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TECHNICAL BULLETIN

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Re Marylebone Warwick Balfour Management Ltd (reg nr 02944316) (in liquidation); Hunt (liquidator of Marylebone Warwick Balfour Management Ltd) v Balfour-Lynn and others [2022] EWHC 784 (Ch)

6 April 2022

Overview

This case concerned a claim against the directors of the company, including de facto directors and shadow directors ('respondents'), for c.£38m, which was the debt admitted on HMRC's proof of debt in the liquidation. The claim amount originated from PAYE and NICs otherwise due to HMRC in respect of the respondents' remuneration for their services to the company but for the respondents participation in a tax avoidance scheme (not an EBT scheme).

Background

The company was a part of a large group that operated hotels, management services and property development. Between 2002 and 2010 the company used an arrangement known as 'conditional share schemes' which was to pay employees and directors in a way which was supposed to reduce the liability of both the company and employees to PAYE and NICs.

The Company originally entered CVL in May 2013 and dissolved in June 2016. The previous liquidator's final report confirmed that HMRC had been desirous of funding a claim against the company's directors "*but following extensive investigation and liaising with duly instructed solicitors, barristers and tax experts, I determined that no such claim could be brought*". While solicitors and barristers were approached on a Conditional Fee Basis neither HMRC nor another funder could be found.

However, HMRC was not content and in June 2017, the company was restored into creditors' voluntary liquidation via an application to the court. Aside from HMRC there are no material creditors in the liquidation.

There was no dispute that the purpose of the payments was to effect remuneration to the recipients. This was not a case, therefore, where the true purpose of the scheme was found to be to effect a disguised distribution.

The claim brought by the liquidator was for:

(a) Breach of the directors' duties under s.172 of the Companies Act 2006 (CA 2006);

(b) Transactions to defraud creditors under s.423 of the Insolvency Act 1986 (IA 1986); and

(c) Breach of CA 2006, s.177 for failure to disclose an interest in a proposed transaction.

Court Decision

The claims brought by the liquidator were dismissed by the court.

With regard to the scheme, the judge decided that *"the Scheme was put in place, and subsequently operated, for genuine commercial reasons."*

Furthermore the judge rejected the liquidator's submission that the professional advice that was received could not be relied upon. The judge held that the fact that the advisors were not lawyers but accountants was a "*distinction without a material difference*" and that there was no conflict of interest as alleged.

In respect of the claim for transactions to defraud creditors, the judge said *"it was a consequence of the Scheme that assets which would otherwise have been used for the payment of PAYE and NICs were put beyond the reach of the creditor who would receive such payments, HMRC. That was not its purpose. Nor was its purpose "otherwise prejudicing the interests of HMRC in relation to a claim which it might make at some time and did in fact make", as the amended particulars of claim have it. The Respondents' evidence was that they had no interest in making, and would not have made, payments under the Scheme without the belief that it was likely to be legitimate; and that was their belief. The purpose, then, was to pay monies pursuant to a legitimate scheme, as to which BDO was consulted at all stages."*

The claim under CA 2006, s.177 did not add to the breach of duty claim (and in any event, rescission was no longer available or pursued as a remedy).

Considerations for R3 members

s.423 of IA86, Transactions defrauding creditors

Although the judgment provides nothing new to the body of cases law in this area, the judge provided useful commentary about s.423 of IA86, which R3 members may wish to consider when deciding whether to pursue this type of claim.

For ease of reference, s.423 of IA86 is as follows –

(1) This section relates to transactions entered into at an undervalue; and a person enters into such a transaction with another person if—

(a) he makes a gift to the other person or he otherwise enters into a transaction with the other on terms that provide for him to receive no consideration;

(b) he enters into a transaction with the other in consideration of marriage [F1or the formation of a civil partnership]; or

(c) he enters into a transaction with the other for a consideration the value of which, in money or money's worth, is significantly less than the value, in money or money's worth, of the consideration provided by himself.

(2) Where a person has entered into such a transaction, the court may, if satisfied under the next subsection, make such order as it thinks fit for—

(a) restoring the position to what it would have been if the transaction had not been entered into, and

(b) protecting the interests of persons who are victims of the transaction.

(3) In the case of a person entering into such a transaction, an order shall only be made if the court is satisfied that it was entered into by him 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.

(4) In this section “the court” means the High Court or—

a) if the person entering into the transaction is an individual, any other court which would have jurisdiction in relation to a bankruptcy petition relating to him;

(b) if that person is a body capable of being wound up under Part IV or V of this Act, any other court having jurisdiction to wind it up.

(5) In relation to a transaction at an undervalue, references here and below to a victim of the transaction are to a person who is, or is capable of being, prejudiced by it; and in the following two sections the person entering into the transaction is referred to as “the debtor”.

The judge’s comments –

“Section 423 is inaptly headed "Transactions defrauding creditors". Fraud is no part of it. Instead what is required is a transaction; at an undervalue; with the requisite purpose”

“As to purpose, in JSC BTA Bank v Ablyazov [2018] EWCA Civ 1176, [2019] BCC 96 the Court of Appeal reviewed the authorities including its own decision in IRC v Hashmi [2002] EWCA Civ 981, [2002] 2 BCLC 489. Leggatt LJ, with whose judgment Gloster and Coulson LJJ agreed, said this:

"[13] As mentioned, the Hashmi case establishes that, where the transaction was entered into by the debtor for more than one purpose, the court does not have to be satisfied that the prohibited purpose was the dominant purpose, let alone the sole purpose, of the transaction…

[14] The description of the requisite purpose as a 'substantial' purpose was not necessary to the decision of the Court of Appeal in the Hashmi case and to my mind it risks causing confusion. The word 'substantial' is not used in s.423 and I can see no necessity or warrant for reading this (or any other) adjective into the section… there is no need to put a potentially confusing gloss on the statutory language. It is sufficient simply to ask whether the transaction was entered into by the debtor for the prohibited purpose. If it was, then the transaction falls within s.423(3), even if it was also entered into for one or more other purposes. The test is no more complicated than that.

[15] …As Arden LJ emphasised, it is not enough to bring a transaction at an undervalue within s.423 that the transaction had the consequence of putting assets of the debtor beyond the reach of creditors. That is so even if the consequence was foreseeable or actually foreseen by the debtor at the time of entering into the transaction. Evidence that the debtor believed that the transaction would result in putting assets beyond the reach of creditors may support an inference that the transaction was entered into for the purpose of doing so, but the two things are not the same. To illustrate the distinction using a less homely example than that given by Arden LJ, a commander may order a missile strike on a military target knowing that it will almost certainly cause some civilian casualties. But this does not mean that the missile strike is being carried out for the purpose of causing such casualties.

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[16] When judging a person's intentions, we are generally more inclined to accept that an action was not done for the purpose of bringing about a particular consequence, even if the consequence was foreseen, if there is reason to believe that the consequence was something which the actor wished to avoid or at least had no wish to bring about. Hence, in the example just given, where the missile strike had a clear strategic purpose, we may readily accept that it was not ordered for the purpose of causing civilian casualties- particularly if, for example, there is evidence that the commander gave anxious consideration to how many civilians were likely to be in the target area and planned the strike for a time when the number was expected to be low. By contrast, a consequence is more likely to be perceived as positively intended if there is reason to think that it is something which the actor desired. Thus, evidence that a person who has entered into a transaction at an undervalue foresaw that the result would be to put assets out of the reach of creditors and desired that result might lead the court to infer that the transaction was entered into for that purpose. But such a conclusion is not a logical or legal necessity. It is a judgment which has to be based on an evaluation of all the relevant facts of the particular case".

Re Edengate Homes (Butley Hall) Ltd (in liquidation) Lock v Stanley (in his capacity as liquidator) and another [2022] EWCA Civ 626, [2022] 2 BCLC 1

Court of Appeal, Civil Division

9 May 2022

Overview

The Court of Appeal dismissed the appeal against the decision of the Chancery Division, which had dismissed an application under s.168(5) of the Insolvency Act 1986 in November 2021 (see [2021] EWHC 2970 (Ch), per HHJ Halliwell (sitting as a High Court judge).

The appellant, Mrs Lock, was a creditor and former director of the company whose only asset concerned a claim against her and members of her family. In the liquidation of the company, the liquidator assigned the claim to a litigation funder, however, Mrs Lock sought to set aside the assignment of the claim to the funder as she and her family were not given an opportunity to buy the claim and thereby bring it to an end.

The Court of Appeal held, among other things, that Mrs Lock did not have standing to make her application (despite being a creditor) and the assignment of the claim by the liquidator was not, in any event, perverse.

Background

The company was a special purpose vehicle to acquire and develop a property. Unfortunately, the company was unable to raise sufficient funds to meet liabilities for the development and was eventually placed into creditors' voluntary liquidation. Following investigations by the liquidator, it transpired that the company had potential claims against several parties including Mrs Lock. Those alleged claims were transactions at an undervalue, preference and misfeasance.

At a meeting between Mrs Lock and the liquidator, Mrs Lock alleged that she had raised the possibility of buying the claims, although no amount of consideration was discussed. Neither was this followed up by either party.

With the company having no funds to pursue the claims, the liquidator sought the services of a litigation funder, who offered to purchase the claims for an upfront payment of £20,000 together with an equal division of recoveries net of costs and reimbursement of the upfront payment. This payment was eventually agreed at £30,000, with an improved share of net recoveries.

Following the assignment, the litigation funder commenced proceedings against Mrs Lock and others. This then led to Mrs Lock's application to set aside the assignment in February 2021.

At first instance, HHJ Halliwell (sitting as a High Court judge) dismissed Mrs Lock's application under s.168(5) of IA86. The judge held that she did not have standing to make the application. The judge noted that 'any person … aggrieved' in IA 1986 s168(5) was shorthand for 'any creditor, debtor or other person aggrieved'. It was not enough to consider whether an applicant was within the category of persons entitled to make the application; it was also necessary to consider whether it had 'a legitimate interest in the relief sought'. Applying that test, Mrs Lock's interest was not aligned with the interest of creditors, which was to maximise the recovery to the estate from the claims; rather, it was to protect her family and herself by ensuring that the claims against them would not be pursued. In any event, the judge held that the liquidator's decision to assign the claim could not be regarded as perverse. Mrs Lock appealed.

Court of Appeal Decision

The appeal was dismissed.

Mrs Lock's challenge to the assignment of claims had not been made for the benefit of creditors generally and was not aligned with the interest of the class as a whole. The court held that, on the facts of the case, the class interest of the creditors was for the claims to be upheld and turned into as much money as possible; whereas the interest of Mrs Lock (and the other defendants) was to defend the claims and avoid paying as much money as possible.

With regard to whether the liquidator's decision to assign the claim was perverse, their Lordships concluded *"While it may often be sensible, or good practice, to give a defendant to a claim an opportunity to acquire (or settle) it before assigning it to a litigation funding company, failure to do so is not necessarily perverse. Whether it is or not must depend on careful scrutiny of all the facts of the case."*

Considerations for R3 members

The case highlights the importance of an office holder maintaining a contemporaneous paper trail when selling an action. This trail should reflect inter alia that the defendant had been advised that the office holder was thinking about assigning the claim and had offered the defendant the opportunity to settle the claim whether by means of assignment of some other form of settlement. The office holder would then be able to demonstrate that the decision to assign was not perverse.

An application for permission to bring a second appeal to the Supreme Court has been filed by Mrs Lock, which we understand has yet to be determined as of September 2022.

Case note on appeals under s 127(5) of the Bankruptcy (Scotland) Act 2016 in the sequestration of Nahid Ali [2022] SC GLW 13

In this case, the trustee in sequestration had adjudicated on the claims of creditors. The petitioning creditor and his wife objected to the trustee's adjudications on the claims of the three appellants in this case and sought a review by the Accountant in Bankruptcy (the AiB) under s 127(1) of the Bankruptcy (Scotland) Act 2016 (the 2016 Act). The AiB revoked the trustee's decisions in relation to the claims by all three appellants. Appeals against that decision were subsequently made to the sheriff under s 127(5) of the 2016 Act. The sheriff dismissed all three appeals.

The main issue in the appeals was the nature of the review by the AiB. The sheriff noted that previously, the review of a trustee's adjudication was carried out by the sheriff, and that it was agreed by the parties that in reviewing the trustee's decisions, the AiB was acting in a quasi-judicial capacity. However, she rejected the appellants' argument that the AiB's decision should be overturned because he had approached the review in the wrong way and had no power to consider matters afresh, particularly in relation to matters of fact. She considered that the correct approach was the same as that which had been held to apply in the case of Japan Leasing (Europe) plc v Weir's Tr (No 2) 1998 SLT 973 where the review had been carried out by the sheriff, namely that all admissible and relevant evidence concerning the claim may be taken into account and not only that which was presented to the trustee. Thus, the AiB was entitled to consider matters afresh where a misunderstanding in law or a misunderstanding of the evidence had been identified. She went on to add that she considered that the AiB was entitled to take into account any relevant issue concerning the claims whether raised by the person seeking the review or not: the statutory provisions did not prescribe any form for the review application, and indeed there was no requirement for any grounds to be stated at all, and the AiB therefore had power to revoke the decisions on grounds not relied on by those seeking the review.

With regard to matters of evidence, the sheriff rejected the appellants' submission that the AiB could not be concerned with matters of fact. She considered that if the AiB formed the view that the trustee had relied on misinformation or had failed to investigate the material before him properly, then that was a matter affecting the exercise of the trustee's discretion, and she rejected the appellants' argument that if the trustee was satisfied with the evidence provided to him, the AiB had no locus to interfere with his decision. The AiB had to consider all the material provided and come to a decision about acceptance of the claim. Furthermore, having decided that there was sufficient evidence to support the existence of the appellants' loans to the debtor, the AiB was not prevented from investigating the evidence available in relation to whether the loans remained outstanding and in what amount. She concluded that on a fair reading of the AiB's decision as a whole, the AiB was entitled to hold that the trustee's decisions should be revoked.

A further issue related to the nature of the obligations at issue. In two out of the three appeals, the sums claimed by the appellants were joint debts on single loans. In each case, the trustee's adjudication had allowed each of the joint creditors to claim for the whole amount of the debt. The sheriff noted that the concept of joint and several liability caused difficulty when applied to creditors. She noted that if, in either of the cases currently at issue, the two creditors were to sue the debtor for repayment, the action would require to be raised by both of them since the loan agreement did not specify any share due to the individual creditors, since where the obligation is indivisible, all creditors must sue. The important thing to note, however, was that were the creditors to sue the debtor in this case, the sum sued for would be the amount of the loan: the joint creditors would not each be able to sue for the whole amount of the loan. Similarly, the joint creditors could not each claim for the whole amount of the loan in the sequestration. The trustee had therefore erred in adjudicating each joint creditor's claim in the whole amount of the loan and the AiB was correct to revoke the adjudications for that reason, notwithstanding the trustee's stated intention to pay only half the dividend payable on each loan to each joint creditor on that loan.

The decision provides welcome clarification on the correct approach to be taken to the review of a trustee's adjudication by the AiB and on the correct treatment of claims where there is more than one creditor.

Association of Business Recovery Professionals

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