Julian Dobson SOLICITORS Insolvency Lawyers

Insolvency
Legal Update
2022

Julian Dobson

www.juliandobson.com

1 Frederick Terrace, Frederick Place, Brighton, East Sussex, BN1 1AX
Tel: 01273 766355 Fax: 01273 766350

JULIAN DOBSON SOLICITORS

We are solicitors dealing exclusively with insolvency matters. Based in the City of Brighton & Hove, we are close to Brighton County Court, one of the busiest bankruptcy courts in the country. The firm acts mainly for insolvency practitioners throughout England and Wales.

As a firm of solicitors, we have a Licensed Insolvency Practitioner (non-appointment taking). We emphasize a practical approach in our dealings with clients, the courts and others.
For all enquiries on insolvency related matters contact:

Information	info@juliandobson.com
Julian Dobson	jcd@juliandobson.com

The contents of these notes are a summary of the relevant provisions. Legal advice should be taken in relation to specific enquiries. Any liability is disclaimed.

www.juliandobson.com

1 Frederick Terrace, Frederick Place, Brighton, East Sussex, BN1 1AX
Tel: 01273 766355 Fax: 01273 766350

INDEX

Administration

Re Caversham Finance Limited [2022] EWHC 789 (Ch)

Extension of administration order by consent -defects

Facts

This was an application by the joint administrators of Caversham Finance Limited and Caversham Trading Limited (”the Companies”) for;

(i) a declaration that administrations were validly extended by consent, and

(ii) to extend their terms of office for another year.

In the alternative the joint administrators sought a retrospective administration order.

The Companies went into administration on 30th March 2020. The administrators sought to extend the administrations by seeking the consent of secured and preferential creditors by following the qualifying decision procedure. The requisite majorities were obtained for the consensual extensions.

Later it was noticed that there were possible defects in the notices sent to preferential creditors. The extensions had been required in order to explore the possibility of a sale of the loan book and to support the ongoing administration of the business.

Notice of the administrators’ applications was given to the secured and preferential creditors via a notice on the creditors portal. No one opposed the applications. The Companies’ business was rent to own for branded household goods. The purpose of the administrations was to achieve a better result for the company’s creditors as a whole than would have been likely had the Companies been wound up.

Para 78 of schedule B1 Insolvency Act 1986 defines what is meant by “consent” in **para 76(2)(b**). It says as follows:

“(1) In paragraph 76(2)(b) “consent” means consent of:
(a) each secured creditor of the company, and
(b) if the company has unsecured debts, the unsecured creditors of the company.

(2) But where the administrator has made a statement under paragraph **52(1)(b**)…

(which was the case)

…” consent” means:
(a) consent of each secured creditor of the company, or
(b) if the administrator thinks a distribution may be made to preferential creditors, consent of:
(i) each secured creditor of the company, and
(ii) the preferential creditors of the company.

(2A) Whether the company’s unsecured creditors or preferential creditors consent is to be determined by the administrators seeking a decision from those creditors as to whether they consent.”

Rule 3.54(2) Insolvency (England and Wales) Rules 1986 says that the notice to creditors must state the reasons why the administrator is seeking an extension. In this case the notices did not contain any reasons.

Rule 15.8 deals with the decision procedure and sets out the requirements as to the contents of the notices which include:

> "(f)a statement that a creditor whose debt is treated as a small debt in accordance with rule 14.31(1) must still deliver a proof if that creditor wishes to vote;
>
> (g) a statement that a creditor who has opted out from receiving notices may nevertheless vote if the creditor provides a proof in accordance with paragraph (e)."

Again, the notices contained no such statements.

For the joint administrators it was said that there were no creditors within the meaning of those sub paragraphs of 15.8 and therefore it would have been pointless putting anything in the notices to that effect.

Were the notices defective?

Rule 3.54(2) requires the notice to state the reason for the extension although no reason was contained in the notice. Reference was made to covering letters that enclosed the notices and to the progress report that accompanied the notice. It was stated that the progress report set out the reasons why consensual extensions would be sought. However the covering letters also sought decisions from creditors as to remuneration and in order to identify the reasons for the extension a thorough reading of the progress report would be required by the creditor.

Decision

The incidental reference to the progress report in the covering letters did not satisfy the requirements of rule 3.54(2)

As to rule 15.8(3) requirements for the notice to creditors, the omission of some paragraphs (f) and (g) should not render the notice defective where the paragraphs in question relate to a non-existent category.

Because of the procedural defect in relation to rule 3.54(2) it was necessary to consider **rule 12.64** which provides as follows:

> "12.64 No <u>insolvency proceedings</u> will be invalidated by any formal defect or any irregularity unless the court before which objection is made considers that <u>substantial injustice</u> has been caused by the defect or irregularity and that the injustice cannot be remedied by any order of the court."

In considering both defects the court considered whether the breaches of the rules were so fundamental as to make the appointment a nullity or whether they were of a procedural nature which was capable of being remedied under rule 12.64.

Having considered the case of **Re A.R.G. Mansfield Limited [2020] BCC 641** it was held that the defect in relation to rule 3.54(2) was of a procedural variety and therefore the question became as to whether or not it had caused substantial injustice. On this point Mr Justice Michael Green concluded that creditors could not credibly claim to have been prejudiced by the failure to provide reasons and declared that the administrations were validly extended by consent to 29th of March 2022.

As to the request for a further extension of the administration order for 12 months regard was had to the decision in **Re Nortel Networks UK Limited [2017] EWHC 3299** in which it was noted that

> "The Court's discretion under paragraph **76(2)(a)** is not circumscribed in any express way, but it is readily apparent that it should be exercised in the interests of creditors of the company as a whole, and that the Court should have regard to all the circumstances, including (i) whether the purpose of the administration remains reasonably likely to be achieved, (ii) whether any prejudice would be caused to creditors by the extension, and (iii) any views expressed by creditors. In that regard, where a company is making distributions to its unsecured creditors within the administration process, it is likely to be appropriate that the administrator's term of office should be extended to allow the distributions to be made, rather than require the company to go into liquidation, which might well increase the costs or delay the distribution process with no countervailing benefit."

Having considered the reasons for extending administration order it was concluded that they were valid reasons i.e. the sale of the loan book and support of the business. It was also noted that other exit routes from the administration were less advantageous, and that dissolution was inappropriate given that the Companies' collection activities were ongoing. Liquidation was also dismissed as a possibility due to the expense and diminished return available to creditors

Comment

- This case provides clarification as to how procedural defects in notices for consent to an extension of an administration order will be dealt with by the courts.

- It also provides guidance on the contents of notices seeking a decision from creditors and in particular the omission of paragraphs that do not apply.

- See also the latter case of **Re E Realisations 2020 Limited (in administration) [2022] EWHC 1575 Ch** which followed the decision in this case.

- When considering cases involving invalidity of appointment and/or an extension of an administration order it should be remembered that any further granting of an extension of an administration order must be on the basis that the conditions for making such an order remain present. See **Re Care Matters Partnership Limited [2011] EWHC 2543 (Ch).**

Administration

Re E Realisations 2020 Limited (In administration) [2022] EWHC 1575 (Ch)

Failure to give reasons for seeking an extension of administration order

Facts

The joint administrators of E Realisations 2020 Limited (in administration) ("Company") made two applications in connection with the extension of the administration order. The directors of the Company previously known as Everest Windows appointed administrators on 8th June 2020. The purpose of the administration was to achieve a better result for the company's creditors as a whole than would be likely if the company were wound up without first being in administration (**para 3(1)(b) Schedule B1 of the Insolvency Act 1986 ("Act").** The Company was subject to a pre-pack sale which took place on 9th June 2020

The first application sought a 12-month extension of the administrators' appointment to 7th of June 2023 under **para 76(2)(a**) of Schedule B1 of the Act. The second application sought a declaration that the term of the administrators' appointment had been effectively and validly extended to 7th of June 2022 by consent under **para 70(2)(b)** and that any defects were remedied under **r 12.64**. In the alternative a retrospective administration order was sought to ensure that there was no intervening period between the appointment of the administrators on 8th of June 2020 and the present time.

The application was transferred to the County Court at Central London. At that hearing District Judge Hart was referred to the recent decision in **Re Caversham Finance Limited (in administration) [2022] EWHC 789 (Ch)**. It was noted that there was a possible issue with the giving of notices to secured and preferential creditors in order to obtain consent to the extension, insofar as compliance with rule 3.54(2) was concerned. The application was referred back to the High Court.

Paragraphs **76-78** of schedule B1 provides as follows:

76

(1) The appointment of an administrator shall cease to have effect at the end of the period of one year beginning with the date on which it takes effect.
(2) But –
(a) on the application of an administrator the court may by order extend his term of office for a specified period, and
(b) an administrator's term of office may be extended for a specified period not exceeding one year by consent.

77

(1) An order of the court under paragraph 76 –
(a) may be made in respect of an administrator whose term of office has already been extended by order or by consent, but
(b) may not be made after the expiry of the administrator's term of office.

78

(1) In paragraph 76(2)(b) "consent" means consent of –
(a) each secured creditor of the company, and
(b) if the company has unsecured debts, the unsecured creditors of the company.
(2) But where the administrator has made a statement under paragraph 52(1)(b) one be "consent" means –
(a) consent of each secured creditor of the company, or
(b) if the administrator thinks that a distribution may be made to preferential creditors, consent of –
(i) each secured creditor of the company, and
(ii) the preferential creditors of the company.

In this case the administrators had made a statement under para 52(1)(b) of schedule B1 in their proposals and consent for the purposes of para 76 meant the consent of each of the secured and preferential creditors of the Company.

Rule 3.54 provides:
“3.54- Application to extend an administration and extension by consent (paragraph 76(2) of schedule B1).

(1) This rule applies where an administrator makes an application to the court for an order; or delivers notice to creditors requesting their consent, to extend the administrator’s term of office under paragraph 76(2) of schedule B1.
(2) The application or the notice <u>must state the reasons</u> why the administrator is seeking an extension

The administrators had by letters dated 4th August 2020 sought a number of decisions from the secured and preferential creditors. Creditors were asked to give their consent that the period of administration be extended by up to 12 months if required. No reasons were stated in the letters dated 4th August 2020. The secured and preferential creditors provided their consent within a couple of weeks however the administrators did not file notice of the extension of the administration with Companies House until some 8 months later.

The court considered the application and had to decide whether the defect amounted to a procedural irregularity (which did not render the appointment a nullity and may be remedied) or a defect going to the fundamental validity of the appointment (which results in an invalid appointment and cannot be cured). It was noted that the out-of-court process for appointing administrators had produced many cases where a defect of one kind or another had led to uncertainty over whether or not the administrators had been validly appointed

It was in **Re A.R.G. (Mansfield) Ltd [2020] EWHC 1133 (Ch)** that the court set out the questions that should be considered:

1) What are the statutory requirements?

2) If they have been breached, is the consequence, as a matter of construction of the provisions, that there is only a procedural defect or is the appointment a nullity?

3) If the appointment is subject to a procedural defect, is substantial injustice caused by what would otherwise be its validation under 12.64?

4) If there is such substantial injustice, can this be remedied by court order?

5) If the appointment is a nullity, can and should the defect be cured by a retrospective order?

In **Re-Caversham Finance Limited** the notices seeking extension did not give any reasons although the covering letter contained a reference to the administrators first progress report. In that case the judge held that the failure to give reasons in the notice did not result in a nullity. No substantial injustice had been caused and a declaration was made that the administration had been validly extended by consent.

.

Decision

Deputy ICC Judge Curl QC considered the questions detailed in **Re-A.R.G. Mansfield Ltd**.
In answer to the first question, he found that the statutory requirements are the need to obtain consent from secured and preferential creditors and for reasons to be given.

On the second question it was submitted that the covering letters sent to creditors dated 4th August 2020 referred to the administrators' proposals and the report they had prepared for the purposes of SIP16 for the pre-pack. However, they did they did not contain reasons for the extension request and therefore the requirements of 3.54(2) were breached.

One difference between this case and **Re-Caversham** was the eight-month gap between creditors' consent being obtained in August 2020 and notice of the extension been filed in April 2021. It was submitted that those consents had been obtained on a contingency basis to be used if required and that it was sensible for the administrators to get the consents '*in their back pocket*'.

Looking at rule 3.54(2) it requires the notice to "*state the reasons why the administrator is seeking an extension*. The use of the present tense implies that the administrator must actually have decided to seek an extension at the time when consent is obtained. Where consents are obtained early in an administration on a contingent basis it is likely to be difficult to be able to give reasons why an extension will be required therefore making compliance with the Act and Rules in this regard difficult.

On the third question having found that the extension of the administrators' appointment was subject to a procedural defect, the question is whether there is substantial injustice caused by what would otherwise be its validation under rule 12.64. In this case both the secured and preferential creditors were paid in full and subsequently they provided their confirmation that they supported the application. As such there was no interest capable of suffering any substantial injustice.

Having answered the second and third questions there was no need to consider the fourth and fifth questions.

A declaration was ordered that the term of office of the administrators was effectively and validly extended to 7th June 2022 and with regard to any defect or irregularity in compliance with the notice provisions under 3.54(2) it is remedied under rule 12.64

A further extension of the administration order to 7th June 2023 was granted.

Comment

- This case is a useful reminder as to the requirements that need to be satisfied in order to validly extend an administration order by consent. The practice of seeking consent from creditors at an early stage before any decision as to whether or not an actual extension should be sought runs the risk of breaching rule 3.54(2) unless at the time the consent is sought a decision to extend has been made and clear reasons for the extension are given in the notice.

- In seeking a further 12-month extension from the court regard was had to the activities that needed to be carried out by the administrators. These included finalising the licence to occupy given to the pre-pack purchaser, dealing with VAT refunds, agreeing unsecured creditors' claims and distributing the prescribed part, and closing the administration. Regard was also had to placing the company into liquidation. On this point the court noted that liquidation was not in the interests of the creditors on the ground of cost.

Bankruptcy

Howlader v Moore [2022] BPIR 985

Appeal against terms of order for possession and sale

Facts

This was an appeal brought by a trustee in bankruptcy in respect of the terms contained within an order for possession sale.

Mr and Mrs Moore were the registered proprietors of Ivy Farm ("the Property"). They held the Property as tenants in common in equal shares. On 8th May 2019 Mrs Moore was made bankrupt. Following the appointment of the trustee in bankruptcy, the trustee wrote to Mr and Mrs Moore seeking to agree an outcome in respect of the Property. Having failed to reach agreement, on 27th October 2020 the trustee issued an application for an order for possession sale of the Property.

Mrs Moore was opposed to the Trustee's application and filed a witness statement. Mr Moore did not file a witness statement. The hearing was conducted by way of a telephone hearing during which counsel appeared for the trustee and Mrs Moore spoke of her opposition. Mr Moore did not say anything.

The application was made under **s14 of the Trusts of Land and Appointment of Trustees Act 1996** and **section s335A of the Insolvency Act 1986.** By the time of the hearing more than one year had elapsed since the making of the bankruptcy order which meant that unless there are exceptional circumstances the interests of the bankruptcy creditors outweighed all other considerations.

The Deputy District Judge concluded that he would have to make an order for possession sale. There then followed a disagreement between the Deputy District Judge and counsel for the trustee as to the mechanics of the order. It was the final order against which the trustee appealed on four grounds.

The first ground of appeal

Paragraph 4 of the order provided that;

> "The Respondents and any occupiers must deliver vacant possession of the Property to the Applicant on or before 4 PM on the 28th day after the Applicant has contracted to sell the Property, but in any event no earlier than six months after today's date being 9 August 2021."

The trustee argued that that provision was wrong as a matter of law and that the District Judge had failed to take into account that the Property is unlikely to achieve the best possible sale price if the Respondents remain in possession.

The second ground of appeal

Paragraph 2 of the order gave conduct of the sale to the Applicant and contained an additional proviso;

> "….and the Applicant shall keep the Respondents fully informed of all developments relating to the sale and shall instruct any surveyor, valuer, estate agent, solicitor or other professional to take reasonable steps to ensure that this is done and shall authorise them to communicate directly with the Respondents where appropriate."

The trustee appealed on the ground that this was wrong as a matter of law and that the trustee had no obligation to keep the bankrupt informed of the sale and that such an obligation would unduly hamper the trustee in selling the Property.

The third ground of appeal

This ground of appeal was in relation to an omission from the order. Paragraph 5 of the draft included a provision that Mr and Mrs Moore were required to cooperate with the trustee in bankruptcy in relation to the sale and do all things reasonably required of them. The Deputy District Judge refused to include that provision in the order or any of the other provisions including the default provisions.

The fourth ground of appeal

Paras 7 and 8 provided that once the Property was sold the proceeds will be split into two equal shares. One equal share would be paid directly to Mr Moore. The costs of the application would be paid from the other equal share and then the remainder for Mrs Moore's bankruptcy estate. The costs to be subject to detailed assessment, if not agreed, with an assessment forthwith.

The trustee argued that the second respondent, Mr Moore should be liable to pay the trustee's application costs, because the trustee had succeeded, and Mr Moore was wrong to oppose the claim and/or not consent to the claim.

Decision

Her Honour Judge Jackson explained that this was a true appeal and not a rehearing. As such she could only interfere with the decision of the Judge below particularly given where she is dealing with the exercise of discretion, if the Judge erred in principle, took into account matters which ought not to have been taken into account, failed to take into account relevant matters, or was plainly wrong.

It was noted that one year had passed since the making a bankruptcy order and therefore the interests of creditors outweighed all other considerations in the absence of exceptional circumstances. Section 335A(2) details the other considerations the court can have regard to which include the conduct of Mr Moore, the needs and financial resources of Mr Moore, the needs of the children of Mr Mrs Moore and all the circumstances of the case other than the needs of Mrs Moore.

First ground of appeal

The Judge referred to the fact that in the family law cases orders are frequently made that provide for vacant possession to be delivered up at a date during the conveyancing process and that this does not affect the value of the property. She continued, that in her experience properties are more valuable if they lived in when they are marketed for sale. This was supported by her experience as a viewer of daytime television which has shows which tell you that if you want to sell your house for more money then you should have a smell of vanilla and freshly baked bread.

On the practical difficulties that may be caused by the order she noted that Mrs Moore had already given a oral assurance of cooperation to ensure the Property was presentable. If contracts are entered into and vacant possession has not been given, then it would be simply be a matter of obtaining a warrant. She concluded the Judge had exercised his discretion and dismissed this first ground of appeal.

Second ground of appeal

On this she held that there was no reason why the co-owner Mr Moore should not be kept informed as to what was happening. This ground of appeal was dismissed.

Third ground of appeal

The Judge did not not include in the order a provision for the cooperation of Mr and Mrs Moore. However, it did not appear that it was necessary to do so in this case as the Judge already had an oral assurance of cooperation from Mrs Moore and in the event that they failed to cooperate the trustee could return to court.

Fourth ground of appeal

This concerned costs and on appeal it was submitted that Mr Moore was illiterate, and that Mr Moore had only received two letters before proceedings were issued. Whilst Mrs Moore opposed the trustee's application she had not purported to act on behalf of Mr Moore. Further, Mr Moore had not filed a witness statement, nor had he said anything at the hearing.

Costs are at the discretion of the Judge, and it was noted that the Judge ordered that they be paid from Mrs Moore share and to be the first thing paid out of the estate as opposed to the more usual order that those costs would be part of the bankruptcy estate. Notwithstanding this the Judge was not wrong in exercisng his discretion not to order the second respondent to pay the costs. This ground the appeal was dismissed.

Comment

- This case is a reminder of the provisions that would normally be found in an order for possession and sale obtained by a trustee in bankruptcy. However, it highlights the fact that District Judges may not necessarily be willing to accept such terms as a matter of course and may in certain circumstances seek to impose different terms in respect of which they have a wide discretion.

- On appeal the trustee could not challenge the six months delay in implementation of the possession order as that six-month period had been proposed by counsel for the trustee at the hearing.

Bankruptcy

Khan v Habib Bank AG Zurich [2022] EWHC 1913 (Ch)

Application of the correct test on an annulment application

Facts

This was an appeal brought by Mr Khan against an earlier decision of District Judge Hart sitting at the County Court at Central London in which she refused to annul Mr Khan's bankruptcy.

Mr Khan was the sole shareholder and director of Geno Services Limited ("Geno"). He also traded on his own account as Afreen Properties. Habib Bank AG Zurich ("Habib") had extended credit to both Mr Khan personally and to Geno. Mr Khan had given a personal guarantee to Habib in respect of Geno's indebtedness. Habib also held security in the form of second charges over Mr Khan's properties.

Geno was struck off by the Registrar of Companies for failing to file returns. Habib demanded repayment under the guarantee of £223,539 and of Mr Khan's personal indebtedness of £558,888. Habib served a statutory demand for the guarantee and subsequently issued a bankruptcy petition. At the hearing of the petition Mr Khan sought an adjournment which was refused, and the bankruptcy order was made. Mr Khan then appealed unsuccessfully against the making of the bankruptcy order.

On 9th July 2018 Mr Khan applied to annul his bankruptcy. Initially the application was based on both grounds under **section 282(1)(a)** and **(b)** although he subsequently abandoned the latter. This left the application to annul on the basis:

> "(a)that, on any grounds existing at the time the order was made, the order ought not have been made…."

Mr Khan applied to annul the bankruptcy order on four grounds:

1) the application to adjourn the hearing of the petition should have been granted
2) the statutory demand had not been validly served
3) neither the statutory demand or petition provided details of security held by the Habib
4) the debt stated in the petition was disputed on substantial grounds.

At first instance the District Judge held that the question of adjournment of the bankruptcy petition had already been dealt with via an appeal process. The statutory demand had been validly served. On the failure to disclose security the District Judge concluded that Habib could apply to amend the petition in the event the annulment were granted and the petition were relisted. But until that time the mandatory requirements had not been met and the bankruptcy order ought not to have been made.

On the dispute point the District Judge concluded there was a genuine triable issue and that on this point the bankruptcy order ought not to have been made because the debt was disputed.

The District Judge then considered the exercise of her discretion as to whether or not to grant an annulment in circumstances where on two separate grounds the bankruptcy order should not have been made.

The District Judge identified the following relevant factors:
1) the effect of the bankruptcy on both Mr Khan and his creditors
2) any element of abuse of process in obtaining or making the bankruptcy order

3) Mr Khan's conduct in the bankruptcy
4) whether Mr Khan was or remained hopelessly insolvent and
5) the amount of time that had passed since the bankruptcy order

The District Judge found a significant lack of cooperation, attempts by Mr Khan to divert rental income away from the bankruptcy estate, the granting of a charge to an associate over the property and the possibility that certain creditors may be left with an unenforceable claim by reason of the passage of time if the annulment were granted. The District Judge concluded that her discretion to annul should not be exercised in Mr Khan's favour.

Mr Khan appealed on the following grounds:

1) when considering annulment on the ground of ought not to have been made annulment should only be refused in exceptional circumstances
2) she had failed to give sufficient weight to his operation
3) she had found there had been delay when there was no limitation period for the application to annul
4) she had found that he did not have sufficient liquidity to meet a fresh petition when he claimed he could
5) she inferred that some creditors may be prejudiced and that their debts might become time-barred since the bankruptcy order when she should have known that the limitation period on a bankruptcy debt is suspended during the period of the bankruptcy and only restarted on annulment.
6) whilst noting the annulment would not assist the trustee in her investigations there was no intention on the part of the trustee to continue to investigate

The appeal was based on the exercise of the discretion to refuse to grant the annulment. It was noted that all appeals are conducted by way of review and that the appeal court will allow an appeal where the decision of the lower court was (a)wrong or (b) unjust because of a serious procedural or other irregularity in the proceedings in the lower court.

Saini J in **Azzam v University Hospital Birmingham NHS Foundation Trust [2020] EWHC 3384 (QB)** stated:

"50. An appellate court will only interfere with a discretionary evaluation where an applicant can identify one or more of the following errors:

i) a misdirection in law
ii) some procedural unfairness or irregularity
iii) that the Judge took into account irrelevant matters
iv) that the Judge failed to take account of relevant matters; or
v) that the judge made a decision which was "plainly wrong".

Decision

The appeal court Judge first considered ground one that the District Judge applied the wrong test it being argued that the court should only decline to annul in exceptional circumstances. On this point the court were bound to follow the decision in **Owo- Samson v Barclays Bank plc (No1) [2003] EWCA Civ 714** in which it was stated;

> "[T]he word 'may' in [IA 1986 s282] makes clear that the courts power to annul, even if the grounds are made out, is discretionary. The court is not bound to set aside the petition, particularly if….. the creditor is found to have acted reasonably and the debtor has failed to raise defences which were open to him at an earlier stage. In such a case, a critical factor in exercising discretion… must be the prospects, if the order is annulled, of the debtor being able to satisfy the petitioner and meet his other liabilities"

The court was referred to authorities dealing with annulment applications is based on COMI where it was held there was no discretion to refuse to annul where the debtor's COMI was not in England and Wales.

The court also considered the position where there is a fully disputed debt. On this point the court followed the decision in **Owo-Samson** in finding that where there was no debt capable of founding a petition, if a bankruptcy order is nonetheless made the court retains discretion when hearing an annulment application.

Having reviewed the authorities the court held that there is no principle which says that the discretion must be exercised in favour of the applicant unless there are exceptional circumstances. Rather, in the exercise of its discretion the court must consider all the relevant factors

On ground 1 the court upheld the decision of the District Judge and dismissed this ground of appeal.

With regard to grounds 2 and 6 conduct and further investigations, the District Judge had found a significant lack of cooperation, diversion of rental income, intimidation of tenants, the creation of agency agreements with his wife to receive rental income and a sustained and deliberate conduct on the part of Mr Khan to impact the trustees investigations. The appeal Judge refused to interfere with the District Judge's decision on these grounds which were dismissed

Ground 3 and the allegation of delay was also dismissed

Ground 4 insolvency. The Trustees second report disclosed assets with a value of just over £750,000 being two unsold properties. The relevant test for bankruptcy is a cash flow test and there was insufficient evidence to show that Mr Khan had liquidity to pay his creditors.

Ground 5 - The appeal Judge noted that for debts outside the bankruptcy time continues to run for limitation purposes. For debts within the bankruptcy, time ceases to run upon the making of the bankruptcy order because those debts fall to be dealt with by the trustee. As to what happens in the event that the bankruptcy is annulled the Judge concluded time should be deemed to have run throughout the period following an annulment and that this was a proper factor which the District Judge took into account in exercising discretion Ground 5 was dismissed.

Comment

- This case demonstrates that on the making of an annulment order based on the ground of ought not to be made, the court has a discretion as to whether or not to grant the annulment. In exercising that discretion, the court shall take into account all relevant factors.

- In considering the question of solvency in deciding whether or not to grant an annulment the test is a cash flow test and not on a balance sheet basis.

- Following the making of an annulment order, time for limitation purposes is deemed to have run throughout the period of the bankruptcy even though whilst the bankruptcy continued debts provable in the bankruptcy would have had time suspended for limitation purposes.

Bankruptcy

Lemon v Gallagher [2022] BPIR 104

Homemade declaration of trust - s339 Insolvency Act 1986

Facts

Mr Gallagher was made bankrupt on 2nd October 2015 on the petition of HMRC for unpaid tax interest and penalties of approximately £500,000. On 19th January 2016 joint trustees in bankruptcy were appointed. The joint trustees issued an application in respect of a property at 48 Kenilworth Rd, Ealing ("no. 48") which comprised six flats. Mr Gallagher lived at flat six ("Flat 6 ") within the building.

Following the bankruptcy order the Residents Association of no. 48 acquired the freehold by the process of enfranchisement. The purchase monies of £50,637 were paid into Court pending resolution of the trustees' claims.

Flat 6 was registered at HM Land Registry in the name of Mr Gallagher's son following it being acquired by him on 14th July 2011 from his father. Flat 6 was also subject to a charge which had been entered into after presentation of the bankruptcy petition.

As to no. 48, Mr Gallagher produced a document purporting to be a declaration of trust bearing the date 24th of December 2003. It was handwritten, unwitnessed and signed by Mr Gallagher alone. In the document Mr Gallagher gifted Flat 6 and no. 48 to his son with the proviso that he would retain the rents and service charges for about 12 years until 5th April 2015.

For the trustees it was argued that the declaration was a salvage document, fraudulently manufactured by Mr Gallagher. However even if it were genuine in the sense that it was created and signed on 24th December 2003, it is nonetheless a sham, and finally if it was created in 2003 it was a transaction at an undervalue and the trustees should be given relief under **section 423 of the Insolvency Act 1986**.

It was common ground that the declaration was not referred to by Mr Gallagher or mentioned to the solicitors who acted on the sale of Flat 6 to his son.

The transfer of Flat 6 stated a value of £172,000 at the time sale. At the time of the purchase the son raised a mortgage of £129,600. The evidence pointed to this being the only consideration paid over to Mr Gallagher. The trustees claimed that the sale was at an undervalue under **s339 Insolvency Act 1986**

The transfer of Flat 6 to the son took place at a relevant time i.e. within the five years ending with 15th May 2015 (petition date). Mr Gallagher's insolvency being presumed to be satisfied and Mr Gallagher failing to adduce evidence to rebut the presumption. The key issue was the extent of the undervalue.

During the trial counsel for the trustee described Mr Gallagher as a *"tax cheat"* and that his position was a *"ticking timebomb"*. Deputy ICC Judge Greenwood described Mr Gallagher's central aim as preserving and transferring to his son as much as possible of his wealth and that in so doing he was willing to act dishonestly to achieve that aim.

Sham

The court was referred to the case of **Snook v London and West Riding Investments Limited [1967] 2 QB 786.** It was also referred to the more recent decision **Hitch v Stone [2001] EWCA Civ 63** in which Arden LJ explained the approach to documents alleged to be shams as follows;

(i) The court is not restricted to the four corners of the document and may consider external evidence such as the parties' explanations, circumstantial evidence and subsequent conduct.

(ii) The test of intention is subjective. The parties must have intended to create different rights and obligations from those appearing from the relevant document and must have intended to give a false impression of those rights and obligations to third parties.

(iii) The fact that an act or document is uncommercial or even artificial does not mean it is a sham. A distinction is to be drawn to the situation where parties make an agreement which is unfavourable to one of them, or artificial, and a situation where they intend some other arrangement to bind them. In the former situation, they intend the agreement to take effect according to its tenor. In the latter situation, the agreement is not to bind their relationship.

(iv) The fact that the parties subsequently depart from an agreement does not necessarily mean that they never intended the agreement to be effective and binding. The proper conclusion to draw may be that they agreed to vary their agreement and that they have become bound by the agreement as varied

(v) The intention must be a common intention. see **Snook's** case.

Those authorities dealt with bilateral documents such as contracts. In this case the alleged declaration of trust was signed by Mr Gallagher only and therefore it is his intention alone that is decisive.

Finding that a document is a sham generally leads to the conclusion that it is void.

The declaration

Mr Gallagher's son knew nothing about the alleged declaration until Mr Gallagher's bankruptcy in 2015.

The declaration was not referred to in any document created before Mr Gallagher's bankruptcy, a point which the judge considered was reflected in the provision to retain rents and service charges for a period of 12 years up until 5th April 2015.

Mr Gallagher claimed that the document was dictated to him by a Mr John Smith who he thought was a legal executive or legal clerk. Mr Smith did not charge for his assistance and could not be traced.

Mr Gallagher claimed that the document had been deposited with his accountants although his accountant was unable to confirm this or willing to give evidence in this regard.

On the declaration, the Judge concluded that it was improbable that Mr Gallagher would have created such an important document without engaging formal legal assistance. The choice of a man called "John Smith" suggested that he was used in order to make the person more difficult to find. It was noted also that Mr Gallagher had instructed solicitors in respect of other transactions and therefore was not someone who could be said never seeks professional legal assistance.

Mr Gallagher accepted that in 2003 he would have been able to produce a typed or printed version of the document but did not do so, the document being handwritten. A consequence of this is that it is more difficult to date and it was probable that Mr Gallagher knew that.

Had the declaration existed in 2003, it was improbable that Mr Gallagher would not have mentioned the document to anyone including the solicitor who dealt the transfer of Flat 6 or in connection with the enfranchisement proceedings

If the document existed, it was undoubtedly kept secret. Mr Gallagher was unable to explain the retention of his entitlement to income from the trust property. A more likely explanation was that the provision was included to enable him to explain or go to some way to explaining how it was that his son had derived no benefit from the properties before then, and that the trust had not been acted upon before then.

Decision

The alleged declaration was not created on 24th December 2003, but very much later probably in 2015 when it was manufactured in order to *"salvage something from the wreckage of Mr Gallagher's bankruptcy"*.
The applicants are entitled to the entirety of the sums paid into court for no. 48.

If the judge was wrong about when the document was created, he concluded that Mr Gallagher did not genuinely or really intend it to have effect according to its written terms – it was a sham document. He referred to the comments of the Judge in **Midland Bank plc v Wyatt [1997] 1 BCLC 242** in which such a document was described as '*not to be acted upon but to be put in the safe for a rainy day*.

If the alleged document was neither manufactured later or a sham then the question was whether it could be challenged under **section 423.** Given the Judge's findings it was unnecessary to consider this in any detail, however had it been necessary to do so he would have been inclined to give the relief sought by the trustees given that Mr Gallagher spoke of avoidance or protection against claims from Ms Losowski, Mr Gallagher's former partner and mother of his son. That being a factor in his decision to gift beneficial ownership to his son. The Judge continued that he would consider that to be a purpose of the transaction within section 423. He noted that the purpose does not have to be the sole or dominant or a substantial purpose. If the transaction was entered into for the prohibited purpose then even if also entered into for one or more other purposes, the requirement is satisfied.

On the **section 339** claim and the alleged undervalue in respect of Flat 6 reference was made to the report and valuation for the mortgagee produced at the time of the transfer of Flat 6 to the son which concluded that the value of Flat 6 once essential works had been completed was £200,000. The trustees also obtained a valuation which stated the value would have been between £190,00 and £200,000. The consideration actually received by Mr Gallagher was certainly no more than £129,600 being the amount of the mortgage advance. The Judge concluded that the amount of the undervalue was £70,000 which it ordered Mr Gallagher's son to pay.

Comment

- The introduction to bankruptcy proceedings of documents allegedly created some years earlier but otherwise previously unknown to parties not named in the document is a regular occurrence. Faced with such a document, that this case provides useful pointers as to the lines of enquiry that should be conducted in order to establish whether or not the document is genuine.

- Note the Judge's comments that the handwritten document is more difficult to date than a typed or printed version.

Bankruptcy

Thomas v Yurova [2022] EWHC 2112 (Ch)

S366 Insolvency Act 1986 -waiver of privilege

Facts

On 23rd January 2020 Mr Justice Bryan gave judgement in proceedings brought by National Bank Trust, a company incorporated in Russia against Mr and Mrs Yurov. Judgement was given for a total of US $900 million. One of the allegations in the proceedings was that Mr Yurov had transferred assets to Mrs Yurova which were held to be transactions defrauding creditors under **section 423 of the Insolvency Act 1986 ("the Act")**.

On 27th of February 2020 Mr Yurov was made subject to a worldwide freezing order, and Mrs Yurova was ordered not to dispose of Mr Yurov's interest in four properties and the proceeds of an investment sold in August 2019.

Mr Yurov petitioned for his own bankruptcy following which trustees were appointed on 12th May 2020.

The trustees as part of their investigations into Mr Yurov's affairs issued an application under **section 366** of the Act against the four respondent banks seeking an order that the banks disclose all bank statements in their possession or control held in the name of Mrs Yurova since 1st January 2016.

The section 366 application was yet to be determined. However, in response Mrs Yurova issued an application against the trustees seeking disclosure of the privileged advice the trustees had obtained in respect of Russian matrimonial law. The privilege application arose as a result of the reasons stated in the trustees' application under section 366. In that application the trustees stated that they had received legal advice concerning the spousal interest in assets acquired by spouses during marriage under Russian law. The witness statement of the trustee stated;

> " I do not waive privilege in that advice but in summary…."

The witness statement then recited an extract of the advice setting out matrimonial rights under Russian law and in so doing asserting that common property would include bank accounts regardless of in whose name the bank account was opened and regardless of the source of funds.

Mrs Yurova sought disclosure of not only the full Russian matrimonial advice obtained by the trustees but also the instructions and all communications in obtaining advice. She further asserted that the trustees had effectively waived their privilege in relation to the advice by referring to it in the trustee's witness statement.

In response to the application the trustees denied waving privilege and pointed out that the application was a delaying tactic, counsel for the trustee describing Mr Yurov "as a sophisticated, dishonest bankrupt".

In deciding whether or not to order disclosure in a particular insolvency application the court is required to have regard to all the relevant circumstances, giving effect to the overriding objective of dealing with cases justly and at a proportionate cost.

There was a discussion as to how the trustees had deployed the Russian law advice. It was noted that in the alternative a direction could have been sought for an expert in Russian matrimonial law to give evidence, but this had not been sought at that stage.

Waiver of privilege

As a preliminary point it was argued that the statement of the trustees that they "do not waive privilege," cannot allow a party to avoid waiving privilege by making such statement. Whether there is a waiver or not is determined by looking at the material itself, not what the party says about it or the intention behind its deployment.

In **Nea Karteria Maritime Co Ltd v Atlantic and Great Lakes Steamship Corp (No 2)[1981] 1Com LR138** it was stated:

> *"….where a party is deploying in court material which would otherwise be privileged the opposite party and the court must have an opportunity of satisfying themselves what the party has chosen to release from that privilege represents the whole of the material relevant to the issue in question. To allow an individual item to be plucked out of context would be to risk injustice through its real weight or meaning being misunderstood."*

Counsel for Mrs Yurova referred to the principal cited in **Great Atlantic Insurance Co v Home Insurance Co [1981] 1WLR 529** in which it was stated:

> *"ii) Where a party waives privilege in the above sense by deliberately deploying material in court proceedings, the party also loses the right to assert privilege in relation to other material relating to the same subject matter……… The underlying principle is one of fairness to prevent 'cherry picking'.*

There are therefore two primary issues:

i) has privileged material been deployed in court, and

ii) what is the extent of the whole of the material relevant to the issue in question?

Decision

On the first question the Judge was satisfied that the trustees had deployed Russian matrimonial law advice in court proceedings.

Turning to the second question the whole of the material relevant to the issue in question, the Court identified the reason that the party relying on privileged material must disclose the whole material is one of fairness and to avoid the risk of any injustice. To not do so would be to allow a party to cherry pick and potentially give a misleading impression of the privileged material as a whole.

The authority on the "whole of the material relevant to the issue in question" is **Fulham Leisure Holdings Ltd v Nicholson Graham and Jones [2006] PNLR 23** in which the court identified the following approach:

> *"i) One should first identify the "transaction" in respect of which the disclosure has been made*

ii) That transaction may be identifiable simply from the nature of the disclosure made – for example, advice given by counsel on a single occasion.

iii) However, it may be apparent from that material, or from other available material, that the transaction is wider than that which is immediately apparent. If it does, then the whole of the wider transaction must be disclosed.

iv) When that has been done, further disclosure will be necessary if that is necessary in order to avoid unfairness or misunderstanding of what has been disclosed."

The "transaction" is the taking of advice on Russian matrimonial property law as it relates to monies held in bank accounts in the name of one of the spouses.

It was noted the trustees had not disclosed the instructions that prompted the extract.

It was therefore ordered that the trustees shall disclose the following:

1) Legal advice received in relation to the Russian law of matrimonial property as it relates to monies held in bank accounts in the name of one of the spouses, including in particular advice addressing the facts of the present case

2) Instructions which led to such advice being given, insofar as those instructions deal with these issues, with redactions to remove any other instructions; and

3) Any communications between the advising lawyer and those giving instructions concerning the substance of the disclosable instructions or disclosable advice, if separate from the advice or instructions themselves.

Comment

- This case highlights the problems that can arise in referring to privileged matters or documents in a witness statement without disclosing all other material relating to the issue disclosed

- The use of a disclaimer or statement stating that privilege is not waived will not be determinative as to whether privilege has been waived.

Liquidation

Brothers Produce Ltd (in liquidation) v Tydene (Western) Ltd [2022] EWHC 291 (Ch)

Transfer of business s127 and s212 Insolvency Act 1986

Facts

This was an application brought by the liquidators of Brothers Produce Ltd (in liquidation) ("the Company") following an assignment of the Company's business which was found to be void under **section 127 of the Insolvency Act 1986 ("IA 86").**

The Company was a wholesale and retail supplier of fruit and vegetables on a market stand in Southall. The Company's accounts for the years ending 31st March 2012, 2013, and 2014 detailed profits of £114,000, £141,000, and £185,000.

By 2014 the Company was experiencing cash flow difficulties as a result of extending too much credit to customers. This in turn meant that it had difficulty paying its suppliers. One of the suppliers presented a petition for winding up on the 13th February 2015. The petition was advertised on 10th March 2015. On 12th March 2015 the Company asssigned its lease for £5000, its fixtures and fittings for £25,000 and its goodwill £5000 to Mr Tarim. On 17th March 2015 Mr Tarim incorporated Tydene (Western) Ltd ("TWL") and transferred everything to TWL. On 21st March 2015 TWL commenced trading from the Company's market stand.

Mr Tarim was the sole director and shareholder of TWL.

On 30th March 2015 the Company was wound up by the court.

Later the market stand ceased trading in January 2019 and Mr Tarim surrendered the lease.

The liquidator claimed that the directors of the Company acted in breach of their duties causing the Company to suffer a loss.

As against Mr Tarim and TWL the liquidators sought;

i) damages in lieu of return of the goodwill on a restitutionary basis

ii) an order for an account in respect of profits derived from the assets and received by Mr Tarim and TWL on a restitutionary basis

iii) damages in lieu of i) and ii) on the basis that Mr Tarim and TWL have been unjustly enriched at the Company's expense.

(together the "restitutionary" claims)

Alternatively, the liquidators claimed that Mr Tarim was liable in knowing receipt and that Mr Tarim held the assets on trust for the Company contingently whilst the petition was outstanding and absolutely once the winding up order had been made. They sought equitable compensation from Mr Tarim being the value of the goodwill assigned and the profits derived from the assets.

Mr Tarim gave oral evidence, which was peppered with inconsistencies. At the time of the negotiations for the purchase of the business he claimed not to be aware of whether the Company was solvent or whether it owed large debts. Yet he acknowledged that he knew the Company was in difficulties and had cash flow problems. He denied that he/TWL had received the Company's laptop and desktop computers, but later acknowledged that it had.

TWL's accounts were described as a moving target. They originally detailed recorded profits of £146,294 in 2016, £375,955 in 2017 and £360,637 in 2018. However, the 2019 accounts showed a trading loss of £83,930. This loss having been recorded after Mr Tarim/TWL were on notice of the liquidator's claim. Similarly, later amended accounts were to show dramatically reduced profits following service of the proceedings.

Having issued the claim, one of the directions given was to apppoint a single joint expert as to the market value of the Company's business and goodwill. That expert reported that the value of the business and goodwill was £1,397,000 as at March 2015. Subsequently, further directions were given for experts reports on the value of the goodwill only. Mr Rose valued the goodwill between £400,000 and £500,000 whereas Mr Aslin appointed by Mr Tarim valued goodwill at between £0 and £5000.

On the question of whether the transfer the business was void pursuant to **section 127 IA 86** the court had no hesitation in finding the disposition was void. That provision does not provide any statutory remedy and as such the court had to look at the general law.

Unjust enrichment

From this it can be derived that office holders faced with a void disposition may look to the law of restitution. The property must simply have a financial value such that the disponee is enriched

To make out a claim for unjust enrichment a claimant must show;

a) that the defendant was enriched

b) that his enrichment was gained at the claimant's expense, and

c) that his enrichment was unjust.

The court will then ask if there is any defence. It is for the defendant to establish a defence not for the claimant to prove an absence of a defence.

Unlike **section 284 IA 86,** there is no defence of receipt in good faith, for value and without notice of the petition under **section 127**. It is possible to put forward a defence of change of position, however such a defence now has limits.

Where a defendant is unjustly enriched at the claimant's expense and no defence is made out the claimant has a right to restitution from the defendant.

As an alternative to a claim based on the law restitution an officeholder may look to equity where a disposition is found to be void. The recipient will hold it contingently for the company and in the event of a winding up order being made, for the company.

Knowing Receipt Claims

Where a third party receives company property in breach of trust and it is unconscionable for him to retain the benefit of his receipt, he will be liable in knowing receipt. It will usually be unconscionable for him to retain the benefits if he has knowledge of the breach of trust. The directors being trustees of the company's property. Knowledge may be;

i) actual, or constructive by

ii) wilfully shutting one's eyes to the obvious

iii) wilfully and recklessly failing to make such enquiries as an honest and reasonable man would make

iv) knowledge of circumstances which would indicate the facts to an honest and reasonable man; or

v) knowledge of circumstances which would put an honest and reasonable man on enquiry.

The claim in this case was brought against the directors under **section 212 IA 86** which provides that if, in the course of the winding up of a company it appears that a person who is or has been an officer of the company has been guilty of misfeasance or breach of any fiduciary or other duty in relation to the company, the court may, on the application of the liquidator compel him to contribute to the company's assets by way of compensation.

This includes a director's duties under **sections 171 to 177 Companies Act 2006**.

The transaction documentation considered by the court was the agreement for sale between the Company and Mr Tarim, a deed for the assignment of goodwill and a deed of the assignment of the lease. Mr Tarim had previously argued that he did not acquire the goodwill and that his solicitors were negligent in preparing and completing a deed for its assignment.

ICC Judge Barber made a number of findings including that TWL traded with the benefit of the Company's name, market presence, staff and loyal customer base. TWL's profits in the first year of trading were £146,000 from a standing start. The goodwill of the Company transferred to Mr Tarim was on a "going concern basis" notwithstanding Mr Tarim's denial. Neither Mr Tarim or TWL paid for the Company's stock. The transaction was not an arm's length transaction.

Decision

It was noted that the liquidator's case by way of undervalue was confined to the goodwill only. The valuation carried out by Mr Brewer was for the business and goodwill whereas the subsequent valuations carried out by Mr Rose and Mr Aslin were for the goodwill only.

Having considered the experts different approaches to valuation the Judge preferred the approach of Mr Rose and concluded that the valuation should be based on past financial performance using the EBITDA ratio method.

The conclusion being that the transfer of goodwill was at an undervalue

Mr Tarim was aware that the Company was likely to become insolvent and therefore **section 172(3) Companies Act 2006** was engaged.

The directors plainly acted in breach of their duties to creditors in selling off the assets at an undervalue and as such the misfeasance claim against them was made out.

The directors were ordered to pay the sum of £80,647 being the value of the goodwill less £5000 together with interest. Under the knowing receipt head, the liquidators were entitled against Mr Tarim and TWL to equitable compensation being the value of the goodwill less £5000 i.e. £80,647.

Comment

- Judgement in this case provides a useful analysis of the various claims that a liquidator may pursue against directors arising out of section 127, undervalue claims and breach of duty.

- It contains a detailed analysis of the experts' valuation reports and the appropriate valuation method to be utilised. The defendants arguing unsuccessfully that the value of goodwill should have been based on liquidation and the price actually paid.

Liquidation

Re Changtel Solutions UK Limited (In liquidation) [2022] EWHC 694 (Ch)

S127 Insolvency Act 1986- void dispositions

Facts

7th June 2013 Winding up petition presented

28th January 2015 Winding up order

22nd January 2021 Application issued by liquidators

ChangTel Solutions UK Ltd ("the Company") went into liquidation on 28 January 2015. The liquidators issued an application against 16 respondents to recover various sums paid by the Company allegedly in breach of the provisions of **section 127 of the Insolvency Act 1986**. The judgement deals with five payments made to G4S Solutions (UK) Limited ("the Respondent") totalling £47,053. The liquidators sought recovery of those payments under section 127.

Section 127 provides:

> "In a winding up by the court, any disposition of the company's property… made after the commencement of the winding up is, unless the court otherwise orders, void"

The application was opposed by the Respondent on the following grounds;

1) the application was time-barred under section 9 of the Limitation act 1980
2) the first payment was made by cheque before presentation of the petition
3) the court should validate the payments under section 127
4) the Respondent changed its position and has a defence to the restitution claim arising by reason of section 127 of the 1986 act

Is the claim statute barred?

The liquidators contended that the limitation period commenced on the date of the making of the winding up order. The Respondents argued that the limitation period commenced when the cause of action arose i.e. when the payments were made. The Judge noted that section 127 starts with the words "In a winding up by the court", which supported the finding that time runs from the date of the winding up order and not the date of payment.

The first payment by cheque

The first payment had been provided by the Company to the Respondent in the form of a cheque on 31st of May 2013. However, the payment was not debited from the Company's bank account until 11 June 2013 some four days after presentation of the petition.

In **Hollicourt (Contracts) Ltd v Bank of Ireland [2000] WLR 895**, Blackburne J said:

> "The debiting to the customer's account of the amount of his cheque on presentation for payment (by paying out that amount to the third party in satisfaction of the cheque) seems to me to be in every sense a disposition the company's property."

The fact that the disposition of the cheque itself took place pre-presentation, therefore, did not prevent a post presentation payment out on that cheque being rendered void under section 127, as such the first payment was void under section 127 unless validated.

Validation

Whilst the Respondent sought validation in respect of the payments, no actual application notice or fee had been paid. On this point the Judge took a pragmatic approach and said that she considered it would be disproportionate and would serve little purpose to decline validation simply because no fee had been paid or application notice issued.

The leading case on validation is **Express Electrical Distributors Ltd v Beavis [2016] 1 WLR 4783** in which the following principles were outlined:

1) Free assets of the insolvent at the commencement of the liquidation shall be distributed rateably amongst the insolvent unsecured creditors as at that date. This is the pari passu principle.

2) Sometimes it may be beneficial to the company and its creditors that it be allowed to complete a particular contract or project or to carry on business generally in its ordinary course with a view to the sale of the business as a going concern.

3) In considering whether to make a validation order the court must always do its best to ensure the interests of unsecured creditors will not be prejudiced.

4) The court should not validate transactions which might result in one or more pre-liquidation creditors being paid in full at the expense of other creditors in the absence of special circumstances.

5) Special circumstances must exist which make a particular transaction one in the interests of creditors as a whole before a validation order will be made to override the usual application of the pari passu principle.

6) Where validation is sought retrospectively the court should look at the matter with the benefit of hindsight.

7) It is incorrect to say that a disposition carried out in good faith in the ordinary course of business at a time when the parties are unaware that a petition has been presented will normally be validated by the court.

8) Save in exceptional circumstances a validation order should only be made in relation to dispositions occurring after presentation of the petition if there are some special circumstances which shows that the disposition in question will be, or has been for the benefit of the general body of unsecured creditors such that it is appropriate to disapply the usual pari passu principle.

9) Where evidence shows that the company traded at a loss, validation orders should not be made in respect of the operation of its bank account used for its ordinary trading to the extent of such loss.

Special circumstances

It was common ground that a creditor's lack of awareness that a petition has been presented and receipt in good faith of a post presentation payment in the ordinary course of business are not themselves special circumstances justifying validation.

The Respondent claimed that the payments were made in special circumstances in that they paid for the guarding and preservation of the Company's premises and contents.

In considering whether special circumstances exist the court must consider the context in which the payments are being made. It was noted that by 1st January 2014 the Company had transferred the remainder of its assets to another company, a transaction which was subsequently successfully challenged by the liquidators.

Having considered all the circumstances the Judge concluded that the Respondent had failed to satisfy her that the unsecured creditors as a whole were any better off, or even no worse off as a result of the payments, and as such there were no special circumstances warranting validation of the payments.

Exceptional circumstances

The Respondent sought to argue that there were exceptional circumstances which justified validation of the payments by reason of the fact that the petition was not advertised. A similar claim was made in **Express Electrical** where a post presentation payment of £30,000 was paid prior to the petition being advertised. Commenting on this the Judge observed that the conventional procedure for service of the petition and advertisement means that there is a period of at least seven days before advertisement takes place following issue and that there is no "carve out in respect of the window of time between presentation and advertisement". Section 127 makes it clear that all post presentation dispositions regardless of whether they occurred before or after advertisement are void, as such the failure to advertise the petition was not an exceptional circumstances warranting validation.

Change of position

Change of position is recognised as a defence to monies had and received if the defendant's circumstances have changed detrimentally as a result of receiving the enrichment. The case **Rose v AIB Group (UK) plc [2003] 1 WLR 2791** is authority for the proposition that a claim for restitution based on section 127 could be met by a change of position defence. In that case the company's bank account was overdrawn and the bank held a charge. After presentation of the petition but before advertisement the bank accepted post-petition payments from the company to pay off the overdraft. The petition was later advertised and a compulsory winding up order made. The bank knowing of the petition and the risk of a claim under section 127 decided to release it's charge assuming the liquidator would not come after them for the payments. When the liquidators did seek recovery, the bank sought validation and, in the alternative, argued change of position defence based on the release its charge. The court rejected validation and found that when the bank released its charge it was not acting in reliance on the validity of the payments it had received, as such the bank was liable to repay that the void payments.

Rose was followed by the decision **MKG Convenience Ltd [2019] BCC 1070**. In that case the respondent contended that it changed its position in good faith in reliance on the validity of the payments by continuing to make supplies and that this gave rise to a defence to the remedy of restitution on which the liquidator relied to recover payments rendered void under section 127. The respondents defence of change of position was rejected as having considered the authorities the Judge concluded that the circumstances in which a change of position defence can succeed are constrained in the same way and for the same reasons as the exercise of the court's discretion to validate. The principles governing the circumstances in which validation should be ordered are those set out in **Express Electrical.** Change of position was therefore not available to the Respondent to defend the liquidators claim.

Decision

ICC Judge Barber held that there were no special or exceptional circumstances which would justify the making of an exception to the principle of pari passu.

Further the Respondent had not persuaded the Judge that by reason of any change of it's position it was unjust to require it to repay any of the sums sought by the liquidators.

The claim was not time-barred.

The cheque payment was void by reason of it being debited from the Company's account after presentation petition.

A validation order in respect of the payments was refused.

Comment

- For any case where s127 is in issue the guiding principle on whether or not to validate is as below:

  "The true position is that, save in exceptional circumstances, a validation order should only be made in relation to dispositions occurring after presentation of a winding up petition if there is some special circumstance which shows that the disposition in question will be (in a prospective application case) or has been (in a retrospective application case) for the benefit of the general body of unsecured creditors, such that it is appropriate to disapply the usual pari passu principle" **para 141 Express Electrical**

- Even if factors are demonstrated that amount to a change of position that change of position is but one of many factors to consider in deciding whether or not to validate a disposition.

- Note temporary changes made by **para 9 of schedule 10 of the Corporate Insolvency and Governance Act 2020** (as subsequently extended), which provided for commencement of the winding up to take place on the winding up order. The position has reverted in the light of the **Corporate Insolvency Governance Act 2020 (Coronavirus) (Amendment of schedule 10) (No2) Regulations 2021** which came into force on 1 October 2021.

Liquidation

Hamilton v McAteer [2022] EWHC 1349 (Ch)

Misfeasance claim- strike out application

Facts

Mr Hamilton as joint liquidator of Mobigo Ltd "(the Liquidator" and "the Company" respectively) brought proceedings under **section 212 of the Insolvency Act 1986** against James McAteer and Teresa Delgaudio ("the Directors"). Ms Delgaudio was the current de jure director of the Company. Mr McAteer was its previous de jure director. Ms Delgaudio claimed she had no involvement in running the company at all and that Mr McAteer continued to act as the de facto director. The substantive application sought declarations against the directors that they breached their duties to the Company and that they make a contribution to the assets of the Company.

At an earlier hearing, ICC Judge Jones unsatisfied with the way in which the Liquidators had particularised their case ordered a further statement be filed indicating which of the duties under the **Companies Act 2006** are alleged to have been breached and to identify the relevant passages referring to evidence in support.

Somewhat unusually the Directors filed an application to strike out the substantive application on the basis that it was an abuse of process and disclosed no reasonable grounds for bringing the case. They also sought to have parts of the Liquidators' evidence declared inadmissible.

The Company was incorporated on 7th April 2014 with Mr McTeer as its sole director and shareholder. He was recorded as having resigned as a director on 11th April 2015 and Ms Delgaudio who is his son's partner was appointed as the Company's sole director on the same day. The notices of resignation and appointment were not filed at Companies House until 4th February 2016. Ms Delgaudio said she had no involvement in the running of the Company and that she was paid £400 a month and that Mr McAteer ran the Company whilst Ms Delgaudio continued to be shown as the sole director at Companies house.

Following a failure to file accounts the Company was struck off the register. It was subsequently restored to the register and wound up by an order of the court on 23rd January 2019. The petition was presented by the Phone- paid Services Authority Limited ("PSA").

The Company offered a pornographic video subscription service which was delivered by IMI/Tap2Bill acting as its agent. IMI/Tap2Bill having carried out a risk assessment concluded that the Company was "high risk" and that Mr McAteer was "very high risk".

On 11th December 2015 an anti-fraud software body called Empello alerted the network operator that 170 consumers had been subscribed as a result of "i-frame masking" or "click-jacking". As a result, on 30th December 2015 the network operator issued a red card to IMI/Tap2Bill suspending the service.

The PSA having been notified by the network operator, but not the Company issued a letter seeking information. That request went unanswered and was followed by a warning notice and a further letter which went unanswered. The PSA Tribunal considered the matter and published its decision on 5th May 2017 when it found breaches categorised as very serious and fined the Company £250,000. It also prevented the Company from having anything to do with the provision of premium rate services for a period of five years. The fine went unpaid.

Mr McTeer's explanation was that the I frame masking software was a result of the activities of a third party and that he was unaware of the PSA investigation.

The Liquidators did not accept the explanation from Mr McTeer and the substantive application alleged that the Directors breached their duty by failing to comply the PSA's code of practice and to respond to its communications.

The Liquidator's revised statement alleged that the acts or omissions were a breach of the duty imposed by **section 172 of Companies Act 2006** which is the duty to promote the success of the company including a duty to consider the interests of creditors. They also relied on section **174** which is a duty to act with reasonable care skill and diligence.

The Liquidators also claimed that the Directors had breached their fiduciary duties in making payments to themselves and others. Mr McATeer claimed the payments made to him were reimbursement of expenses and remuneration for consultancy services provided by him and that the payments to Ms Delgaudio represented her remuneration as a director.

The strike out application

The Directors sought to strike out the Liquidators' application on the following basis;

a) it was an abuse of process to seek to enforce the PSA fine against the Directors personally
b) if the Directors were in breach of their duty, then Mr McAteer as the sole shareholder could ratify those breaches under the **Duomatic** principle
c) the remuneration and other commercial transactions entered into before the PSA fine are also subject to ratification under the Duomatic principle
d) the Directors sought to exclude the decision of the PSA tribunal and the risk assessment report carried out by IMI/Tap2Bill which described Mr McTeer as "very high risk".

The legal principles

CPR 3.4 provides;

"(2) The court may strike out a statement of case if it appears the court-

> (a) that the statement of case discloses no reasonable grounds for bringing or defending the claim;
> (b) that the statement of case is an abuse of the court's process or is otherwise likely to obstruct the just disposal of the proceedings"

CPR 24.2 provides;

> "The court may give summary judgement against a claimant or defendant on the whole of a claim or a particular issue if-
> (a) it considers that-
> (i) that claimant has no real prospect of succeeding on the claim or issue; or
> (ii) that defendant has no real prospect of successfully defending the claim or issue; and
> (b) there is no other compelling reason why the case or issue should be disposed of at trial."

The test being whether the court considers the party has a realistic as opposed to a fanciful prospect of success.

The challenge to the PSA claim

The Directors allege that the PSA claim is an abuse in that it offends the principle in **Safeway Stores Ltd v Twigger [2010] EWCA Civ 1472** and secondly that any breaches of the duty were ratified under the Duomatic principle.

The duties relied on in this case are set out in **172 of the Companies Act 2006** being the duty to promote the success of the company.
That duty is qualified and is overridden by the duty to act in the interests of creditors. That duty arises when the directors know or should know that the company is or is likely to become insolvent, **BAT Industries plc v Sequana [2019] EWCA Civ 112**

The second duty alleged to have been breached is **s174 Companies Act 2006** which requires a director of a company to exercise reasonable care skill and diligence. On the abuse of process argument reference was made to the **Safeway** case in which the Office of Fair Trading prosecuted the retailer for breaches under the Competition Act 1998. Safeway chose to admit the beaches and then sought to sue some of its directors and employees for an indemnity alleging that they breached their duties and caused the company to contravene the Act and incur the penalty. The defendant directors/employees sought summary judgement on the grounds of the "illegality defence". On appeal the directors/employees won.

Decision

Having reviewed the authorities at ICC Judge Mullen concluded that the Safeway case was of an unusual nature and that it is not authority for the proposition that misconduct attributed to a company in a claim by a third-party bars an action by the company in a breach of duty claim against its directors.

Without deciding the points which will be dealt with at trial, it was clear from an early stage that the Directors knew or should have known no later than the point at which the service was suspended that the Company was likely to face a substantial fine from the PSA, and that it would have no way of paying. The Judge was not satisfied that the PSA claim would fail as an abuse of process.

Duomatic principle

The Duomatic principle was explained by Buckley J in **Re Duomatic Ltd [1969] 2 Ch 365** as follows;

> *"where it can be shown that all shareholders who have a right to attend and vote at a general meeting of the company assent to some matter which a general meeting of the company could carry into effect, that assent is as binding as a resolution in general meeting would be."*

ICC Judge Mullen observed that the principle does not however apply where the company is insolvent. **Kinsella V Russell Kinsella Pty Ltd. (in liq) (1986) 10 ACLR 395**

He also identified other issues concerning the application of the Duomatic principle, in particular the question of whether or not the shareholders had actually applied their minds to the question of whether to ratify the transaction. Again, this is a matter that will have to be dealt with at trial.

A further question in relation to the Duomatic principle is whether the shareholders' approval is expressed by some outward manifestation. Again, that this will be a matter for trial.

Misapplication of monies

It was noted that there are no board minutes, remuneration agreements or contracts to show that the payments to the directors were indeed proper transactions. As fiduciaries the Directors must account for their dealings with Company monies and again this is a matter that will have to be dealt with at trial.

As to the PSA and IMI/Tap2Bill documents there was no reason to exclude these documents from the trial of the matter. The documents in question form an important part of the factual background.

Decision

The strike out application fails and is dismissed.

Comment

- This case considers the use of **section 212 of the insolvency act 1986** as a remedy against directors. Such claims are supported by a statement in which it is alleged that the directors have breached their duties as directors under the Companies Act 2006. It should contain sufficient detail to identify the relevant statutory provision and also the evidence supporting each alleged breach.

- It also highlights the limitations of defendant's relying on the Duomatic principle in respect of alleged breaches of duty and/or misfeasance following the Company becoming insolvent.

Liquidation

Kelmanson v Gallagher and De Weyer [2022] BPIR 682

Preference claim-whether creditors' belief secured "genuine"

Chronology

21st May 2014	Company incorporated. Mr Gallagher and Ms De Weyer appointed directors
17th August 2014	Board resolution recording loans to Company by directors
10th November 2014	Ms De Weyer pays in £210,500 to Company's account
14th July 2016	Ms De Weyer resigns as director of the Company
18th October 2016	Settlement agreement between Company and Fournier
8th February 2017	Completion of sale of Company's premises
9th February 2017	De Weyer Ltd ("the Company") makes payment of £315,750 to De Weyer Design Ltd ("Design")
10th February 2017	Design paid £105,200 to Mr Gallagher and £210,500 to Ms De Weyer
21st March 2017	Company goes into creditors voluntary liquidation

Facts

The Company's liquidator brought a claim against Mr Gallagher and Ms De Weyer in respect of payments they had received of £105,200 and £210,500 respectively. The liquidator's claim being the payments constituted preferences in breach of **section 239 of the Insolvency Act 1986 ("the Act")**. The liquidator also sought an order under **section 212** of the Act against Mr Gallaher.

The Company was incorporated in May 2014 and the respondents each held 50 of the 100 issued shares. They were both appointed directors at incorporation although subsequently Ms De Weyer resigned as a director on the 14 July 2016. The Company was involved in interior design and it had entered into a franchise agreement with the French kitchen manufacturer, Fournier.

The Company acquired premises at 2 Park Street Chelsea which it purchased with the assistance of HSBC. Ms De Weyer had lent the sum of £210,500 which was paid into the Company's account on 10th November 2014. Mr Gallagher paid sums to the company totalling £105,200.

On 17th August 2014 a board resolution was passed acknowledging receipt of the directors' loans. The significance of the board resolution was that Mr Gallagher originally claimed that he was a secured creditor having believed that following the passing of that board resolution a charge had been registered at Companies house. Subsequently it became apparent that no charge had been registered although he continued to maintain his belief that he was a secured creditor. The board resolution itself predated the company's acquisition of the premises and receipt of the loan monies from the directors.

The relationship with the French company deteriorated and ultimately ended up with a settlement agreement being entered into between the Company and the French supplier.

Not long after the settlement agreement was entered into, the Company sold its premises on the 8th February 2017 having redeemed the charge HSB. The following day the Company paid £315,750 to Design a company of which the respondents were directors and shareholders. The following day on the 10th February 2017 Design paid £105,200 to Mr Gallagher and £210,500 to Ms De Weyer. On 21st March 2017 the Company went into creditors voluntary liquidation.

Mr Gallagher responded to the liquidator's claim under **section 239** in respect of the payment he received by saying he was a secured creditor. He even went as far as issuing an application for a declaration that he held an equitable charge. That application came before District Judge Hart who found that the evidence for an equitable charge was "very thin" and dismissed the claim.

At trial Mr Gallaher's claim to be a secured creditor fell away and he eventually accepted that he was not secured in any way. However, he maintained that he genuinely believed he was a secured creditor and that this was relevant in considering the claim against him under **section 239** of the Act.

Section 239 provides;

> "(2) Where the company has at a relevant time… given a preference to any person, the officeholder may apply to the court for an order under this section.
>
> (4) For the purposes of this section and section 241, a company gives a preference to a person if –
>
> (a) that person is one of the company's creditors… and
>
> (b)the company does anything or suffers anything to be done which (in either case) has the effect of putting that person into a position which, in the event of the company going into insolvent liquidation, will be better than the position he would have been in if that thing had not been done.
>
> (5) The court shall not make an order under this section in respect of a preference given to any person unless the company which gave the preference was influenced in deciding to give it by a desire to produce in relation to that person the effect mentioned in subsection (4)(b).
>
> (6)A company which has given a preference to a person connected with the company…. is presumed, unless the contrary is shown, to have been influenced in deciding to give it by such a desire as is mentioned in subsection (5)."

"Relevant time" is defined by **section 240** of the Act as;

(i) in the period of six months ending with the onset of insolvency which may be increased to 2 years where the preference is given to a person who is connected with the company within the meaning of section 249 of the act; and

(ii) when the company is unable to pay, or becomes unable to pay in consequence of the preference, its debts within the meaning of section 123 of the IA 86.

Were the payments at a relevant time?

The payments fell well within the six-month period prior to the onset of insolvency. The insolvency element of the test was also satisfied as the Company's accounts for the year ending 31st March 2015 showed that the Company was balance sheet insolvent and that the Company had sought forbearance from creditors being HMRC and Fournier. Mr Gallaher admitted that the Company's liabilities considerably exceeded its assets.

Were the Respondents creditors?

It was common ground that respondents were creditors for at least £105,200 and £210,500 respectively at the time when they received the payments on the 10th February 2017.

Did the company do anything or suffer anything to be done which had the effect of putting the respondents into a better position in the event of insolvent liquidation?

Could the Company be said to have done or suffered anything to be done as distinct from Design bearing in mind that the payments went to Design first before being paid by Design to the respondents? The court considered the decision in **Phillips v Brewin Dolphin Bell Lawrie Ltd [2001] 1 WLR 143** and concluded that the payment to Design was part of a single coordinated scheme or composite transaction. In making the payment to Design the Company did something that had the necessary effect of improving the respondent's position on liquidation in the terms required by **section 239(4)(b)** in that it entered into that composite transaction. Further the Company suffered the payments to be made by Design to the respondents

Was the Company influenced by a desire to produce in relation to the respondents the effect mentioned in subsection 239(4)(b)?

As Mr Gallagher was the Company's sole director at the time of the payments the question of whether or not the Company was influenced by the necessary desire depended on whether Mr Gallagher himself had that state of mind.

Mr Gallagher was also a person connected with the Company and therefore the desire requirement was presumed to have been satisfied unless Mr Gallagher was able to rebut it.

No such presumption applied in relation to the claim against Ms De Weyer and so the applicant must positively prove that the necessary influence and desire on the part of the Company in causing her to be paid.

Mr Gallagher maintained that he genuinely believed that they were secured creditors. On this point however the Judge was satisfied that Mr Gallagher had not rebutted the presumption that the Company was influenced by a desire in repaying him.

Turning to Ms De Weyer it was found that the liquidator had discharged the burden of proof in showing that the desire to produce the effect in section 239(4)(b) of the Act was influential in the Company's decision to repay her. There was no explanation for what Mr Gallagher (as the company sole director) did, in the context in which he did it, other than that he acted on 9th and 10th February 2017 under the influence of a desire to produce the effect in section 239(4)(b) of the Act in relation to Ms De Weyer.

Decision

Deputy ICC Judge Curl QC held that the liquidator's claim by way of preference against Mr Gallagher had been made out and Mr Gallagher was ordered to repay the sum of £105,200.

The liquidator's claim against Ms De Weyer as a preference was also made out and she was ordered to repay the sum of £210,500.

The liquidator's claim also sought relief under **section 212** of the Act on the grounds that Mr Gallagher breached his duty as a director of the Company and that he should therefore compensate it for the entirety of £315,750. The liquidator's claim under **section 172** of the **Companies Act 2006** recited the director's duty to act in good faith in a way most likely to promote the success of the company for the benefit of it is a whole. This was qualified by the fact that it was insolvent or likely to be insolvent and as such the director should have acted in the interests of the creditors. **(BTI 2014 and LLC v Sequana SA [2019] 2 All ER 784).**

The Judge found that there was no evidence of the interests of the Company being properly considered or indeed those of creditors. As such Mr Gallagher was ordered to repay the sum of £315,715, that the order overlapping with the order in respect of the preferences and not being cumulative.

Comment

- This case examines the situation where the payments are made through third parties and not directly to the creditor.

- It should be remembered that even an incorrect belief provided that that there is some basis for it may be sufficient to demonstrate that there wasn't the sufficient desire to achieve the effect in section 239(4)(b), as was the case in **Re-MC bacon Ltd [1990] BCC 78** where the controlling mind of the company held the incorrect belief that if the company granted a debenture to the bank then the bank would have to continue to support the company for a further six months of trading.

Liquidation

Manolete Partners Plc v Dalal [2022] EWHC 1597 (Ch)

Liquidators claim to recover under declared profits

Facts

This was a claim brought by Manolete as assignee of Bolton Poultry Products Ltd ("the Company") and its liquidator. The claim was brought against the Dalal family who comprised of Ebrahim the father, Sajid the son, Anisha, Sajid's wife and Johra.

The Company traded from April 2005 until January 2015 when it went into creditors voluntary liquidation. Shortly before liquidation the Company sold its assets to a newly formed company owned by Sajid and Anisha.

The claimant alleged;

a) That the Company made a great deal more money from its business than was recorded in its accounts and that the defendants misappropriated cash referred to as additional sales receipts.

b) Properties purchased in the name of the defendants were acquired using money from the Company.

c) Ebrahim, Sajid and Anisha authorised payments of Company money to themselves in breach of their duties owed to the Company

d) The new company acquired the business of the Company without paying for goodwill.

The business of the Company was chicken. Slaughtering, selling birds as a whole, or cutting them up and selling parts. Over half of all sales were paid for in cash.

The directors

Ebrahim was registered as as director of the Company from incorporation in April 2005 until liquidation.
Sajid, Anisha and Johra were registered as directors from incorporation until 20th June 2008. The claimant alleged that Sajid and Anisha continued to act as de facto directors and were therefore subject to the duties imposed on company directors.

In July 2011 land was purchased next to the factory and registered in the names of the four defendants. The price paid was £200,000 and was referred to as the Thynne Street property. The claimant alleged the property was purchased with money belonging to the Company.

In 2011 HMRC began an investigation and formed the view that the turnover reported in its accounts for the year ending 30th September 2009 did not appear nearly high enough.

On 9th February 2012 the property known as Borsdane Farm was purchased by the four defendants for £1.2 million to be used for rearing chickens. The claimant alleged that the property was purchased with money belonging to the Company.

HMRC's Investigation continued and resulted in a document headed "Business Economics Exercise" in which it set out its conclusions and which was a key part of the claimant's case. In the covering letter sent with the report it stated that the *"figure was massively higher than the declared turnover of £2,695,644"*.

The Company accountants requested details of the analysis and copy invoices. There was an exchange of information although it became apparent that HMRC had subsequently destroyed all the records the Company had provided to them

In September 2014 minutes of a board meeting signed by Ebrahim recorded that the Company would give £250,000 to Sajid and Anisha to enable them to purchase a property. The sum representing monies owed by the Company to Ebrahim.

In the meantime, the Company had appointed new accountants who continued to dispute the figures with HMRC. During the course of correspondence, they stated;

> *"we believe that the level of additional sales should be close to 20% of the additions proposed in your letter."*

On 30th January 2015 a resolution for winding up the Company was passed, and Mr Morris was appointed as liquidator.

19th June 2015 HMRC served corporation tax assessments for alleged unpaid corporation tax. Subsequently there followed a police investigation which resulted in the seizure of £176,000 in cash.

Were Sajid and Anisha directors after 20th June 2008?

On this question after consideration of the various authorities the following principles were distilled;

a) A director of a company is someone who directs the affairs of the company, or some specific part of those affairs alone or together with others.

b) The question of whether or not an individual acted as a director is to be to determined objectively

c) To establish that a person is a de facto director it is necessary to plead and prove that they undertook functions in relation to the company which could properly be discharged <u>only</u> by a director, it is not sufficient to show that they were concerned in the management of the company's affairs or undertook tasks in relation to its business which could properly be performed by a manager, agent or employee, below the level of director

d) It is not enough that an individual was consulted about decisions made by others about the affairs of the company

e) There is no single test to determine if someone is a de facto director. Factors that may be relevant include;
    i. whether the individual is accountable to others for what they do
    ii. whether they are treated as being on an equal footing with the registered directors,
    iii. whether the individual is called a director or held out to third parties as a director or treated by third parties as a director.

f) If it is unclear, the person in question is entitled to the benefit of the doubt.

Decision

It was claimed that their roles did not change after they resigned in 2008. On this point the Judge did not accept that it could be inferred that they remained as directors after that date.

The fact that Sajid was a signatory to the Company's bank account was something that a trusted senior manager might well do. Sajid was responsible for hiring, staff supervision, slaughtering and making returns. They were all matters that could be the responsibility of a senior manager who was not a director.
Anisha was responsible for the company's payroll preparing accounts and securing the cash collected. There was no evidence that this was anything more than an administrative function. There was no evidence she was involved in making decisions about the conduct of the Company's business.

Neither Sajid or Anisha were or acted as directors after 2008.

Were there any additional sales receipts?

The particulars of claim pleaded the corporation tax assessments made by HMRC and in particular the statement that the Company made no less than £7,123,644 of additional sales.

The Judge undertook a detailed analysis of the accounts and the claims made by both HMRC and the Company's accountants. In that analysis he dismissed placing any weight on the figure of 20% expressed by the Company's accountants as likely additional sales. The Judge conducted an analysis of sales for the year ending 30th September 2009 which produced an estimated figure for income from sales of around £2.6 million which contrasted with the Business Economics Exercise which for the same period estimated sales as being more than 200% of the amount recorded in the accounts. The Judge concluded that his estimate was not enough to produce a discrepancy to justify the conclusion that there were additional sales receipts.

He further held that as there were no additional sales receipts claims to all of the properties were without foundation save in the case of the Brinksway property which was where Ebrahim purportedly gifted £250,000 of the Company's money to Sajid and Anisha which was to be accounted for by money allegedly owed by the Company to Ebrahim on his director's loan account.

The first question was did the Company owe Ebrahim at least £250,000? The conclusion was that it did.

Did the deficiency on the balance sheet mean the Company was insolvent at the date of the payment? The balance sheet as at 30th September 2014 showed assets being worth £25,140 less than liabilities. On this point the Judge concluded that this did not mean that the Company was insolvent.

The Judge then asked the question that knowing of HMRC's claim at the date of payment was Ebrahim in breach of his duty in causing the Company to repay the money it owed to him.

The Judge then considered **BTI 2014 LLC v Sequana [2019] EWCA Civ 112** and the test stated in that case;

> "that directors are under a duty to consider the interests of creditors where a company is insolvent or is more likely than not to become insolvent."

Although the claimant had failed to prove additional sales receipts, HMRC were in a different position as they had raised assessments which would stand in the event that the Company was unable to prove that there were no additional sales receipts. It was therefore probable that a substantial amount of money would be owed to HMRC in excess of what the Company could pay. This meant the Company should be treated as probably insolvent in September 2014. As a consequence, Ebrahim was required to consider the interests of creditors in deciding whether to cause the Company to repay the money owed to him. It was apparent that he did not give any thought to the interests of creditors and that as such he was in breach of his duty to creditors when he caused the payment to be made.

The Judge referred to the decision in **GHLM Trading Ltd v Maroo [2012] EWHC 61 Ch.** In that case a director of a company caused it to sell stock to another company with the sale proceeds being taken by the director on the basis that he was owed money by the company. In those circumstances it was held that a company can disavow a contract which a director has caused it to enter into if the director was acting in his own interests rather than those of the company its members or creditors and the other party to the contract had notice of the director's breach of duty. Any such contract was held void.

In the current case, the director acted in breach of his duty under **section 172** of the **Companies Act 2006** in causing the payment to be made, as such the Company is entitled to a proprietary claim to the money at the point it was paid to Sajid and Anisha. It followed on from this the Company is entitled to trace its money into the property purchased by them by reason of a proprietary claim. The claimant is entitled at its election to a proportionate interest in the property or an equitable lien for £250,000.

Payments to the directors

Where a director of a company receives money from the company the burden is on the director to justify the payment see **GHLM Trading Ltd v Maroo**. Having analysed the various payments made to Ebrahim the Judge found that they were not justified and must be repaid.

As the additional sales receipt claim had been rejected there was nothing in the claim for goodwill.

The Judge also held that two payments of £7000 to Sajid and Anisha should be repaid.

Comment

- This case highlights the difficulties faced by a liquidator and an assignee in pursuing a claim based on undeclared income/profits. Following destruction of many of the relevant documents by HMRC the liquidator was forced to rely on the report prepared by HMRC. Had the documentation been available the claimant would have been in a better position to produce its own expert evidence in support of the claim.

- The case contains a useful analysis of how to identify a de facto director.

Company Directors Disqualification Act 1986

Official Receiver v Obaigbena [2022] EWHC 1399 (Ch)

Trading to the detriment of creditors- disqualification

Facts

This was an appeal by Mr Obaigbena ("Mr O") against an order of Deputy Insolvency and Companies Court, Judge Agnello QC following his disqualification from being involved in the management of a limited company pursuant to **section 6 of The Company Directors Disqualification Act 1986 ("the 1986 Act").**

Mr O was the sole director of Arise Networks Ltd ("the Company"). The Company was part of a group based in Nigeria and the plan for the Company was to facilitate broadcast production services in the UK concentrating on African news and events.

Following the Company going into compulsory liquidation, the Official Receiver claimed unfit ness as a director against Mr O. In particular:

> "Mr O caused Arise Networks Ltd to trade to the detriment of creditors from 31st December 2014 onwards with no reasonable prospect of creditors being paid or of the company avoiding insolvent liquidation"

Following a trial the Judge disqualified Mr O for a period of seven years. The Judge found that Mr O caused the Company to continue to trade whilst insolvent when there was no reasonable prospect that the creditors would be paid. She further found that whilst Mr O genuinely believed that sufficient funds would one day be available to pay the Company's increasing liabilities that was not a reasonable belief in the circumstances. Mr O's belief was irrational and unjustified and that his decision to continue to trade was gambling with sums owing to creditors without regard for or compliance with proper standards.

The Judge considered that the case fell within the middle bracket as detailed in the guidance on disqualification given in **Re Sevenoaks Stationers(Retail) Ltd [1991] Ch 164**, even though there was no dishonesty found.

The Appeal

The first ground of appeal was that the Judge had applied the wrong legal test in that whilst she found there was no reasonable prospect of creditors being paid or the Company avoiding insolvent liquidation, she failed to go on and find that the appellant ought to have so concluded.

The second ground was that in disqualifying Mr O for a period of seven years that was grossly disproportionate and left out of account relevant mitigating factors.

Insolvency

The Company's business plan identified that it would not make any profits for a period of five years. Income was dependent upon advertising revenue which in turn was dependent upon a positive review from the Broadcasters Audience Research Board (BARB). That would only be available once the Company had a more substantial range of programs. This required increasing the level of production which in turn required significant capital investment. The Company had previously failed a BARB review.

Working capital was provided by group companies in Nigeria. Problems arose in September 2014 when the Nigerian Central Bank imposed foreign currency exchange restrictions following the oil price collapse. This inhibited the ability of the group to send funds to the Company.

The level of the Company's losses and debts increased significantly over the period from 31st December 2013 to 22nd April 2016, albeit the allegation of trading to the detriment of creditors was confined to the period starting 31 December 2014 through to winding up. In that time trade debts of the Company increased by a little over £2.1 million from a starting point of £3.737 million. Debts to employees increased from £465,250 in December 2014 to £2,597,583 in April 2016.

Mr O had received correspondence from a union with regard to the debt due to employees. He accepted that the Company had been trading whilst insolvent, but honestly believed that sometime in the future the currency restrictions would be eased enabling him to transfer yet more funds from Nigeria with which to pay the Company's debts.

Mr O described the Company's financial position as being subject to "pot luck" is and that losses were caused by "force majeure". At first instance the Judge found the evidence did not support any rational basis for the belief that sums will become available and that Mr O's conduct amounted to an inappropriate gamble with creditors money for which there was no justification. She concluded that Mr O's conduct was such as to render him unfit to act as a director under section 6 of the 1986 act.

Having considered the different brackets for the period of disqualification as detailed in **Re Sevenoaks Stationers(Retail) Ltd [1991] Ch 164** the Judge also considered the general guidance in **Re Westmid Packing Services Ltd [1998] BCC 836** which identified the protection of the public as being the primary purpose of disqualification and that the gravity of the offence and mitigation shall be taken into account.

Ground 1 Application of wrong legal test

This ground of appeal was that the Judge applied the wrong legal test by failing to consider and decide whether Mr O knew or ought to have known that there was no reasonable prospect of creditors being paid or of the Company avoiding insolvent liquidation.

Section 6 of the 1986 Act provides that the Court shall be satisfied that the person's conduct as a director of that company either taken alone or taken together with the person's conduct as a director of one or more other companies or overseas companies makes the person unfit to be concerned in the management of a company.

Further, the Official Receiver is required to make a statement of the matters by reference to which the defendant is alleged to be unfit to be concerned in the management of a company. That statement did not contain any specific reference to whether Mr O ought to have known that there was no reasonable prospect of paying creditors or avoiding insolvent liquidation. Mr O claiming on appeal that that was a requirement and that the judge should have made such a finding in order to make the order that she did.

In considering the authorities it was noted that in **Re Bath Glass Ltd [1988] BCLC 329** it was said that the test for wrongful trading under **section 214 of the Insolvency Act 1986** and the test in section 6 are quite different that difference being highlighted in the case of **Re Synthetic Technology Ltd [1993] BCC 549** in which it was noted that;

> "a director can permit his company to continue to trade while insolvent, while not exposing himself to a charge of wrongful trading under section 214 of the 1986 act, but still be guilty of conduct amounting to misconduct under section 6"

Further it is established law that trading whilst insolvent is not of itself sufficient to make a finding of unfitness under section 6 of the act.

Decision

The only question for the Judge was whether the statement of matters alleged in paragraph 6 of the Official Receiver's report were proved by the evidence and if so whether those matters made Mr O unfit to be concerned in the management of the Company

The Judge did not err in law by failing to apply a legal test of whether Mr O ought to have concluded that there was no reasonable prospect of creditors being paid or the Company avoiding insolvent liquidation.

Mr O was gambling with creditors money for a period of 16 months as the Company's liabilities increased by millions of pounds. The risks were unwarranted because there was no evidence or objective justification for Mr O's optimism

Whilst various authorities were referred to with a finding of trading to the detriment of creditors which had resulted in disqualification for a period of 2 to 3 years, this case involved additional factors namely:

a) the high sums involved

b) the extended period of trading while insolvent to the detriment of creditors

c) there was at no time a prospect of creditors being paid

d) the company was insolvent at all times during the period

e) that the company had no revenue which meant that it had no prospect of "trading out" of its insolvency, and

f) the finding that Mr O was gambling with creditors money

The Judge did not err in principle or law in imposing a period of disqualification of seven years.

Whilst Mr O put forward various mitigating factors they were not found to mitigate the seriousness of Mr O's irrational decision to continue to gamble with the unconnected creditors over a period of sixteen months.

Comment

- This case highlights the requirements of section 6 in order to establish that a director is unfit. When considering trading to the detriment of creditors for the purposes section 6 it should be remembered that there is little similarity with section 214 and the wrongful trading provisions.

- There was no requirement to prove that Mr ought to have known that there was no reasonable prospect of paying creditors or avoiding insolvent liquidation.

- Although this case did not involve any degree of dishonesty it was nevertheless serious enough to fall within the middle bracket for disqualification purposes as set out in **Re Sevenoaks.**

Insolvency
Legal Update

SESCA
6TH October 2022

Presented
by
Julian Dobson

Julian Dobson SOLICITORS

Re Caversham Finance Limited [2022] EWHC 789 (Ch)

Application by administrators for-

(1) **a declaration that administrations validly extended by consent, and**

(2) **to extend the administrations for another year**

Re Caversham Finance Limited [2022] EWHC 789 (Ch)

Para 78 of schedule B1 Insolvency Act 1986 defines "consent" in para 76(2)(b)

- **"consent" means consent of**

  (a) each secured creditor of the company, and

  (b) if unsecured debts, the unsecured creditors

  BUT if administrators have made statement under 52(1)(b)

  "consent" means consent of each

  (a) secured creditor

  (b) preferential creditors (if thought distribution will be made)

Re Caversham Finance Limited [2022] EWHC 789 (Ch)

- Rule 3.54(2) -reasons for extension
- Rule 15.8- contents of notices

Decision

- References in Progress Report did not satisfy rule 3.54(2)
- Notices not rendered defective if statements omitted
- Rule 12.64 applied to remedy defect under 3.54(2)
- Administrations both extended for 12 months

Re E Realisations 2020 Limited (in administration) [2022] EWHC 1575 (Ch)

- **Administrators applied for –**
- **(a) a 12 month extension of administration**
- **(b) a declaration that extension by consent was valid**

Issues-

1) **Rule 3.54(2) Notice –reasons for extension**
2) **Rule 12.64 can it remedy defect ?**
3) **Consent not filed for 8 months**

Re E Realisations 2020 Limited (in administration) [2022] EWHC 1575 (Ch)

Decision

- Procedural irregularity v Fundamental defect as to validity
- Re A.R.G. (Mansfield) Ltd [2020] EWHC 1133 (Ch)
- Procedural irregularity remedied under rule 12.64
- Administration extended for further 12 months

Howlader v Moore [2022] BPIR 985

- Trustee appealed against terms of order for possession and sale on four grounds-
- Ground 1 Order wrong to provide for vacant possession to be given after exchange of contracts.
- Ground 2 Trustee should not be ordered to keep respondents fully informed.
- Ground 3 Order should include provisions requiring respondents to cooperate in sale.
- Ground 4 Mr Moore should pay costs as opposed application.

Howlader v Moore [2022] BPIR 985

Decision

Ground 1	Mrs Moore’s verbal assurance of cooperation meant that court would not interfere with decision
Ground 2	Dismissed as no reason why Mr Moore should not be kept informed.
Ground 3	No need for cooperation provision in light of Mrs Moore’s verbal assurance.
Ground 4	Mr Moore would not be ordered to pay costs.

Khan v Habib Bank AG Zurich [2022] EWHC 1913 (Ch)

- Application to annul under s282(1)(a) – order ought not to have made

- Judge exercised her discretion and refused application

- Bankrupt appealed on following grounds-

  1. Annulment on ought not to have been made should be only be refused in exceptional circumstances

Khan v Habib Bank AG Zurich [2022] EWHC 1913 (Ch)

2. Judge failed to give sufficient weight to bankrupt's operation
3. Judge had found delay yet no time limit to apply to annul
4. Finding that bankrupt had insufficient liquidity wrong
5. Inference that some creditors claims might become statute barred wrong
6. Trustee had no intention of continuing investigations

Khan v Habib Bank AG Zurich [2022] EWHC 1913 (Ch)

Decision

- Ground 1 dismissed no exceptional circumstances requirement – Judge correct to exercise discretion
- Grounds 2 and 6 Judge found lack of cooperation and justified in exercising discretion –dismissed
- Ground 3 Delay complaint dismissed
- Ground 4 Judge applied cash flow test = lack of liquidity ground dismissed
- Ground 5 Limitation was factor Judge may take into account - dismissed

Lemon v Gallagher [2022] BPIR 104

24th December 2003	Declaration of Trust re No 48 the block
14th July 2011	Flat 6 transferred to son
5th April 2015	Rent and service charges paid up to this date to Mr Gallagher
15th May 2015	Bankruptcy petition presented
2nd October 2015	Bankruptcy order Mr Gallagher

Lemon v Gallagher [2022] BPIR 104

- Trustees challenged declaration under s423 Insolvency Act 1986 (“IA86”)
- Declaration was a sham
- Transfer of Flat 6- alleged transaction at an undervalue caught by s339 IA86

Lemon v Gallagher [2022] BPIR 104

Decision

- The Declaration was a sham
- It would have been in breach of s423 IA86
- It was a transaction at an undervalue under s339, the undervalue being £70,000
- The bankrupt's son ordered to pay the undervalue

Thomas v Yurova [2022] EWHC 2112 (Ch)

- Trustees application under s366 IA86 –banks
- Mrs Yurova's application against Trustees for disclosure
- Legal advice on Russian matrimonial law
- Statement declaring not waiving privilege

Thomas v Yurova [2022] EWHC 2112 (Ch)

Decision

- Non waiver of privilege statement of no effect
- Trustees had deployed Russian matrimonial advice in proceedings
- Fairness and risk of injustice
- Advice to be disclosed in full
- Instructions to be disclosed
- Communications with lawyer advising to be disclosed

Brothers Produce Ltd v Tydene (Western) Ltd [2022] EWHC 291 (Ch)

Chronology

13th February 2015	Winding up petition
10th March 2015	Petition advertised
12th March 2015	Company assigns “assets” to Mr Tarim
17th March 2015	Mr Tarim transfers “assets” to TWL
21st March 2015	TWL commences trading
30th March 2015	Winding up order against Company

Brothers Produce Ltd v Tydene (Western) Ltd [2022] EWHC 291 (Ch)

Liquidators' claims-

a) Damages for goodwill on restitutionary basis

b) An account for profits gained from assets

c) Damages for unjust enrichment

d) Equitable compensation for knowing receipt

Brothers Produce Ltd v Tydene (Western) Ltd [2022] EWHC 291 (Ch)

Decision

- Transfer of goodwill was at an undervalue
- Valuation to be on basis of past performance
- Mr Tarim was aware of insolvency s172(3) CA 2006 engaged
- Directors were misfeasant
- Directors ordered to pay compensation for undervalue

Re Changtel Solutions UK Limited [2022] EWHC 694 (Ch)

- 7th June 2013   Winding up petition presented
- 28th January 2015 Winding up order
- 22nd January 2021 Application issued by Liquidators

Liquidators' claim under s127 Insolvency Act 1986 opposed on following grounds-

1) Application time barred
2) Cheque payment made before presentation of petition
3) Court should validate payments
4) Respondents change of position defence

Re Changtel Solutions UK Limited [2022] EWHC 694 (Ch)

- **Principles in Express Electrical Distribution Ltd v Beavis [2016]**

1) **Assets at commencement to be rateably distributed amongst unsecured creditors –pari passu principle**

2) **Sometimes beneficial to complete a particular contract**

3) **Court will ensure interests of unsecured creditors not prejudiced**

4) **Court will not validate if a pre liquidation creditor is paid in full at expense of others in absence of *Special circumstances***

5) ***Special circumstances* must exist for a transaction to be validated overriding pari passu principle**

Re Changtel Solutions UK Limited [2022] EWHC 694 (Ch)

6) **Retrospective validation should be looked at with hindsight**
7) **Incorrect to say transaction in good faith and parties unaware of petition will be validated**
8) **Save in Exceptional circumstances a validation order should only be made if *Special circumstances* and appropriate to disapply pari passu principle**
9) **Where a company has traded at a loss operation of it's bank account should not be validated for ordinary trading to the extent of the loss**

Re Changtel Solutions UK Limited [2022] EWHC 694 (Ch)

Decision

- There were no Special or Exceptional circumstances justifying departure from the pari passu principle
- The respondent could not rely on change of position
- The claim was not time-barred
- Cheque payment was void
- Validation order for payments refused

Hamilton v McAteer [2022] EWHC 1349 (Ch)

- **Liquidators' claim under s212 IA 86 against de jure and de facto directors**

- **Directors' strike out application**
  1) **Liquidators' claim to recover PSA fine = abuse of process**
  2) **Directors breach of duty could be ratified under Re Duomatic**
  3) **Remuneration and other payments ratified under Duomatic**
  4) **Directors sought exclusion of Report**

Hamilton v McAteer [2022] EWHC 1349 (Ch)

Decision

- Although the matter was yet to be heard at trial;
- The Directors would have been aware that following suspension of the service they could expect a fine from the PSA
- The Duomatic principle does not apply where a company is insolvent –Kinsella v Russell Kinsella Pty Ltd (in liq)(1986) 10 ACLR 395
- The IMI/Tap2Bill report is an important part of factual background
- Strike out application dismissed

Kelmanson v Gallagher & De Weyer [2022] 682 BPIR

Chronology

21st May 2014	Company incorporated Mr G and Ms De W directors
17th August 2014	Board resolution for D’s loans to Company
10th November 2014	Ms De W pays £210,500 to Company
14th July 2016	Ms De W resigns as D
18th October 2016	Company settlement with Fournier
8th February 2017	Company completes sale of premises
9th February 2017	Company pays £315,750 to De Weyer Design Ltd (“Design”)
10th February 2017	Design pays £105,200 to Mr G and £210,500 to Ms De W
21st March 2017	Company goes into voluntary liquidation

Kelmanson v Gallagher and De Weyer [2022] BPIR 682

Liquidator's claims-

1) **Payments of £105,200 and £210,500 to Mr G and Ms De W were preferences within s239 Insolvency Act 1986**

2) **That Mr G had breached his duties under s172 and s175 Companies Act 2006 and s212 Insolvency Act 1986**

Kelmanson v Gallagher and De Weyer [2022] BPIR 682

- "Relevant time"
- Payments made by Design not the Company
- Mr G claimed he was a secured creditor
- Influenced by a desire

Decision

1) Mr G ordered to repay preference of £105,200
2) Ms De W ordered to repay preference of £210,500
3) Mr G ordered to pay £315,715 for misfeasance

Manolete Partners Plc v Dalal [2022] EWHC 1597 (Ch)

Manolete's claims-

a) The Company made more money than disclosed in it's accounts.

a) Properties were purchased using Company money

a) Directors authorised payments to themselves in breach of duties

b) Newco acquired business without paying for goodwill

Manolete Partners Plc v Dalal [2022] EWHC 1597 (Ch)

Issues-

- **Additional sales receipts**
- **HMRC's "Business Economics Exercise"**
- **Were Sajid and Anisha Directors after 20th June 2008?**
- **De facto directors?**

Manolete Partners Plc v Dalal [2022] EWHC 1597 (Ch)

Decision

- Neither Sajid or Anisha acted as directors after 2008
- Judge's estimate of Company income concluded there were no additional sales receipts
- Property claims dismissed (save for £250k gift)
- Repayment of loan of £250K to Sajid and Anisha was at time when Company insolvent
- Ebrahim in authorising repayment of £250k loan in breach of his duties as a director
- Company could trace £250k into property purchased by Sajid and Anisha
- Payments of £7000 to Sajid and Anisha to be repaid

Official Receiver v Obaigbena [2022] EWHC 1399 (Ch)

Appeal against 7 year disqualification order

Appeal grounds-

1) **The Judge had failed to find that Mr O knew or ought to have known that there was no reasonable prospect of creditors being paid or the Company avoiding insolvent liquidation**

2) **7 years was grossly disproportionate and did not take account of mitigating factors**

Official Receiver v Obaigbena [2022] EWHC 1399 (Ch)

Decision

- Judge correct to base finding on whether evidence in Official Receiver's report made out. Ground 1 dismissed

- Ground 2 –

  Additional factors supported 7 year order.

  Mitigating factors did not mitigate disqualification period

- Ground 2 dismissed

www.juliandobson.com

Julian Dobson SOLICITORS