

Contingent claims

When to distribute in a members voluntary liquidation?

The choice of a Members Voluntary Liquidation (MVL) as a means of bringing a company's existence to an end and distributing its remaining assets amongst its shareholders is often driven by tax saving benefits. However, it can also be used where a company faces the uncertainty of claims that may arise in the future, (referred to as contingent claims).

What is a contingent claim?

Such claims are referred to as contingent claims because the obligation to discharge them depends on a contingency or event occurring which may not happen. Examples of such claims vary in their nature and are not always obvious. They can range from claims for asbestos related illness to a potential liability under share/asset sale agreements where indemnities have been given to the buyer.

Claims arising from industrial diseases

A solvent company will often have a surplus of assets which could be the sale proceeds following a share or asset sale. Alternatively, there may be circumstances where the shareholders wish to retire and realise their investment. Plans to place a company into an MVL and distribute the remaining assets amongst the shareholders may be complicated by the existence of contingent claims.

Returning surplus assets to shareholders

Claims for industrial diseases can, in many cases, take years before they become apparent. Solicitors acting for claimants may trawl through Companies House records to identify the existence of former employers who may have been responsible for the circumstances in which the employee contracted the industrial disease. In particular they will be looking for companies that, whilst having now ceased to exist, held insurance cover for the relevant period. Claimants whose former company employers had since been liquidated or dissolved and where an insurer cannot be traced were often left without a remedy. The **Mesothelioma Act 2014** aimed to rectify this situation for some industrial diseases linked with asbestos by providing compensation packages for those employees who qualified, and for assisting those affected to bring proceedings.

Where the employer company still exists, the claimant may still have the opportunity of pursuing their claim. That claim may not always be against the insurer, as some insurance policies specifically exclude liability for mesothelioma and related diseases. In those circumstances, the claim would have to be brought against the company itself.

Directors' declaration of solvency

Where a company is placed into MVL, the directors must make a declaration to the effect that they have made "a full enquiry into the company's affairs" and that the company will be able to pay its debts in full, with interest, in a period not exceeding twelve months. For a director swearing a statutory declaration of solvency this is a potentially onerous task, particularly if the company has been involved in an industry where claims for industrial disease are frequent. Where a declaration of solvency is made by a director without reasonable grounds, the directors concerned commit a criminal offence.

Statutory mechanism for dealing with contingent claims

Once a company has gone into liquidation, if a contingent claim arises, then the **Insolvency (England and Wales) Rules 2016** sets out the mandatory approach which the liquidator must adopt in respect of the claim. (**Rule 14.14**). This requires the liquidator to estimate the value of a debt that does not have a certain specific value because it is subject to a contingency or for any other reason. Once valued the liquidator then notifies the creditor of the valuation. The creditor may subsequently challenge that valuation.

Unknown claimants

A particular difficulty arises where there may be potential contingent claims but the identity of the claimants remains unknown. This may be because the company's records for the relevant period are no longer in existence or are incomplete. The difficulty then becomes whether the company can safely be placed into a MVL and the assets distributed to the shareholders, in circumstances where contingent claims may become known of in the future.

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Contingent claims

The treatment of such claims and, in particular, the ability of the liquidator to distribute the remaining assets amongst the shareholders/members of the company has been the subject of a number of decisions which indicate the approach that the courts will adopt in such situations, although not always with the same outcome.

Earlier authorities

Re R-R Realisations Limited [1980] 1WLR 805 - Distribution refused

The company was placed into voluntary liquidation and was in a position to pay all its known debts and to pay a substantial surplus to the stockholders. Prior to doing so, there was an air accident at Bombay Airport which resulted in a number of claims for personal injury arising out of the accident and potentially defective engines.

The liquidator applied to Court for leave to distribute the remaining assets amongst the creditors and stockholders without providing for payment from those assets of any claim or liability which might arise from the Bombay accident. The Court held that the test to be applied is whether in all the circumstances of the case it is just to make an order, the Judge noting that the Court should be slower to shut out a creditor as against members than as against other creditors. It was also noted that if the application to distribute were allowed, then it would have the effect of preventing claims arising out of personal injury and loss being made which would otherwise be within the Statute of Limitations.

"The Courts must be cautious in laying down any rules which would in effect shorten the periods available to a claimant under the Statute of Limitations".

In reaching its decision, the Court also considered the availability of insurance and the Judge noted that he was unable to be sure that the existing insurance cover would be enough. It was further held that:

"on making such an Order the Court may impose such terms and conditions as in all the circumstances of the case it considers fitting, or may make such an Order as it thinks just".

It was held:

"Where the order is sought in order to facilitate a distribution among members, the court would be more reluctant to grant it than if the distribution is to be made to creditors".

In that case the liquidator's application to distribute was refused.

Tombs v Moulinex [2004] EWHC 454 (Ch) – Distribution allowed

A company, MUKL, had gone into MVL. Although it owed a substantial amount of money to its French parent, the French parent company had agreed to subordinate its debt behind the ordinary creditors of MUKL. Within the liquidation there was a surplus of 4.3 million pounds which was due to go back to the French parent company. The liquidators of MUKL applied to court for directions for the payment of the surplus and whether a reserve should be retained by the liquidators to cover annual insurance against the risk of contingent claims arising out of product liability.

In that case, the court observed that it had jurisdiction to authorise a distribution of the company's assets in an MVL notwithstanding the possibility of future creditors emerging. The Court considered the inconvenience caused if no distribution was made. That inconvenience has to be weighed against the injustice of shutting out claimants who may have a subsequent claim.

The Court's task in such circumstances, is to balance the competing claims by considering and evaluating all the relevant circumstances of the case. This included assessing the nature and size of the likely contingent claims, by whom they are likely to be made, the extent to which they are likely to be met by insurance and the chances that any such creditor would go unpaid, the level of hardship that it is likely to cause to the creditor and the benefit that is likely to result from a distribution and the hardship if none is made.

In that case, the Court concluded that the potential claims could be adequately insured against and the risk to contingent creditors if a distribution was made was slight and therefore the balance was in favour of a distribution being made.

Ricoh v Spratt – Distribution allowed

A more recent case was the decision in **Ricoh Europe Holdings v Spratt** otherwise referred to as re **Danka Business Systems Plc (In Liquidation) [2013] EWCA Civ 92**.

In that case, the company had sold its business to another company and had agreed to give an indemnity in respect of potential tax liabilities arising over the following 7-year period. 2 years after the sale of the business, the company went into MVL, and the liquidator sought permission to make a final distribution. *Continues...*

Contingent claims

The purchaser/creditor complained that the amount that had been provided for claims for potential tax liabilities (the contingent claim) was insufficient and sought that the distribution should be delayed until such time as the liabilities had been determined. The liquidator had valued the potential tax liabilities pursuant to **Rule 4.86** of the **Insolvency Rules 1986 (Rule 14.14 Insolvency (England and Wales) Rules 2016)**, which was disputed by the creditor.

The Judge gave clear judicial support for the view that members are entitled to place a company into an MVL and as part of that process a liquidator must deal with contingent claims in accordance with the Act and Rules. Provided the liquidator does so, there is no reason why after dealing with creditors' claims, the remaining assets should not be distributed amongst the shareholders.

That approach is consistent with the position in a creditors voluntary liquidation where **Rule 14.27** provides that:

"whenever a liquidator has sufficient funds he must while retaining such sums as may be necessary for the expenses of the winding up, declare and distribute dividends amongst the creditors."

It is not necessary to unduly delay the conclusion of a liquidation because a claim may potentially emerge at a later date. However where there is a contingent claim and the contingency is imminent, a liquidator might be advised to wait for the event to occur before commencing the valuation process under **Rule 14.14**.

Protections for purchaser offered indemnities

For purchasers who have been offered an indemnity by selling a company, it would be as well to consider the possibility of insurance or separate guarantees/covenants from the shareholders of the seller in addition to any reduction in the price. For companies whose shareholders wish to liquidate with a view to distributing the remaining assets in circumstances where there are contingent claims, then those claims can be dealt with by the liquidator through the valuation process under the Rules.

Unknown claimants – procedure

If the existence and identity of potential claimants is unknown, then an application to court for directions under **S112 Insolvency Act 1986** should be considered. Any such application will involve consideration of the principles detailed in the **Ricoh** and the earlier decisions referred to above.

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