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Young Professionals: TUVs & Preferences

(ss. 238 & 239 Insolvency Act 1986)

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S. 238 IA - TUVs

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Purpose?

To prevent insolvent companies disposing of property at an undervalued amount just before winding up as a means of asset-stripping.

S. 238 - TUVs

Pursuant to s.238 IA, the following must be present to establish a TUV:

- The company makes a gift to a person or otherwise enters into a transaction with that person on terms that provide for the company to receive no consideration; *or*

- The company enters into a transaction with that person 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 the company;

And…

- The company enters into the transaction at a relevant time (defined in s.240(1));
  - Onset of insolvency (defined in s. 240(3))
- The company was insolvent when the payment was made, or became insolvent in consequence of the transaction (ss.240(2), 123(1)(e) and 123(2));
  - Presumed insolvency when transaction with connected person
  - *Darty Holdings SAS v Carton-Kelly* [2021] EWHC 1018 (Ch) at [109]

The burden is on the applicant to prove that the company was insolvent when the transaction was entered into. The test of insolvency in section 123 IA was explained by the Supreme Court in *BNY Corporate Services Ltd v Eurosail-UK 2007 3BL Plc* [2013] UKSC 28, and summarised by the Court of Appeal in the context of a liquidator's claim in *Re Casa Estates (UK) Ltd* [2014] EWCA Civ 383 at [27-28].

1. The cash-flow test looks to the future as well as to the present. The future in question is the reasonably near future.
2. The balance sheet test, especially when applied to contingent and prospective liabilities, is not a mechanical test.
3. Whether the balance sheet test is satisfied depends on the available evidence as to the circumstances of the particular case. It requires the court to make a judgment whether it has been established that, looking at the company's assets and making proper allowance for its prospective and contingent liabilities, it cannot reasonably be expected to meet those liabilities.
4. The cash-flow test and the balance sheet test stand side by side.

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No subjective element…

There is no obligation on the applicant to prove that the insolvent company intended to sell at an undervalue.

But, a 2-limbed defence…

1. The company entered into the transaction in good faith and for the purpose of carrying on its business; and
2. At the time of entering into the transaction there were reasonable grounds for believing that the transaction would benefit the company.

Limitation

Actions under s. 238 are generally to be regarded as actions on a specialty, covered by ss. 8 and 9 Limitation Act 1980, and as a consequence there is a 12-year limitation period in which office-holders can commence proceedings, *provided* that the substance of the application is to set aside a transaction, and not to recover a sum that is recoverable (*Re Priory Garages (Walthamstow) Ltd* [2001] BPIR 144 at [149], [160]).

If a claim for a sum that is recoverable is ancillary to a primary head of relief that involves the setting aside of a transaction, then the limitation period is 12 years (*Priory* at [160]).

A couple of helpful cases…

- *Re Ovenden Colbert Printers Ltd* [2013] EWCA Civ 1408 at [30]-[34] – The requirement that the company itself enters into the transaction is an essential part of a TUV claim, and comprises 2 interrelated elements. First that there was a transaction (i.e. a gift or arrangement, which encompasses a payment), and second that the transaction was something which the company itself entered into. The expression "entered into" connotes the taking of some step or act of participation by the company. It follows that the unilateral misappropriation by a director of his or her company's property does not constitute a transaction between the director and the company.

- *Simms v Oakes* [2002] EWCA Civ 8 – Any transfer that is expressed to be simply for natural love and affection will constitute a TUV unless there is some other explanation for it.

S. 239 IA - Preferences

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Purpose?

To prevent insolvent companies from paying more to a creditor than would be due to them in a winding up, which would affect the statutory regulated system laid down for payment of creditors.

S. 239 - Preferences

Pursuant to s.239 of the IA, the following must be present to establish a preference:

- A payment or other benefit is made/given to a person by the company (the person being one of the company's creditors or a surety or guarantor for any of the company's debts);
- The payment or other benefit is made/given at a relevant time (defined in s.240);
- The payment or other benefit has the effect of putting the person into a better position than they would otherwise have been in the event of the insolvency of the company;
- In deciding to make/give the payment or other benefit, the company was influenced by a desire to produce such an effect;
  - *Re MC Bacon Ltd* [1990] BCLC 324
- The company was insolvent when the payment was made, or became insolvent in consequence of the payment (123(1)(e) and 123(2)).

The burden is on the applicant to prove that the company was insolvent when the payment/each of the payments was made to the respondent. The test of insolvency in section 123 IA was explained by the Supreme Court in *BNY Corporate Services Ltd v Eurosail-UK 2007 3BL Plc* [2013] UKSC 28, and summarised by the Court of Appeal in the context of a liquidator's claim in *Re Casa Estates (UK) Ltd* [2014] EWCA Civ 383 at [27-28].

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SOLVENCY

1. The cash-flow test looks to the future as well as to the present. The future in question is the reasonably near future.
2. The balance sheet test, especially when applied to contingent and prospective liabilities, is not a mechanical test.
3. Whether the balance sheet test is satisfied depends on the available evidence as to the circumstances of the particular case. It requires the court to make a judgment whether it has been established that, looking at the company's assets and making proper allowance for its prospective and contingent liabilities, it cannot reasonably be expected to meet those liabilities.
4. The cash-flow test and the balance sheet test stand side by side.

Payment of a petition debt

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If a company makes a payment to dispose of a winding up petition presented by a creditor, and the petition is then dismissed, but subsequently the company enters liquidation (either voluntarily or on a subsequent petition), whether or not the payment to dispose of the original petition is a preference depends on whether the elements of a preference are satisfied (see slide 9 of this presentation).

In particular, was the payment made at a relevant time (remember to differentiate between a connected party and any other party) , was the company influenced at all by a desire to prefer, and was the company insolvent when the payment was made?

Often where the company was insolvent at the relevant time there will be another creditor waiting to be substituted as petitioner.

Limitation

Actions under s. 239 are generally to be regarded as actions on a specialty, covered by ss. 8 and 9 Limitation Act 1980, and as a consequence there is a 12-year limitation period in which office-holders can commence proceedings, *provided* that the substance of the application is to set aside a transaction, and not to recover a sum that is recoverable (*Re Priory Garages (Walthamstow) Ltd* [2001] BPIR 144 at [149], [160]).

If a claim for a sum that is recoverable is ancillary to a primary head of relief that involves the setting aside of a transaction, then the limitation period is 12 years (*Priory* at [160]).

A few helpful cases…

- *National Australia Bank Ltd v KDS Constructions Services Pty Ltd* (1987) 163 CLR 668 (Aust HC) – Any payments made to secured creditors who have valid security does not improve the position of the secured creditor and it does not affect the position of the other creditors in the winding up.

- *Re Transworld Trading Ltd* [1999] BPIR 628 – The giving of security to cover existing indebtedness would be preferential.

- *Re Agriplant Services Ltd* [1997] 2 BCLC 598 – The court equated the state of mind of the director who essentially ran the company with the state of mind of the company.

- *Re de Weyer Ltd; Kelmanson v Gallagher* [2022] EWHC 395 (Ch) – An incorrect, but nonetheless sincerely held, belief that a particular creditor held registered security and would be paid first on an insolvent liquidation, would exclude the existence of the necessary desire.

Remedies

- If the court considers that an office-holder has proved a case under s. 238 and/or s. 239 IA, it will make a declaration to that effect.

- Pursuant to ss. 238(3) and 239(3), the court shall make such order as it thinks fit (if any) for restoring the position to what it would have been if the company had not entered into the TUV or given the preference.

- Ss. 238 and 239 are therefore restitutionary rather than compensatory provisions.

- S. 241 sets out a list of potential orders to restore the position. The list is not exhaustive, but it indicates the wide range of orders available to the court.
  - ➢ *Bucknall v Wilson* [2021] EWHC 2149 (Ch)

Thank you for your kind attention!

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