Dealing with surplus assets in voluntary winding up (Qureshi v Association of Conservative Clubs Ltd)

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Restructuring & Insolvency analysis: Michael Bowmer, barrister at 4 New Square Chambers, advises that the decision in Qureshi v Association of Conservative Clubs Ltd is of wider relevance to practitioners dealing with voluntary winding up and the application of surplus assets and is a reminder of the need to pay close attention to the articles of association of the company. The need to do so arises particularly acutely in the case of companies that are registered societies whose rules will govern the position.

Qureshi v Association of Conservative Clubs Ltd [2019] EWHC 1165 (Ch), [2019] All ER (D) 68 (May)

What are the practical implications of the judgment?

The effect of section 107 of the Insolvency Act 1986 (IA 1986) is that the company’s property in a voluntary winding up shall on the winding up be applied in satisfaction of the company’s liabilities pari passu and, subject to that application, shall, unless the articles otherwise provide, be distributed among the members according to their rights and interests in the company.

With some companies there may be an absolute prohibition on the distribution of surplus assets to members. It is common for companies limited by guarantee—such as charities and not for profit clubs and societies—to have so-called ‘not for profit’ articles prohibiting dividends or funds being distributed to members. For charitable companies this is mandatory. So, one sees, for example, in the Charity Commission’s model articles of association, an article stipulating that none of the income or property of the charity may be paid or transferred directly or indirectly by way of dividend, bonus or otherwise by way of profit to any member of the charity. A similar approach applies to companies registered as community benefit societies under the Co-operative and Community Benefit Societies Act 2014 (CCBSA 2014) as the Financial Conduct Authority (FCA) guidance on the FCA’s registration function makes clear.

With other companies—even companies registered with the FCA as registered societies under CCBSA 2014—the question is whether the articles ‘otherwise provide’ for a distribution of the company’s property among the members. The implication of the judgment is the importance, firstly, of making sure one is looking at the right articles of association or in the case of a registered society its correct rules. These must be the articles validly adopted by the company, or in the case of a registered society, the rules actually registered with the FCA.

Having done so, it is vital, secondly, to construe the relevant articles or rules in order to determine whether they do actually ‘otherwise provide’. In this regard the judgment of Sarah Worthington QC (Hon) sitting as a Deputy High Court Judge in Qureshi is a reminder, in keeping with the decision in Re Merchant Navy Supply Association Ltd [1947] 1 All ER 894, that one needs to find express provision substituting an alternative scheme of distribution for that to be the case.

What was the background?

This was a claim brought by the liquidator of Edgware Constitutional Club Ltd (the Club) for declarations that the distribution by her of the surplus assets of the Club equally among its members was proper and lawful.

The Club was incorporated and first registered as an industrial and provident society in 1934. Upon the introduction of CCBSA 2014, it became a registered society. The Club owned its premises in Edgware, the evidence being that the purchase had been funded many years earlier by the membership. In 2015, the Club resolved to sell its premises, pay all its debts and liabilities, and then to be voluntarily wound up and to distribute the surplus to members. In early 2016, the premises having been sold for a sum in excess of £1m, the Club resolved to enter members’ voluntary winding up and appoint the claimant as liquidator. Some three months later, all creditors having been paid, the liquidator made an interim distribution of some £890,000 among the 137 members, with the balance of the net sale proceeds being held back pending final agreement with HMRC.
At that point, the Association of Conservative Clubs Ltd (the Association) came forward claiming that it was wholly entitled to the surplus assets of the Club, that any distribution to members was wrong and that the liquidator potentially faced a personal liability in so far as the surplus already paid to members could not be recovered.

The Association initially argued the Club was governed by a set of rules dating from 2011 which arguably prohibited a return to members—but which the judge held did not in any event have that effect—but later argued that the effect of the registered rules prohibited the distribution to members. It argued that the effect of the relevant rule—which provided that ‘except on the dissolution or winding up of the Club no surplus or assets should be distributed among the members’—was that the Committee should have applied the surplus to assisting the local Conservative and Unionist Association and Conservative and Unionist Central Office, alternatively that the Association had accrued rights to the surplus before the Club entered voluntary liquidation.

The Association also advanced a variety of arguments contending that the procedure by which the Club resolved to go into members’ voluntary winding up and appoint the claimant as liquidator was marked by certain irregularities in terms of the number of committee members convening meetings and voting on resolutions and in terms of the compliance with certain quorum requirements. In doing so, the Association mounted a challenge to the very existence of the winding up and the appointment of the claimant as liquidator.

**What did the court decide?**

The court rejected all of the arguments advanced by the Association and accepted the liquidator’s position that she had correctly complied with **IA 1986, s 107** and the rules of the Club. As such the court granted the declarations sought that the distribution of the Club’s property among its members was proper and lawful.

In doing so the court decided that:

- the exception in the Club’s rule for a distribution to members in a voluntary winding up was completely consistent with the mandatory impact of the default rule in **IA 1986, s 107**—it was impossible for the Association to argue that the Club’s rules ‘otherwise provided’ when they expressly contemplated what **IA 1986, s 107** made mandatory provision for
- while the Club was an on-going concern, the Association had no entitlement to any distribution and it was for the committee to decide how its resources should be used. In the absence of such a decision any other approach would render the insolvency exception for a distribution to members wholly redundant

The court also disposed of the Association’s arguments about procedural irregularities, agreeing with the liquidator that such irregularities as there may have been were immaterial and that the court’s guiding principle (derived from cases such as **Browne v La Trinidad** [1887] 37 Ch D 1, **Southern Counties Deposit Bank v Rider and Kirkwood** [1895] 73 LT 374, and **Bentley-Stevens v Jones** [1974] 1 WLR 638, [1974] 2 All ER 653) was not to intervene if the irregularities could be set right and the result would inevitably be the same. The members of the Club unanimously agreed with what had been done—and indeed had in the course of the claim passed further resolutions in general meeting ratifying all that had been done—and the court agreed that even if everything had been done perfectly and if everything had only now been done again perfectly, the same ends would inevitably have been delivered.

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