Julian Dobson SOLICITORS *Insolvency Lawyers*

Recent developments in Insolvency Law

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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:

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Introduction

Whilst the numbers of both personal and corporate insolvencies are currently at an historical low, some key legislative changes have recently been brought into effect.

In this presentation we will look at some of the more significant and interesting changes.

Legislative changes which came into effect on 1st October 2015

A number of legislative changes came into effect on 1st October 2015 which are contained in the **Deregulation Act 2015.** Further changes have also have been brought into effect from 1st October 2015 under the **Insolvency (Amendment) Rules 2015.**

Fees – Advance information and fees estimates

The **Insolvency (Amendment) Rules 2015** now require office holders to provide all creditors with an estimate of their fees when they are seeking remuneration on a time costs basis. The estimate will require creditor approval both for the amount and basis on which the remuneration is sought.

The office holder will be required to give an indication of the likely work that will be needed in a case, and provide details of anticipated expenses. An estimation of likely legal expenses, i.e, legal costs likely to be incurred will be for information only and will not require creditor approval.

The estimate must be provided to creditors at an early stage and in sufficient time to enable creditors to consider the fee estimate and make an informed decision about the reasonableness of it before approving both the basis of remuneration and the fee estimate.

In the case of a creditors voluntary liquidation, it would not be sufficient to provide the information at the **Section 98** meeting and expect creditors to approve it at that meeting. The estimate should be provided in advance of the meeting and in cases where it is only available at the meeting, the approval of both the basis and estimated amount of the remuneration should be dealt with by a subsequent resolution passed in correspondence.

The Office Holder will not be able to exceed the total amount of the fees estimate. However there will be cases where the Office Holder incurs costs in excess of the fees estimate before approval is sought/obtained. Whilst the fees can continue to be incurred pending approval, they cannot be drawn down and taken until subsequently approved by creditors.

The provision of estimates will be challenging and whilst it is permissible to provide an estimate up to a particular mile-stone and then seek further approval at a later stage, it will not be permissible to provide a range of possible fees. The estimate should be one clear and absolute figure and must be fixed. Any subsequent change may only be made with creditors' subsequent approval of a revised fees estimate.

Whilst it is not possible to provide a range of fee remuneration for the Office Holder, it will be permissible to provide an estimate which provides for a range of possible fees likely to be incurred by the Office Holder i.e, legal fees in the case of litigation.

The provision of estimates represents a significant challenge to the way in which Office Holders both seek their appointment and the level of remuneration incurred. At this early stage, it is difficult to say what the impact will be in practical terms. It is not clear to what extent creditors will flex their muscles to require practitioners to reduce estimated figures prior to creditors approving both their appointment and the fees estimate involved. Similarly it remains to be seen whether the provision of estimates will create a more competitive environment between different insolvency practitioners in seeking an appointment.

Bank accounts for bankrupts

The **Deregulation Act 2015** brings in changes to the provisions of **S307** of the **Insolvency Act 1986** which deals with after-acquired property. That section enables a trustee to claim any property which has been acquired or has devolved upon the bankrupt since the commencement of the bankruptcy. The bankrupt is under an obligation to disclose any such property to his trustee. Following the trustee receiving notice of such property from the bankrupt, the trustee has 42 days in which to claim by notice the property as after-acquired property. The trustee may not claim any property acquired or devolved upon the bankrupt after he has received his discharge from bankruptcy (usually one year from the date of the bankruptcy order).

The provisions that provide protection for third parties, including bankers dealing in good faith and without notice in this provision have been amended to provide that the banks who operate bank accounts containing monies which may be claimed as after-acquired property, will be protected provided they have not been served with a specific notice claiming funds within that account as after-acquired property by the trustee. This change has been brought in in order to provide bankers with a greater degree of safety in dealing with bankrupts' bank accounts. The banks have indicated that following the implementation of this change they will provide basic banking facilities to bankrupts in the future.

Bankruptcy petition debt level

The minimum level of debt in respect of which a creditor can present a bankruptcy petition has increased from £750 to £5,000 for petitions presented on or after 1st October 2015. This change was introduced by the **Insolvency Act 1986 (Amendment) Order 2015**.

The bankruptcy level had remained unchanged for many years and had been regarded by many as being too low. The consequences of bankruptcy being potentially disproportionate to the level of debt involved in small debt cases. This was particularly the case with bankruptcy petitions brought by Local Authorities for arrears of Council Tax. In some cases petitions were presented for arrears as little as £850 which resulted in a bankruptcy order being made and ultimately the bankrupt's home being re-possessed. The increase to £5,000 has taken some commentators by surprise as to the level of increase involved. Whilst we await to see the practical effects of the change work through, it is apparent that some petitions will no longer be presented as the debt remains too small. On the other hand it is possible that creditors will simply wait to allow the debts to accrue up to and over the bankruptcy level before petitioning.

The new minimum level of £5,000 is now more consistent with the significantly increased costs in presenting a bankruptcy petition (£280) and the payment of the Official Receiver's deposit (£750) on issue. A further possible effect is that once the bankruptcy order is made, it is likely to be more difficult for some bankrupts to raise sufficient funds to pay off the petition debt and the expenses enabling them to annul the bankruptcy order at an early stage.

Protection of Essential Supplies

The Insolvency (Protection of Essential Supplies) Order 2015 (SI 2015/989) came into effect on 1st October 2015. Its purpose is to give further protection to the essential supplies of insolvent businesses. It extends the scope of **section 233** for corporate insolvencies and **section 372** for individual insolvencies of the **Insolvency Act 1986** to include a wider list of private suppliers of gas, electricity, water or communication services including the supply of utilities from a landlord to tenant. The scope of these sections is also expanded to include the supply of certain goods and services that are made for the purpose of enabling or facilitating anything done by electronic means. These are:

- point of sale terminals;
- computer hardware and software;
- information, advice and technical assistance in connection with the use of information technology;
- data storage and processing;
- website hosting.

The order also inserts new provisions which provide further protection for essential supplies in administrations and company and individual voluntary arrangements. These provisions prevent suppliers from terminating a supply or contract, or altering the terms of the contract or compelling higher payments for the supply, when a company enters into administration or when a voluntary arrangement is approved in respect of a company or individual.

The supplier may terminate the contract if:

- the insolvency office holder consents,
- the court grants permission (which it may only do if it is satisfied that the continuation of the contract would cause the supplier hardship), or
- charges in respect of a supply incurred after the insolvency began remain unpaid for 28 days after the date due for payment.

The supplier may also terminate a supply if it gives the office holder written notice that it requires a personal guarantee to continue the supply and the office holder does not give the guarantee within 14 days.

Sections 233A and **372A** only apply to contracts entered into after 1 October 2015.

Administration – fraudulent and wrongful trading

The **Small Business, Enterprise and Employment Act 2015** (SBEEA 2015) **section 117** extends the power to bring actions for fraudulent or wrongful trading to administrators. Previously such actions could only be commenced by a liquidator.

Power to assign causes of action

Where a company is in administration or liquidation, the office holder may assign a right of action (including the proceeds of an action) arising under any of the following:

- section 213 or 246ZA (fraudulent trading);
- section 214 or 246ZB (wrongful trading);
- section 238 (transactions at an undervalue (England and Wales));
- section 239 (preferences (England and Wales));
- section 244 (extortionate credit transactions).

(**SBEEA 2015, section 118**)

Previously an office holder could assign a cause of action but only those causes of action vested in the company and in the case of individual insolvency, in the individual. An office holder was previously not permitted to assign any of the statutory type claims that belong to an office holder exclusively. Under the changes brought in by **SBEEA 2015 section 118**, an office holder may now assign an action such as wrongful trading, transactions at an undervalue and preferences. This will in some cases enable a liquidator to realise a benefit of such an action without having to take the action himself. From a director's point of view facing such a potential action, previously a director may have been able to avoid such action where the liquidator either had insufficient funds or will to pursue the claim. Now there are an increasing number of companies specialising in pursuing insolvency litigation who will potentially be more willing to take on such claims against directors.

At present in insolvency litigation the office holder still retains the right to recover a success fee under a conditional fee agreement from the opposing party in the event that the claim is successful. Similarly for such claims the ATE insurance may also be recovered from the losing party. That exemption from the changes that were previously brought in to the operation of conditional fee agreements, is still in operation although it is due to come up for review in the near future and may well be removed. The argument being that this now gives office holders, and their assignees, an unfair advantage in litigation against directors and individuals for insolvency related claims.

Debt relief orders – changes to monetary limits

The maximum level of debts for eligibility for a debt relief order is increased from £15,000 to £20,000, and the maximum value of property increased from £300 to £1,000. The change is introduced by the **Insolvency Proceedings (Monetary Limits) (Amendment) Order 2015(SI 2015/26)**.

Extension of period for applying for a disqualification order

The period within which an application for a disqualification order must be made is extended from two years to three years. (**SBEEA 2015, section 108**)

Dealing with client's potential insolvency

Sometimes it may be just a throw-away remark that you may hear as a solicitor that your client is potentially insolvent. Other clients are more forthcoming and may come to you for advice and produce to you copies of correspondence they have received from creditors' solicitors or other organisations such as HMRC. In the case of corporate clients they may also let slip the fact that the company is potentially facing insolvency. Whilst you may not be expected to provide them with detailed insolvency advice as to matters facing a client, it can layer a client's instructions or transaction with an additional level of concern.

One of the most common scenarios involves correspondence received from HMRC. Often there is a lengthy exchange of correspondence between the debtor and HMRC either directly or via the debtor's accountants concerning tax and other sums claimed by HMRC. Invariably the sums are disputed, and the debtor and his advisors, usually accountants, but sometimes also solicitors, continue to argue and dispute HMRC's claim.

Whilst the dispute continues, the debtor and his advisors feel justified in ignoring HMRC'S threats that a petition may be issued. The dispute remains unresolved and ultimately a bankruptcy or winding up petition is presented against the individual. Howls of indignation follow, often with a degree of finger pointing.

The consequences of a petition having been issued are serious and potentially bring into play the provisions of **s127** in the case of the **Insolvency Act 1986** in the case of companies and **s284** of the **Insolvency Act 1986** in the case of individuals.

> **127 Avoidance of property dispositions, etc.**
>
> **127(1) [Dispositions etc. void after commencement of winding up]** In a winding up by the court, any disposition of the company's property, and any transfer of shares or alteration in the status of the company's members, made after the commencement of the winding up is, unless the court otherwise orders, void.
>
> **127(2) [No effect on administrator while petition suspended]** This section has no effect in respect of anything done by an administrator of a company while a winding-up petition is suspended under paragraph 40 of Schedule B1.
>
> **284 Restrictions on dispositions of property**
>
> **284(1) [Where person adjudged bankrupt]** Where a person is adjudged bankrupt, any disposition of property made by that person in the period to which this section applies is void except to the extent that it is or was made with the consent of the court, or is or was subsequently ratified by the court
>
> **284(2) [Application of s.284(1) to payment]** Subsection (1) applies to a payment (whether in cash or otherwise) as it applies to a disposition of property and, accordingly, where any payment is void by virtue of that subsection, the person paid shall hold the sum paid for the bankrupt as part of his estate.

284(3) [Relevant period] This section applies to the period beginning with the day of the presentation of the petition for the bankruptcy order and ending with the vesting, under Chapter IV of this Part, of the bankrupt's estate in a trustee.

284(4) [Limit to effect of s.284(1)-(3)] The preceding provisions of this section do not give a remedy against any person -

(a) in respect of any property or payment which he received before the commencement of the bankruptcy in good faith, for value and without notice that the petition has been presented, or

(b) in respect of any interest in property which derives from an interest in respect of which there is, by virtue of this subsection, no remedy.

284(5) [Debt after commencement of bankruptcy] Where after the commencement of his bankruptcy the bankrupt has incurred a debt to a banker or other person by reason of the making of a payment which is void under this section, that debt is deemed for the purposes of any of this Group of Parts to have been incurred before the commencement of the bankruptcy unless -

(a) that banker or person had notice of the bankruptcy before the debt was incurred, or

(b) it is not reasonably practicable for the amount of the payment to be recovered from the person to whom it was made.

284(6) [Property not in bankrupt's estate] A disposition of property is void under this section notwithstanding that the property is not or, as the case may be, would not be comprised in the bankrupt's estate; but nothing in this section affects any disposition made by a person of property held by him on trust for any other person.

Whilst both provisions only apply in the event that a subsequent bankruptcy order or winding up order is made, following the making of such an order their effect is retrospective. In the case of corporate insolvency, it is the effect of **s127** which will following the advertisement of the petition result in the company's bank accounts being frozen. They is likely to have an immediate and severe impact on the company's ability to trade.

Whilst it is possible to apply to court for a validation order under **s127** of the **Insolvency Act 1986** the procedure is involved and the hurdles that have to be overcome in order to obtain an order are significant. In essence, the court will not grant a validation order unless the transactions that it is being asked to validate i.e, the operation of a bank account, can be shown to be for the benefit of unsecured creditors.

It is sometimes mistakenly believed that a bankruptcy petition or winding up order can be successfully challenged on the grounds that it is based on assessments raised by HMRC which the debtor and his advisors consider to be wrong. Unfortunately there are numerous authorities which confirm that the position is otherwise and that a winding up order/bankruptcy order may be made on the basis of assessments only.

Bankruptcy and conveyancing

The recent decision in **Kandola v Mirza Solicitors LLP [2015] EWHC 460 (Ch)** examined the extent of a solicitor's duty to undertake bankruptcy searches against a vendor in a conveyancing transaction.

The claimant in this case sued his former solicitors for negligence. He had previously instructed them to act on a purchase of a property in 2010 for £425,000. On exchange of contracts a deposit of £96,000 was paid on terms, unusually that it be held by the vendor's solicitors, as agents for the vendor. The vendor did not complete, the deposit was lost, and the vendor was subsequently made bankrupt. The solicitor who acted for the vendor disappeared, and the SRA intervened. The two principals in the vendor's solicitors firm were struck off.

At the time of the purchase a bankruptcy petition was outstanding against the vendor. The claimant alleged that his solicitors were negligent and in breach of contract because he argued that he should have received better advice about the risks involved which would have revealed the bankruptcy petition. The defendants argued that he had been advised specifically of the risks and that the client had elected not to follow the advice.

The decision in this case was that the claim was dismissed. The court noted that the standard of a solicitor's duty was not that of a particular meticulous and conscientious practitioner, but what a reasonably competent practitioner would do having regard to the standards normally adopted in the profession.

The court referred to the Law Society's conveyancing handbook and acknowledged that it was a good guide to accepted practice.

The solicitor was required to explain matters in such a way that reflected the relevant experience of the client. The advice that had been given was that the solicitor had advised as to the possible risk of the loss of the deposit.

The client was further advised that the vendor might not be able to complete the contract and might become bankrupt. The client was advised that in such circumstances the contract would not be completed and the claimant would have to look to the vendor to repay the deposit which he might be unable to do, particularly if he was bankrupt.

The court further held that it was not the solicitor's duty if advising of the risk of the vendor's insolvency to make searches that would have revealed the existence of the bankruptcy petition. This is so even if such a search would have revealed the existence of a petition before exchange had it been undertaken. It was not the solicitor's duty to check on the credit status of his client's counter-party in a transaction unless instructed to do so. The report states:

> *"A solicitor might have to check specifically for the commencement of bankruptcy proceedings, since that might affect a party's ability to complete a transaction or give a good title, but that was not the same as a general duty to make checks about risk of futures insolvency."*

The court held that the solicitor was not under a duty to make either a bankruptcy search or Land Registry search prior to exchange.

Solicitor's practice and the Statutory Trust

The recent decision in **Williams v The Law Society [2015] EWHC 2302 (Ch)** examined the effect of the statutory trust on a solicitor's practice. The case concerned a solicitor whose practice was intervened by the SRA.

Under **Paragraph 6 Part II** of **Schedule 1** of the **Solicitors Act 1974:**

> 6(1)......if the Society passes a resolution to the effect that any sums of money to which this paragraph applies, and the right to recover or receive them, shall vest in the Society, all such sums shall vest accordingly (whether they are received by the person holding them before or after the Society's resolution) and shall be held by the Society on trust to exercise in relation to them the powers confirmed by this part of the Schedule and subject thereto and to the rules under paragraph 6B upon trust for the persons beneficially entitled to them."

The above provisions are referred to as the Statutory Trust. In this particular case the court had to determine the extent of the statutory trust and in particular whether Legal Aid monies fell within a solicitors "practice" and were therefore subject to the statutory trust. If so they vested in the SRA and not Mr. Williams.

The provision itself relates to not only the solicitor's practice but also his *"former practice"*. There was concern that this could affect firms where a solicitor was previously involved with a firm but had subsequently left. On this point the Judge confirmed that it only related to the individual solicitor's practice or *"former practice"* and that all other monies held by a former firm would be untouched by the statutory trust.

One of the effects of the statutory trust is that it severely limits the options available to an insolvent solicitor and his practice where there is a risk of subsequent intervention. An insolvent solicitor may enter into an individual voluntary arrangement with his creditors which provides for him in conjunction with his Supervisor to realise the assets of his business which may include outstanding work in progress and uncollected book debts for the benefit of his creditors. The difficulty is that if that solicitor's practice is subsequently intervened, then all work in progress, book debts and other monies belonging to the solicitor's practice automatically vest in the SRA and cannot be dealt with under the terms of the individual voluntary arrangement.

This would also apply in the case of bankruptcy and whilst the **s306** of the **Insolvency Act 1986** provides that the bankrupt's assets automatically vest in his bankruptcy estate/trustee, that provision is in direct conflict with the statutory trust and the vesting provisions contained in the **Solicitors Act 1974** in the event of a subsequent intervention. This presents real practical difficulties to an insolvency practitioner advising an insolvent solicitor and his practice as to the options available to him particularly if there is a risk of intervention.

Appendix

Williams v The Law Society [2015] EWHC 2302 (Ch)

A Solicitor's practice and the Statutory Trust

Facts

This was an application by a solicitor, Mr. Williams, who applied to enforce the terms of a consent order entered into with the Solicitors Regulation Authority (SRA) providing for certain sums received by the SRA from the Legal Aid Agency to be paid to Mr. Williams.

Mr. Williams had been in practice as a solicitor in a partnership with a Mr. Lillywhite. With effect from 1 February 2014 they converted the partnership to an LLP of which they were the sole members.

On 28 October 2014 the SRA resolved to intervene in the practice of the LLP and another practice, Nationwide Solicitors LLP and also in the individual practices of Mr. Williams and Mr. Lillywhite.

On 4 November 2014 Mr. Williams issued an application for an order that the intervention be withdrawn. That resulted in a consent order being made which withdrew the intervention with regard to Mr. Williams' practice and lifted the automatic suspension of his practising certificate. It had no effect on the intervention in the other practices.

Following the resolution being passed to intervene the provisions of Paragraph 6 of Part II of Schedule 1 of the **Solicitors Act 1974** applied. It provides:

> "6(1)......if the Society passes a resolution to the effect that any sums of money to which this paragraph applies, and the right to recover or receive them, shall vest in the Society, all such sums shall vest accordingly (whether they are received by the person holding them before or after the Society's resolution) and shall be held by the Society on trust to exercise in relation to them the powers confirmed by this part of the Schedule and subject thereto and to the rules under paragraph 6B upon trust for the persons beneficially entitled to them."

Subsection 2 of the paragraph continues:

> "(2) This paragraph applies - (a) where the powers conferred by this paragraph are exercisable by virtue of paragraph I to all sums of money held by or on behalf of the solicitor or his firm in connection with –
>
> > (i) <u>his</u> practice or <u>former</u> practice,
> >
> > (ii) any trust of which he is or formerly was a trustee, or
> >
> > (iii) any trust of which a person who is or was an employee of the solicitor is or was a trustee in the person's capacity as such an employee;..."

The trust referred to in paragraph 6B is referred to as "the statutory trust". The rules referred to are the **Intervention Powers (Statutory trust) Rules 2011**. Those rules require the SRA to identify and, subject to verification, distribute to all persons who have a potential beneficial interest in them the monies held in the statutory trust accounts for which they provide.

The issue the court had to consider was the scope of the statutory trust and in particular whether or not it extended to monies which could be shown to belong to the practice when it was conducted in the name of the partnership. Mr. Williams claimed that those monies were not caught by the statutory trust whilst the SRA maintained that they were.

The SRA following the intervention had received a payment from the Legal Aid Agency in the sum of £62,826. Mr. Williams claimed that those monies related to the partnership and therefore he was entitled to them. He wrote to the SRA requesting that sum be paid to him. The SRA responded by asking him to provide evidence in support of his claims. However before providing a response to the SRA's letter Mr. Williams issued the current application.

Before the application was heard the SRA reached terms whereby it was agreed that a sum of £22,552 would be paid to Mr. Williams and that a further payment of £22,108 would also be released to him. There was some delay on the part of the SRA in reaching agreement with regard to the latter sum as it was concerned that the Legal Aid Agency may seek to recover part of the monies that it had paid over to the SRA. The reason for this was that the partnership operated under a franchise agreement. Following the conversion of the partnership into the LLP, the franchise agreement was never transferred to the LLP. It was also noted that on the transfer to the LLP the partnership ceased to have any professional indemnity insurance.

During the course of submissions it was noted that Mr. Williams had suffered the draconian consequences of an intervention which can result in:

(a) A loss of control of practice monies and documents

(b) Suspension of the Solicitor's Practising Certificate

(c) The solicitor becomes instantly unemployable

(d) The costs of intervention are to be paid by the solicitor and are recoverable as a debt.

A further concern was the reference in **Regulation 6(2)** to *"former practice"*. The Judge expressed concern that the reference to former practice could automatically catch and vest in the SRA practice monies held in connection with other practices from which the solicitor in question had moved and in some cases had no doubt had long moved prior to the intervention into the practice named in the resolution. It was recognised that this would cause significant practical complications.

Decision

The Judge considered that the key to the matter was to understand what is meant by the expression "practice". In this context it means the activities of the solicitor or authorised body so far as carried out in that capacity

The Judge concluded that the Legal Aid monies insofar as they were attributable to the activities of Mr. Williams (as deriving from his "practice") while a member of the partnership fell within the scope of the statutory trust imposed by paragraph 6(1) as being sums held by or on behalf of the solicitor or his firm (or the recognised body) in connection with his (or its) practice or former practice.

The Judge acknowledged that in argument it had been explained that the statutory trust only operates in respect of monies held by the Solicitor or his firm in connection with that solicitor's practice or former practice. All other monies held by the former firm are untouched by the statutory trust.

Comment

- Whilst vesting only takes place following the Society passing a resolution to intervene, the effect of the resolution is retrospective.

- The SRA's position is that it also applies to work in progress despite the fact that until realised it would not ordinarily be a sum of money. Following intervention the intervening solicitor or his trustee/liquidator/administrator retains the right to recover practice debts. The effect of paragraph 6 would be to vest any sums actually recovered in the SRA. In **Dooley v The Law Society [2001**] Lightman J confirmed that an intervened solicitor could take action to recover costs but then stated that:

  "First, any recovery automatically vests in the Society. Second implicit in the statutory scheme a solicitor is precluded from any dealing with the debts before payment which operates to evade or undermine the scheme and protection intended to be afforded to clients and the Society."

- As an insolvency practitioner seeking an appointment in respect of a solicitor's practice, careful consideration should be given to the risk of a subsequent intervention and the effect that it may have on the way in which the assets and liabilities of the practice are dealt with.

Wilson v SMC Properties Limited [2015] EWHC 870 (Ch)

Court validates sale of property post petition – Section 127 of the Insolvency Act 1986

Chronology

17 February 2013	Short-term loan to company for £600,000 from Unitguide Limited (secured)
26 February 2014	HMRC issue winding up petition
6 March 2014	Contract for Sale of property for £850,000 to SMC
4 April 2014	Completion of sale of property to SMC
14 April 2014	Winding up order

Facts

The company operated from a property at 58G Hatton Garden, London EC1N 8LX ("the Property") from where it traded as a scrap gold and silver merchant. The Property had been purchased in 2011 for £1.2 million. On 7 February 2013 the company borrowed £600,000 on a short term loan from Unitguide Limited which was secured over the Property by means of a charge.

On 6 March 2014 the company agreed to sell the Property to SMC for £850,000. The contract for sale having been entered into after the presentation of the petition to wind the company up by HMRC on 26 February 2014. Completion of the sale took place on 4 April 2014 when the proceeds were distributed £631,049 to Unitguide the holder of the secured charge and £217,366 was paid into the personal bank account of the sole director.

Following the appointment of the liquidator, enquiries by the liquidator's staff established that the director of SMC and the solicitors acting for SMC on the purchase of the Property were unaware of the outstanding winding up petition.

Prior to the sale having been agreed, the Property had been marketed at £1.5 million and contracts had been issued to potential purchasers for £1.1 million and £1.3 million. Both of those sales failed to proceed. During the course of the proceedings it was stated that had the company not sold the Property to SMC, Unitguide would have entered possession and would have sought to sell the Property to recover its debt.

The applications before the court were firstly to validate the sale of the Property under **s127** of the **Insolvency Act 1986** ("s127") and alternatively the liquidator sought a declaration that the transaction was void and sought relief against the sole director of the company.

s127 provides that that in a winding up by the court,

> *"any disposition of the company's property made after the commencement of the winding up is void unless the court otherwise orders".*

The court considered the principles behind the section which it identified as the maintenance of the pari passu principle namely that the estate of the insolvent should be distributed rateably among creditors of the same class. The essential purpose of the principle is that by preserving the pari passu distribution of the company's assets it protects the interests of unsecured creditors.

In deciding whether or not to validate a transaction the court has a discretion and in exercising that discretion it carries out a balancing exercise weighing the interests of the general body of creditors against the target transaction under scrutiny. The principles under which the discretion will be exercised were set out in **Denney v John Hudson & Co Ltd [1992] BCLC 901**. They include the following:

(a) The policy underlying s.127 is that the assets of the insolvent should be distributed pari passu among the same class of creditors

(b) There may be situations where it is beneficial for the company and unsecured creditors that dispositions in the closing period are validated to enable the company to continue business in its ordinary course. In making its decision the court should ensure that the interests of unsecured creditors are not prejudiced.

(c) A disposition made in good faith in the ordinary course of business at the time when the parties were unaware that the winding up petition had been presented normally will be validated unless there are grounds for supposing that the payment was intended to prefer the recipient above other unsecured creditors.

(d) Good faith alone is not enough. The court should have regard to the interests of all creditors and not just certain creditors.

Registrar Briggs further added that the court would be slow to validate a transaction where there was a significant reduction in the Company's assets. The further away from value a transaction is or was the less likely it is that the court will find that it was made in good faith.

For SMC it was argued that they had entered into the transaction without knowledge of the petition, in good faith and had purchased the Property for full or near full value. The liquidator's position was that the transaction was not entered into in good faith and was at an undervalue.

Decision

Registrar Briggs heard evidence from the key witnesses. He accepted that the director of SMC and his solicitor were not aware of the presentation of the petition.

The Registrar considered in detail the differing methods of valuing the Property and took into account both its condition, costs of refurbishment and its value as an investment. Having conducted that exercise he stated that he had reached "the conclusion that the appropriate sum is £900,000".

He accepted that had the sums due to Unitguide (the secured creditor) not been repaid by 6th April Unitguide would have entered into possession of the Property and sold the Property.

Registrar Briggs held that SMC had entered into the transaction in good faith and that the sale of the Property at £850,000 meant that the company had in theory (against the value that he had held) suffered a loss of approx. £50,000.

He therefore held that there had been no significant loss to creditors and that the policy behind s.127 had not been undermined. He exercised his discretion to validate the transaction.

Comment

- The outcome of this case depended upon the conclusion reached as to value after having considered various valuation approaches.
- Whilst the Registrar held that there had been no loss to creditors it is not explained in the judgment as to the position with regard to the £217,366 paid to the director's personal bank account after the secured creditor Unitguide had been paid in full. If that money had been returned to the company, then this would explain the Registrar's findings that there was no loss to unsecured creditors.
- The original TR1 signed by the director of the company was subsequently rejected by HM Land Registry as it had not been attested. The document was then later attested by someone at the solicitors acting on behalf of the company's solicitors and then re-submitted. A more detailed explanation would assist in understanding exactly what took place. Nothing further seems to have turned on this point.
- In evidence the director of the purchasing company, a key witness, had to subsequently accept that earlier statements he had made were incorrect as a result of the liquidator obtaining metadata attached to photographs taken by the witness on one of his visits to the Property.