Lord Thankerton observed, it is generally the defender who complains of the impossibility of *restitutio.* These comments are entirely consistent with the general rule of pleading in Scottish cases, that he who asserts a state of affairs (here, the impossibility of *restitutio* and other matters the defender preyed in aid) has the onus of pleading and proving that state of affairs. Accordingly, the defender's challenge in the form of the reduction issue is, in my view, ill-founded.

[38] In the light of these observations it is clear that it is for the party resisting reduction, or who asserts that *restitutio in integrum* is not possible, to put this in issue in *its* pleadings. In this case, that would be the defender. While *Spence* involved adjustments in order to achieve a state of affairs as close to restitution as possible, it should be noted that that was done after proof. In my view, having regard to the equitable character of the remedy and to the court's application of the doctrine of *restitutio* in a pragmatic and flexible way, it is unlikely that a court would be able to resolve this matter on the pleadings even if the defender had raised this. It suffices for the purposes of the argument presented at debate, to reject the defender's contention that the onus rests on the pursuer to aver that *restitutio* is possible.

[39] Finally, in relation to the *mora* issue, the same rule of pleading just referred to applies. In his note of argument the defender argues, under reference to Professor Johnston's book, *Prescription and Limitation* (2nd Ed., 2012 at page 401), that actions of reduction must be brought "expeditiously". While that is true as a generality, it does not meet the fundamental point, which is that the onus of pleading *mora* rests with the party taking the plea. The defender did not place any authority before the court which disapplied the normal rule of pleading in Scottish actions already noted. Furthermore, there is no general rule in the context of the plea of *mora* which operates like the rule special to prescription, namely, that if a defender raises prescription the pursuer is bound to respond. In relation to the criticisms of a lack of specification, being the omission of the pursuer to plead precisely when he became aware of the asserted conflict of interest on the part of David Maguire, in my view, there is no force in this criticism. It is predicated on the onus argument advanced in respect of the *mora* issue. In any event, the pursuer has averments to explain what assurances or actings on the part of David Maguire influenced him to refrain from raising the present proceedings. Those averments are sufficiently specific to go to proof.

Decision

[40] It follows that I reject the defender's challenges to the relevancy and specification of the pursuer's pleadings and that the pursuer's whole averments should be admitted to probation. I shall put the case out By Order to determine further procedure.