

# Insolvency: transactions at an undervalue

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## Author(s)

Morwenna Macro - Five Paper

Office-holders have the power to challenge transactions that appear to have been made for nil consideration or significantly less than value, have them set aside, and restore the position for the benefit of creditors. This is an important set of provisions allowing for the recovery of assets where the insolvent person has sought to put such beyond the reach of creditors or benefit a connected party (or has simply acted imprudently).

## Overview of Topic

1. The power to adjust prior transactions at an undervalue is contained in ss.238 and 339 of the Insolvency Act 1986 for companies and individuals respectively. The provisions apply to companies in administration or liquidation and to individuals adjudged bankrupt. The office-holder (administrator or liquidator for companies; the Trustee in Bankruptcy for individuals) has the power to make an application to the court. These powers overlap with a provision contained in s.423 of the Act dealing with transactions "defrauding creditors". This latter provision applies to any debtor and an application may also be brought by a "victim".
2. **Transactions At An Undervalue:** pursuant to ss.238 and 339, the office-holder may apply to the court where the insolvent (i.e. the company or the bankrupt and not any other person, such as an earlier office-holder: *Ovenden Colbert Printers Ltd (In Liquidation)*, Re [2013] EWCA Civ 1408; [2014] B.P.I.R. 285) has, at a relevant time, entered into a transaction with a person at an undervalue.
3. The "relevant time" for companies (s.240) is:
  - a. within 2 years of the onset of insolvency *and* at that time the company is unable to pay its debts, or becomes unable to as a result of the transaction (it is rebuttably presumed that the company is unable to pay its debts if the transaction is with a connected party - defined by s.249 the court should consider both balance-sheet and cash-flow insolvency and evaluate the commercial reality: *Bucci v Carman* [2014] EWCA Civ 383; [2014] B.C.C. 269, *Husky Group Ltd, Re* [2014] EWHC 3003 (Ch); [2015] 3 Costs L.O. 337;
  - b. between the making of an administration application and the making of an administration

order;

- c. between the filing of a notice of intention to appoint an administrator under paras 14 or 22 of Sch.B1 and such appointment.
4. The "relevant time" for bankrupts (s.341) is:
    - a. within 5 years prior to the presentation of a petition upon which the individual is adjudged bankrupt; *and*
    - b. at that time the individual is insolvent (unable to pay debts as they fall due or balance-sheet insolvent) or becomes so as a consequence of the transaction; this is rebuttably presumed where the transaction is with an associate of his (including a spouse or civil partner and relatives - s.435 - unless the transaction is by reason only of being his employee) - See *Salter v Wetton* [2011] EWHC 3192 (Ch); [2012] B.P.I.R. 63; or
    - c. where it is within 2 years prior to such petition being presented.
  5. A transaction includes a gift, agreement or arrangement (s.436), formal or informal, oral or in writing (*Secretary of State for the Environment, Food and Rural Affairs v Feakins* [2005] EWCA Civ 1513; [2007] B.C.C. 54) and involves some form of dealing between the insolvent and another - simply sending a cheque to a party in payment of a third party's debt involved no dealing and was not a transaction: *Knights v Seymour Pierce Ellis Ltd* (formerly *Ellis & Partners Ltd*) [2001] 2 B.C.L.C. 176 at paras 19-20); likewise, nor was a payment to a third party unconnected to the company, where there were no prior communications between them (and the payment was a means by which a Director was misappropriating funds): *Hampton Capital Ltd, Re* [2015] EWHC 1905 (Ch); [2016] 1 B.C.L.C. 374; and nor was an appointment pursuant to a power in an insurance policy: *Clarkson v Clarkson (A Bankrupt)* [1994] B.C.C. 921 at 926C-F. Further, a department store segregating payments from concession licensees into separate accounts created a trust, which was not a transaction at an undervalue: *Lewis's of Leicester Ltd, Re* [1995] B.C.C. 514. A dividend is a transaction: *BTI 2014 LLC v Sequana SA* [2016] EWHC 1686 (Ch); [2017] Bus. L.R. 82 (a case relating to s.423 - see further below). The "transaction" may be one step in a number of linked transactions, may comprise several dealings, or may be an arrangement that uses another dealing as a means to an end (*Feakins*). A payment into a joint account is not necessarily a transaction with all account-holders and all the evidence must be looked at to determine who any dealings were with; but in the absence of any explanation, it might be regarded as a gift to all account-holders jointly : *Kiss Cards Ltd, Re* [2016] EWHC 2176 (Ch).
  6. A transaction is defined as being at an undervalue where:
    - a.

it is a gift or for no consideration;

- b. (in the case of bankruptcy) the consideration is marriage or civil partnership;
- c. the value of the consideration received is, in money or money's worth, significantly less than the value of the consideration provided by the insolvent.

7.

**Consideration:**

- a. The value of consideration must be assessed at the time of the transaction, in money or money's worth, and from the point of view of the company/bankrupt. Millet J. in the leading case of *MC Bacon Ltd (No.1)*, Re [1990] B.C.C. 78 held that s.238 required a comparison between the value of consideration given and received by the company. A precise valuation of each of the incoming and outgoing consideration is preferable where possible, but is not necessary where it is clear that there is a significant difference: *Reid v Ramlort Ltd* [2004] EWCA Civ 800; [2005] 1 B.C.L.C. 331. Further, the court must give preference to reality over speculation and is entitled to look at events after the transaction was entered into in assessing the value of consideration: *Phillips (Liquidator of AJ Bekhor & Co) v Brewin Dolphin Bell Lawrie Ltd (formerly Brewin Dolphin & Co Ltd)* [2001] UKHL 2; [2001] 1 W.L.R. 143 (in that case, a collateral agreement in reality provided no consideration as the company did not use the computers under the sub-lease)
- b. Consideration may be provided by a third party; it was important to look at the whole picture where there were linked transactions and ascertain what the consideration was rather than looking at the transaction in isolation: *Phillips (above)*.
- c. Where a company was transmitting money that in reality was not its own (was held on trust for another), there could be no consideration given by the company and so the fact that it received no consideration for such was of no consequence and there was no undervalue: *Re Taylor Sinclair (above)*.
- d. Where an employee receives benefits in kind (such as reimbursement of motor expenses), these transactions cannot be considered in isolation and the whole remuneration package must be evaluated to determine whether it is so far in excess of the commercial value of the services provided as to amount to a transaction at undervalue: *Re Kiss Cards Ltd (above)*.
- e. A payment inevitably susceptible to being set aside as a preference cannot constitute valuable consideration: *Sonatacus Ltd, Re* [2007] EWCA Civ 31; [2007] B.C.C. 186.
- f. As to s.238, the creation of security over a company's assets was held not to be a

transaction at an undervalue in *Re M C Bacon Ltd* (although in *Hill v Spread Trustee Co Ltd* [2006] EWCA Civ 542; [2007] 1 W.L.R. 2404, a case concerning s.423, Arden L.J. held that it does not follow that the granting of security can never amount to a transaction for no consideration; for example, it may be given in return for forbearance).

- g. As to s.339, consideration includes the settlement of claims between the parties (*Marsh, Re* [2009] B.P.I.R. 834), but not where the transfer of an interest in the matrimonial home gives a far greater share of equity than the contributions made call for (*Kumar (A Bankrupt), Re* [1993] 1 W.L.R. 224). A matrimonial property order made in contested proceedings at the relevant time will not (save perhaps where the court was misled or there was collusion) be a transaction at an undervalue (*Hill v Haines* [2007] EWCA Civ 1284; [2008] Ch. 412). There was no consideration for the gratuitous granting of security for a prior loan in *Official Receiver for Northern Ireland v Stranaghan* [2010] NICH 8. However, in *Tailby v HSBC Bank Plc* [2015] B.P.I.R. 143, it was found that a guarantee entered into by the bankrupt in respect of his company's overdraft facility was for valuable consideration despite being entered into after the company drew down the full facility; a guarantee involved a two-way flow of rights and obligations, was contingent liability, and was inherently linked to the loan facility; in this case the company was financially secure at the time and it was continuing a facility.

8. **Order:** If satisfied that the conditions are met, the court must (save in exceptional circumstances: *Paramount Airways Ltd (No.2), Re* [1993] Ch. 223 at 239G-H; *Claridge's Trustee in Bankruptcy v Claridge* [2011] EWHC 2047 (Ch); [2012] 1 F.C.R. 388 at paras 48-49; or where to so restore the position would provide no benefit: *MDA Investment Management Ltd (No.1), Re* [2003] EWHC 2277 (Ch); [2005] B.C.C. 783) make such order as it thinks fit for restoring the position to what it would have been had the transaction not been entered into. The court has a wide range of powers open to it (s.241/342), including:

- a. vesting the property or proceeds of sale in the company/Trustee;
- b. releasing or discharging any security;
- c. requiring payment of such sums as the court may direct;
- d. reviving surety obligations;
- e. provide for security to be provided, charged on the property, and given appropriate priority;
- f. provide for the extent to which the other person to the transaction may prove in the insolvency; and
- g.

such order may affect the property of or impose an obligation on any person, but such an order shall not prejudice/require payment from a third party who has acquired a proprietary interest or received a benefit from a transaction in good faith and for value. It will be rebuttably presumed to have been obtained otherwise than in good faith if the person at that time had notice of the transaction at undervalue *and* of the relevant proceedings, or was connected with the company/bankrupt (s.249) or an associate of the company/bankrupt (s.435), or of the other party to the transaction. The onus is on the third party to establish good faith; relevant knowledge includes shutting one's eyes to a possibility: *Re Sonatacus Ltd*.

9. The court looks to restore the insolvent company/individual's position and the fact that it may not be possible to restore the position of another party does not prevent the making of an order (but may be a factor in the court's decision): *Lord (Liquidator of Rosshill Properties Ltd) v Sinai Securities Ltd* [2004] EWHC 1764 (Ch); [2004] B.C.C. 986. The remedy must be assessed on a case-by-case basis, taking into account all the facts including subsequent events, and the most appropriate remedy for restoring the position should be adopted, whether by setting aside or by monetary compensation, or otherwise: *Reid v Ramlort Ltd* [2003] EWHC 1999 (Ch); [2005] 1 B.C.L.C. 331 (above).
10. Overall (and subject to the Statutory defence for companies), there is no requirement to show any kind of malevolent intention or purpose in relation to the transaction.
11. **Defences:** Companies have a defence available to them pursuant to s.238 - the court shall not make an order if satisfied that:
  - a. the company entered into the transaction did so in good faith and for the purpose of carrying on its business; and
  - b. that at the time it did so there were reasonable grounds for believing that the transaction would benefit the company.
12. The onus is on the company to prove the statutory defence. The determination of good faith contains an objective element: *Lord*.
13. There is a 12-year limitation period (ss.8, 9 of the Limitation Act 1980) for bringing the claim (unless the substance of the claim overall is to recover a sum of money paid or for an order for a sum of money to be paid, rather than to set aside a transaction, in which case it is 6 years: *Priory Garage (Walthamstow) Ltd, Re* [2001] B.P.I.R. 144). Time runs from the appointment of the Trustee (or Official Receiver as Trustee), although some cases refer to the date of the bankruptcy order as being the relevant date; or when the company enters liquidation/administration. The limitation period may be postponed in the case of fraud, concealment or mistake (s.32 Limitation Act). A claim may also be struck out for want of prosecution/abuse of process.

14. **Transactions Defrauding Creditors:** As stated above, there is a further power relating to transactions at an undervalue - that provided for in s.423 and applying to debtors generally (both companies and individuals). The provision is wider in who it applies to as it is not restricted to those in formal insolvency (i.e. companies in liquidation/administration and bankrupts) and nor is there a "relevant time". However, it is narrower as to the scope of transactions caught as there is a criterion that the court must be satisfied that the person entered into the transaction for the purpose:
  - a. of putting assets beyond the reach of a person who is making, or may at some time make, a claim against him; or
  - b. of otherwise prejudicing the interests of such a person in relation to the claim which he is making or may make.
  
15. "Undervalue" has the same definition as ss.238 and 339 (see above). The Court has a discretion as to making such order as it thinks fit for restoring the position and protecting the interests of victims of the transaction.
  
16. It is sufficient if the statutory purpose is a substantial purpose of the transaction (*Inland Revenue Commissioners v Hashmi* [2002] EWCA Civ 981; [2002] B.C.C. 943); although "purpose" must be distinguished from "consequence" (*Hashmi*); and there is a line to be drawn between "mere hopes" and "settled aims" (*Hill v Spread Trustee Co Ltd*). It is sufficient that the majority of directors acted with the statutory purpose: *Sequana* (above). It is the entry into the transaction and not the transaction itself that must have the relevant purpose, at that time: *Hill*. In that case it was also held that the court may make an order despite the absence of a "victim", although it may not be proportionate to do so.
  
17. An application is treated as made on behalf of every victim of the transaction. Section 424 sets out who may make an application:
  - a. Where the company/individual is in formal insolvency, the office-holder can apply, as can (with the leave of the court) a victim;
  - b. Where the victim is bound by a voluntary arrangement, the supervisor or the victim;
  - c. In any other case, a victim of the transaction (a third party who is not a creditor may constitute a "victim" and have standing to bring a claim - such as HMRC in *Hill* who had been deceived by the transaction into under-assessing tax liability).
  
18. The advantage of this power over the "transactions at an undervalue" power discussed above are two-fold: its wider application to those not in formal insolvency; and its lack of

time limit (although the court will be reluctant to reopen transactions entered into years ago and limitation applies - see below). Further, applications can be made by "victims" and not just office-holders. Section 423 is intended to be a wide-ranging, anti-avoidance remedy which operates irrespective of whether an estate is insolvent and is available for use as an alternative remedy in family proceedings: *B v IB* (Order to set aside disposition under Insolvency Act) [2013] EWHC 3755 (Fam); [2014] Fam. Law 287. The disadvantage is that it is much harder to prove.

19.

**Defences:** There is no change of position defence (indeed bad faith on the part of the recipient is not a pre-requisite of liability; although the knowledge of the recipient may be relevant as to what relief may be appropriate): *Sequana* (above). The limitation period is prima facie 12 years (ss.8 and 9 Limitation Act), but may be 6 years (see above and Hill) and may be postponed by fraud, concealment or mistake (s.32 Limitation Act). The limitation period begins to run against different applicants at different times as follows:

- a. Trustee in Bankruptcy: Appointment of Trustee (or when Official Receiver becomes Trustee, whichever is earlier) (although some cases refer to the date of the bankruptcy order);
- b. Liquidator: The entry into liquidation;
- c. Administrator: The entry into administration;
- d. Supervisor: Approval of voluntary arrangement (IVA or CVA);
- e. Victim: The date of the relevant transaction or whenever the victim becomes a creditor, whichever is the later.

20.

**Disapplication:** ss.238, 339 and 423 are disappplied in relation to certain financial market contracts and payment and securities settlement systems (s.165 Companies Act 1989; Reg.17 of Finality Regulations 1999). No order may be made under ss.238, 339 and 423 where a recipient of a "tainted gift" under the Proceeds of Crime Act 2002 is the subject of a restraint or confiscation order (ss.419; 427).

## Key Acts

Insolvency Act 1986

Limitation Act 1980 ss.8, 9, 32

## **Key Subordinate Legislation**

None.

## **Key Quasi-legislation**

None.

## **Key European Union Legislation**

None.

## **Key Cases**

Secretary of State for the Environment, Food and Rural Affairs v Feakins [2005] EWCA Civ 1513; [2007] B.C.C. 54

Knights v Seymour Pierce Ellis Ltd (formerly Ellis & Partners Ltd) [2001] 2 B.C.L.C. 176

MC Bacon Ltd (No.1), Re [1990] B.C.C. 78

Reid v Ramlort Ltd [2003] EWHC 1999 (Ch); [2005] 1 B.C.L.C. 331

Phillips (Liquidator of AJ Bekhor & Co) v Brewin Dolphin Bell Lawrie Ltd (formerly Brewin Dolphin & Co Ltd) [2001] UKHL 2; [2001] 1 W.L.R. 143

Sonatacus Ltd, Re [2007] EWCA Civ 31; [2007] B.C.C. 186

Hill v Spread Trustee Co Ltd [2006] EWCA Civ 542; [2007] 1 W.L.R. 2404

Hill v Haines [2007] EWCA Civ 1284; [2008] Ch. 412

Paramount Airways Ltd (No.2), Re [1993] Ch. 223

Claridge's Trustee in Bankruptcy v Claridge [2011] EWHC 2047 (Ch); [2012] 1 F.C.R. 388



MDA Investment Management Ltd (No.1), Re [2003] EWHC 2277 (Ch); [2005] B.C.C. 783

Lord (Liquidator of Rosshill Properties Ltd) v Sinai Securities Ltd [2004] EWHC 1764 (Ch); [2004] B.C.C. 986

Priory Garage (Walthamstow) Ltd, Re [2001] B.P.I.R. 144

Inland Revenue Commissioners v Hashmi [2002] EWCA Civ 981; [2002] B.C.C. 943

Bucci v Carman [2014] EWCA Civ 383; [2014] B.C.C. 269

Tailby v HSBC Bank Plc [2015] B.P.I.R. 143

Re Hampton Capital Ltd [2016] 1 BCLC 374

B.A.T Industries PLC v Sequana SA [2016] EWHC 1686 (Ch)

Re Kiss Cards Ltd [2016] EWHC 2176 (Ch)

## **Key Texts**

None.

## **Further Reading**

None.