KINGS CHAMBERS INSOLVENCY

DIRECTOR LIABILITY CLAIMS

June 2023

KINGS CHAMBERS

CONTENTS

03 EDITORIAL
Jonathan Fletcher-Wright, Barrister

04 OFFICE HOLDER CLAIMS: A FOCUS ON DIRECTOR'S LOAN ACCOUNTS
Nick Taylor, Barrister

07 DIRECTOR LOAN ACCOUNT CLAIMS AND RESTITUTION
Mark Harper KC, Barrister

08 MENTAL HEALTH AND VULNERABILITY ISSUES IN INSOLVENCIES
Mark Sands, Head of Insolvency at Apex Litigation Finance

13 1982 LIMITED - V - LANGDON CASE NOTE: LIABILITY UNDER S.217 OF THE INSOLVENCY ACT 1986
Andrew Grantham KC, Barrister

17 AFTER THE DUST HAS SETTLED: THE CREDITOR DUTY IN SEQUANA AND SOME UNANSWERED REAL-WORLD QUESTIONS
Louis Doyle KC, Barrister

Click here to view all members of the Kings Insolvency Group and the webpage

EDITORIAL

Hello, and a warm welcome to this issue of Kings Insolvency, from the artist formerly known as Jonathan Wright. Following my socially-distanced (but still truly magical) lockdown wedding in 2021 – remember those days? – I've now started using my married surname professionally. Under my new guise as Jonathan Fletcher-Wright, I can deliver my advocacy with both barrels blazing.

Hopefully, I'll soon get to stick yet another bunch of letters on the end of my name. Kings Chambers kindly let me take a sabbatical, and I've spent the past year doing what any hard-working insolvency counsel would do with a large dose of free time: studying for a master's degree in Commercial Law! I'm currently at the University of Birmingham, and it's been an absolute blast. In fact, a blast from the past.

Take the student lifestyle, for example. I've always been a bit of a night owl, so it's great to return to an environment where I can stay up working in the library till 2am, then sleep in till 10am without any judgment or consequences. On the subject of judgment and consequences: these are precisely what befell the director in **Re Bronia Buchanan Associates Ltd (in liquidation) [2022] BCC 229,** as covered in this issue's lead article by **Nick Taylor**. The case is a salutary warning about the risks of attempting, after the event, to re-categorise the nature of drawings on a director's loan account.

This spring, I teamed up with Kings Chambers' newest Business and Property Team member, **Rory Goodson**, to deliver an all-day advocacy workshop for Birmingham undergrad students. It was nice to do something for the next generation of up-and-coming lawyers, and hopefully will have equipped them with some transferable skills to take into their future careers. Speaking of all things transferable, did you know that in **PSV 1982 Ltd v Langdon [2022] EWCA Civ 1319**, a judgment in proceedings not involving a director as a party was in itself sufficient to establish the company's liability, in proceedings brought subsequently against the director under s.217 of the Insolvency Act 1986? The head of our very own Business and Property Team, **Andrew Grantham KC**, explains all.

One worry that plagues students and insolvency litigators alike is funding. Who better to tell us about that than guest writer **Mark Sands**, the Head of Insolvency at Apex Litigation Finance? A considerable upgrade on dealing with the Student Loans Company, Apex is a litigation funder specialising in supporting small and mid-sized insolvency claims. Mark has over 35 years' experience in the field. His article looks at developments in the recently incepted and vitally important mental health and moratorium regime, by surveying the court's approach by reference to five instructive cases, most recently **Kaye v Lees [2022] EWHC 3326 (KB)**. Mark presented a paper on this subject to a large audience, together with our very own **Louis Doyle KC,** at the Insolvency Practitioners' Association (IPA) conference in Manchester in November 2022. He's kindly expanded and updated that paper into an article for this edition of Kings Insolvency.

Two of my favourite modules on my masters course have been Company Law (which has a lot of insolvency content), and Conflict of Laws (a fascinating area, currently in flux following Brexit, but extremely relevant to cross-border insolvency claims). On both modules, one case has come up time and again – the recent decision of the Supreme Court in **BTI 2014 LLC v Sequana SA [2022] UKSC 25, [2022] 3 WLR 709**. In his article, **Louis Doyle KC** looks at some unanswered questions which remain following the long-awaited judgment. I had to plough through my coursework earlier this year without the benefit of his wisdom on the subject, but after this edition of Kings Insolvency, no future generation of students will have to suffer the same fate.

I'm very much looking forward to returning to my practice this coming autumn. In the meantime, I can think nostalgically about all those happy days in Manchester Civil Justice Centre, when I read **Mark Harper KC's** piece about **Barton v Morris in place of Gwyn Jones [2023] UKSC 3**, a case that started life in front of Manchester's HHJ Pearce before ending up in the Supreme Court. The SCJs grappled with the intersection of contractual agreements, silence, and unjust enrichment, and produced a 4-1 split decision.

I wish all of our readers an excellent summer. I'll be spending mine on a dissertation about smart contracts and blockchain technology, but maybe you'll be spending yours on a sun lounger by the beach, piña colada in hand, and Kings Insolvency by your side for some light reading. Remember the SPF, and I hope to see you in court once again very soon.

Jonathan Fletcher-Wright
Barrister
6th June 2023

OFFICE HOLDER CLAIMS: A FOCUS ON DIRECTOR'S LOAN ACCOUNTS

Nick Taylor

Why use DLAs?

It is both common (and typically recommended as best practice by accountants for tax reasons) for small businesses to pay owner-directors a nominal salary below the PAYE threshold and for the director's monthly or annual income to be topped up by way of further payments paid directly from the company.

Those further payments, often loosely referred to as 'drawings' (although that is language that is borrowed from the partnership world and does not have a particular meaning in the context of company law) ought to be recognised by companies in their accounts as a loan to a director **("DLAs")**, at least in the first instance. The intention being that sufficient distributable profits are made by the end of the year for a dividend to be declared which off-sets the DLA. In accounting terms the DLA is credited down by the amount of the dividend. The upshot is that the director benefits from the more favourable tax treatment of dividends.

These arrangements are often carried out or recorded relatively informally, or carried out with the assistance of an accountant who the director may claim to abrogate responsibility and decision making to. Consequently, if a company goes into liquidation and a dividend has not or cannot be declared they can be ripe for "attack" by an office holder.

The basic position

Before getting into the detail, it helps to start with and emphasise the most straightforward example. Simply put, if a DLA is overdrawn when the company goes into insolvency then that is a debt owed to the company for which the director is liable.

How does one know whether or not the DLA is overdrawn? At its highest it might be shown in the company's statutory accounts (it should be shown in a note towards the end). And even if the most recent accounts are not available, the accounts from the prior year are a good starting point. If not the statutory accounts, then accountants or directors will often keeping a running DLA tab. At worst, the company's bank statements will show payments out.

If there is a DLA and the outstanding sum is formally demanded but remains unpaid thereafter then an ordinary debt claim could be issued. Or, if there is a suspicion that the director would be unable to pay that sum, then bankruptcy proceedings could be initiated by way of a formal statutory demand.

If the overdrawn DLA is simply that then there are relatively few avenues of defending a claim or process of that sort. For example, a set-off of a debt owed to the director by the company against the DLA is generally not possible as the improper removal of money from the company are not considered mutual dealings for the purposes of Rule 14.25 IR 2016 (***Manson v Smith (Liquidator of Thomas Christy Ltd)*** **[1997] 2 BCLC 161)**

Was the loan lawful in the first place?

It may in fact be wise to go back a step and check whether the loan made to the director was lawful in the first place – in other words, did it comply with section 197 of the Companies Act 2006 ("CA 2006")?

Per section 197(1) CA 2006:

(1) A company may not—

> *(a) make a loan to a director of the company or of its holding company, or*
> *(b) give a guarantee or provide security in connection with a loan made by any person to such a director,*
>
> *unless the transaction has been approved by a resolution of the members of the company.*

There are further matters in respect of the requirements for that members' resolution (set out in s197(3) – (4)).

There are exceptions to the requirement for members approval at ss204 – 209 CA 2006, e.g. for expenditure on company business, expenditure on defending proceedings in connection with regulatory action and so on. The most general in scope and potentially relevant is the s207 exception which sets a minimum threshold of £10,000 for transactions requiring members approval.

In the case of a company with a sole director-shareholder the above steps can be a mere formality and there is also a possible saving provision at s214 CA 2006 whereby a resolution passed within a *"reasonable time"* from a contravention of s197 CA 2006 means that the transaction is no longer voidable.

If the provisions of s197 CA 2006 have not been complied with, then the loan is unlawful and there is a further standalone statutory remedy in s213 CA 2006 where the loan voidable at the instance of the company and the director liable to account for the gain (i.e. the amount of the loan).

How are claims for DLAs usually brought?

DLA claims are often brought by way of Insolvency Act applications which can be used to challenge and recover loans on various bases. The application that might be appropriate in each case can vary, depending on how the loan has been characterised or what it is said to be by the director. Applications can often be brought on multiple bases. The most general, catch-all, is likely to be a misfeasance claim under s212 of the Insolvency Act 1986 ("IA 1986").

A tale of Mrs Buchanan

The rest of this note will discuss issues that can arise in DLA claims in the context of a recent case which is neither ground breaking nor significant but provides a typical and useful illustration.

Re Bronia Buchanan Associates Ltd (In Liquidation) **[2022] B.C.C. 229** raises common issues such as: (a) a sole-director-shareholder (b) informal methods of cash extraction from the company (c) director 'ignorance' (d) acting on advice (e) evidence considered by the court.

The facts are straightforward. The company ("**C**") had a sole director and shareholder, the eponymous Ms Buchanan ("**Mrs B**") . Her practice, on the advice of accountants (who changed over time and appear to have been competent to varying degrees) was to receive a nominal salary of £6k per annum but receive additional more significant sums of cash directly from C. Importantly, these were initially characterised in the accounts (including the statutory accounts of C signed by Mrs B) as a DLA.

C came under pressure from HMRC in respect of outstanding tax liabilities, penalties and interest. As a result of that pressure attempts were made by Mrs B via C to recharacterize the DLA as "*drawings*". In a somewhat farcical twist, the recharacterization appears to have occurred on the advice of Mrs B's husband – who is an insolvency (!) solicitor.

C ultimately went into liquidation. The liquidator disagreed with the attempted recharacterization of the DLA as "drawings", not least because there were insufficient distributable profits for them to be treated as dividends and no evidence that they had been treated as remuneration. Proceedings were therefore brought against Mrs B.

Mrs B's defence amounted to a defence of *quantum meruit* – i.e. in effect she worked 15 hours a day for the company but only had received a £6k per annum amount as salary, so (the submissions may have been run) surely she deserved more than this? Surely the payments were a fair representation of some sort of income for her? She also relied on a further line of defence that she had at all times acted reasonably on professional advice.

By way of a summary of the reasoning in the judgment relevant legal principles:

(1) For office-holders, a helpful point to note is that although the claimant has to prove the case overall on the balance of probabilities as in the usual way, where payments are made to a defendant in the capacity of a director the burden switches, and the burden is then on the director to explain the transactions in question (per Lesley Anderson QC in

***Re Idessa (UK) Limited* [2011] EWHC 804);**

(2) Whilst it may seem like an obvious point, it is not open to directors who have carried on their business with high degree of informality to seek to escape liability by being judged to a lower standard than that which applies to other directors because certain documentation is not available (***Re Mumtaz Properties Limited* [2011] EWCA Civ 610);**

(3) S1157 CA 2006 does not allow relief to be granted to a director to enable them to escape liability in respect of sums received by him or her (***Toone & Murphy v Robbins* [2018] EWHC 569)**;

(4) Quantum meruit claims post-liquidation often face severe difficulty – either because the company's Articles of Association may impose requirements as to directors remuneration which will probably not have been complied with, or because such a claim amounts to an unliquidated claim in a liquidation which the applicant would have to prove for (***Toone & Murphy v Robbins* [2018] EWHC 569** per Norris J at para. 40);

(5) Unsurprisingly, Mrs B's defence failed: *"86. In my judgment, it is simply not open to a director to recreate history and the basis upon which they have historically received money from a company. Following Re Idessa, having established by reference to the Company's accounts that significantly more was paid to Ms Buchanan than was expressly accounted for as salary or dividend, the burden of proof lies with Ms Buchanan to show that she was entitled to receive those monies."* The Judge went on to note and make the unanswerable point that if a director could simply recharacterize a DLA as "drawings" when a company was on the verge of insolvency then every director would do it.

A short point on limitation – pursuant to section 6 of the Limitation Act 1980 – where a contract of loan does not provide for repayment of the loan on or before a fixed or determinable date time does not begin to run until date of demand. Accordingly C's claims for repayment were not statute barred as the DLA had not been demanded more than 6 years prior to the commencement of proceedings.

The Judge did not particularly engage in the judgment with the arguments around Mrs B's claimed reliance on professional advice, such reasoning unlikely to have been of significance to the decision. But in certain circumstances, e.g. for a misfeasance claim where a company continues to trade on advice can act as a defence (***Re Continental Assurance Co of London plc (No.4) [2007]* 2 B.C.L.C. 287**). But it is less likely to be effective where a director simply abrogates any knowledge as to how they are being paid even when the position is reflected in accounts that they have signed. And bear in mind s173 CA 2006 – a director always has a duty to exercise independent judgment.

The application was brought as a transaction at an undervalue – the outstanding DLA was simply ordered to be repaid. But it could also have conceivably been brought as a misfeasance action.

Or as an alternative to a debt claim, a director such as Mrs B may be liable for breach of fiduciary duty in permitting C's loan account to become outstanding, and so liable for breach of the duty in equity, or as a ground for misfeasance.

What might be suggested as the key takeaways for DLA claims?

(1) Company records are key – whilst the director may themselves consider that the payments they have received are one thing ('salary', 'drawings', etc.) , the company records may record them very differently. But if the requirements for distributions to members are not met and if there is no evidence of them being remuneration on top of what might be an existing nominal salary (i.e. resolutions approving director remuneration, PAYE, NI etc.) then the amount is probably a DLA;

(2) If they are classed as loans, check whether they are lawful (i.e. satisfy the requirements of s197 CA 2006);

(3) Consider the best form of proceedings for recovery – could be a debt claim in the name of the company but more often an insolvency application by the office holder for misfeasance may be a quicker and cheaper method of realising the money;

(4) Limitation is probably not going to be an issue, a defence of quantum meruit is probably not going to work and if you are acting for an office-holder use the 'switch' in the burden of proof to your advantage.

Director Loan Account Claims and Restitution

Mark Harper KC

A common scenario:

A and B are directors and shareholders in a company ("X Limited"). The Articles of Association permit the remuneration of directors. A and B agree that they will be remunerated by way of a nominal salary and drawdowns against director loan accounts that would be cleared or reduced each financial year upon declarations and payments of dividend.

A and B fall out. A causes X Limited to bring proceedings against B for repayment of his loan account that is outstanding due to the fact that the shareholders have been unable to agree the declaration and payment of a dividend.

There is no dispute that the debt on the loan account is due and repayable. But B has provided valuable services to X Limited from which it has benefited and in relation to which it was expected and understood by A, B and X Limited that B would be remunerated. He has not been remunerated because the agreed mechanism for payment has failed.

Can B recover a payment by way of quantum meruit to remedy X Limited's unjust enrichment at his expense?

The answer is no. There is no unjust enrichment. In ***Barton v Gwyn-Jones [2023] 2 WLR 269***, the Supreme Court decided that where an agreement between the parties failed to cater for the situation that arose, a claim in restitution was not available as to do so would be counter to the contractual arrangements. In this scenario the parties chose to be remunerated through a payment of nominal salary and dividends with permission (until the fall-out) for the parties to be able to draw on their loan accounts with a view to a debit balance being repaid using the proceeds of subsequently declared dividends. To allow a quantum meruit claim would be to impose on X Limited a greater obligation for paying remuneration than had been agreed. It does not matter that X Limited will have benefited from B's work and paid nominal amounts for the same as it did not matter in Barton that he had benefited the Defendant to the tune of £6.5m by introducing a buyer for the Defendant's property and the Defendant didn't have to pay him anything for so doing.

Mental health and vulnerability issues in insolvencies

Mark Sands, Head of Insolvency at Apex Litigation Finance

Insolvencies and mental health issues increasingly cross over and the insolvency profession needs to be alert to these issues and have plans and policies for how to react to what can be very sensitive situations. Inevitably, the Courts are being asked to decide how cases where mental health issues at their heart are dealt with. I have brought together five recent cases which show that the Courts will, as you would expect, analyse the situation in detail and make robust decisions. In most cases the Courts have ensured that the insolvency process proceeds, but with one rather surprising and unhelpful decision which serves as a warning to creditors to engage quickly to ensure they are not locked out from their recovery and enforcement options.

Re Djurberg (a bankrupt); *Hyde and another v Djurberg* [2022] EWHC 1534 (Ch)

This was an application for a search and seizure order where the debtor claimed to be suffering from mental health issues and to lack capacity.

A search and seizure order is a draconian remedy but there is a need for the debtor to cooperate with his Trustee and so the Court decided that a balancing act needs to be performed.

The Court made a finding that the debtor did not lack mental capacity, despite a report to the contrary, in part as the evidence before the Court demonstrated the debtor's ability to engage and to enter into complicated legal arguments. However, the Court was conscious of vulnerability issues and so considered the mental health issues in detail.

Whilst there had been a delay in bringing the application, for a power often used earlier in a case or when a Trustee first becomes aware of assets or documents he wants to take possession of, that did not, in this case, mean that the remedy being sought was disproportionate or could no longer be used. The Court found that there was a real prospect that assets and documents were at the premises.

The remedy sought is a discretionary one (S365(1) Insolvency Act 1986 *"…the Court may…."*). The guidance given in ***Lasytsya v Koumettou* [2020] EWHC 660 (Ch)** was followed and, perhaps, expanded upon as regards the mental health considerations. It may no longer be sufficient to demonstrate that the bankrupt has capacity **[see Rules 12.23/12.24 2016]**. Even where capacity exists, the Trustee needs to carefully consider any evidence of mental health issues and to be prepared to explain to the Court either why the mental health issues will not give rise to harm, or come up with a plan to mitigate any such risks to the satisfaction of the Court.

It helped that the High Court Tipstaff attended the hearing and made clear that he was willing to execute the order himself, which could include forcibly entering the home of the bankrupt, and to do so whilst bearing in mind the specific guidance which exist in the event of mental illness having been identified. That assisted with ensuring that the remedy was proportionate.

The Court considered what would have happened had the bankrupt cooperated and concluded that the draconian powers being sought, including the use of forced entry, would not be necessary if the bankrupt had simply cooperated with his Trustee. The bankrupt could also open up his premises when the order was being executed and avoid much of the impact of the proposed course of action on his mental health.

So provided IPs guide the Courts through the issues and demonstrate that the mental health of the debtor has been taken into account, there is no reason why, when needed, IPs cannot continue to use their powers to the full.

Re De Freitas; *Revenue and Customs Commissioners v De Freitas* [2022] EWHC 1946 (Ch)

This case considered whether a bankruptcy petition, presented by a public body, should be dismissed on grounds of the mental health of the respondent debtor. The case is specific to public bodies who have a Public Sector Equality Duty ("PSED"). The debtor's mental health issues meant that he was treated as disabled for the purposes of s6(1) of the Equality Act 2010. As a result, the creditor had to demonstrate to the Court that it had carried out an enquiry into the potential impact of the proposed action on the debtor's mental health and then to make reasonable adjustments to ensure that the debtor would not be disadvantaged as a result of the disability.

The Debtor applied to dismiss the petition on four grounds – the HMRC complaints procedure was not complete, there was an error in the petition document, he could pay the petition debt and (most relevant to this article) HMRC's conduct had an effect on his mental health.

The creditor was able to satisfy the Court that the correct procedures had been followed, which had resulted in the creditor determining that no reasonable adjustments were possible or appropriate. The Court found that there had been no breach of the Equality Act. The petition was not therefore dismissed.

When looking to enforce a debt, by presenting a petition for bankruptcy, public sector bodies, when acting as creditors, now have clear guidance on the processes they need to follow and what they can do when the information available is incomplete. It is possible to breach (hopefully inadvertently!) the PSED whilst not breaching the duty to make adjustments, if there are in fact no reasonable

adjustments which need to be made. The PSED and the Duty to Make Adjustments are separate and distinct duties which need to be considered in turn.

The Court also decided that whilst there was a final possible step in the complaints process, arising from a judicial review which created the option for the debtor to request a review of the final stage of the process, that option had not been actioned, and the Court decided that even if it were progressed it had no prospect of reducing the debt below the threshold needed for a petition to be issued, so there was no benefit in dismissing or adjourning the petition to allow that process to be completed. Where there is a complaint procedure or an ability to enter into an alternative dispute resolution process, the petitioning creditor should ensure that any such processes which have been commenced have been exhausted prior to issuing a petition.

The Court was also asked to consider the meaning of *"the debtor is able to pay all his debts"* in Section 271(3) of the Insolvency Act 1986. The Court could find no guidance on whether that test was to be on the balance sheet or cashflow basis. The Court declined to dismiss the petition as HMRC would have no comfort that the Debtor would actually pay the petition debt but did agree to adjourn the hearing of the petition to allow the Debtor time to pay the petition debt in full.

The Court rejected an assertion that the petition contained factual errors as the Court had earlier granted HMRC permission to amend the petition.

Whether in the public sector or elsewhere, creditors will protect their rights to enforce their debts by ensuring that any processes which are in place are followed and documented and, when necessary, explained to the Courts.

Breathing Space

The Debt Respite Scheme (Breathing Space Moratorium and Mental Health Crisis Moratorium) Regulations 2020 ("the Regulations")

Nihal Mohammed Kamal Brake & Anor v Geoffrey William Guy & Ors [2022] EWHC 2797

The Guy Parties sought to enforce a Third Party Debt Order ("TPDO") which had been made on 20 July 2022, which was before Mrs Brake entered into a Mental Health Crisis Moratorium ("MHCM") on 27 August 2022 but after Mr Brake had earlier entered into his own MHCM on 6 May 2021 (a few days after the regulations came into force). The Guy Parties had applied to have the MHCM for Mr Brake discharged but that application failed and the Court made some unless orders relating to costs orders in ongoing litigation. A MHCM covers joint debts and so Mr Brake argued that Mrs Brake entering into a MHCM after the debt arose meant that the debt could not be enforced against either of them.

The Guy Parties had asked the debt advisor to review and cancel the MHCM of Mrs Brake but that was refused so they sought leave to enforce the TPDO. There is clear guidance in the Regulations (Reg 7(5)) as to how the Court should decide whether to use its discretion to allow enforcement action while a MHCM is in place: is it reasonable to allow the step, the step must not be detrimental to the debtor (and that is not limited to financial detriment) and the step will not significantly undermine the protections provided by the MHCM. All three need to be met and even then the Court has a discretion.

Directions were given for medical evidence to be filed. Mrs Brake part complied but then asked that if the Court was not satisfied with the evidence filed she should be given the chance to file more evidence. That request was rejected – a trial is not a dress rehearsal – it is the first and last night of the show! The Court did find that a therapist is perfectly capable of providing the medical evidence needed. However, in this case the therapist misunderstood the position. It is worth noting that the medical evidence required here was greater than that required when a debtor seeks to enter into a MHCM.

The three tests were considered as follows:

1. Reasonableness – Mr and Mrs Brake were found to have deliberately delayed the enforcement of the TPDO so that Mrs Brake could enter into a MHCM before the TPDO was enforced. Enforcement was nearly complete and Mrs Brake no longer needed to be involved in that process. The Court found that it was reasonable in the circumstances to permit enforcement;

2. Detriment – there was no financial detriment to Mrs Brake as the asset at stake (a pension fund in the name of Mr Brake) was not her asset and in any event the benefit of that asset had

already been lost when the TPDO was made. The matter being considered related only to the enforcement of the TPDO, not the making of it. There was no non-financial detriment to Mrs Brake (which can also be considered had it existed);

Undermining the protection – the proposed enforcement of the TPDO did not undermine the protections provided by the MHCM as the asset being enforced against was not Mrs Brake's and she had no need to be involved in the enforcement steps;

3. Discretion – the Court looked at 13 points raised by Mrs Brake. After noting that the pension was already lost, that Mrs Brake did not need to be involved in the enforcement process and that Mr and Mrs Brake had caused delay, the Court decided to use its discretion to grant the relief sought.

This provides welcome guidance on how the Courts will consider enforcement by creditors when a MHCM is in place.

IV Fund Limited SAC v Frank James Mountain [2021] EWHC 2870 (Ch)

The applicant creditor sought the cancellation of a mental health crisis moratorium ("MHCM"). The debtor did not appear.

The creditor had presented a bankruptcy petition on 8 February 2021. Key here is that the petition had been expedited and part heard and was due to be finalised on 16 June 2021. A Breathing Space Moratorium ("BSM") was put in place on 11 June 2021. The petition hearing was adjourned to 17 August to allow the 60 day period of the moratorium, to enable the debtor to obtain advice and enter into some acceptable debt solution. After the BSM expired the debtor applied for a MHCM. The petition was again adjourned and directions were given including for the disclosure of medical evidence. Some medical evidence was served and the debtor sought a further adjournment on medical grounds. The creditor argued that as the medical evidence had been filed (as part of the Debtor's application to adjourn on medical grounds) the application itself could be considered. The Judge agreed and so the request to adjourn was declined, noting also that the mental health crisis appears to have stemmed from the ongoing litigation and so an adjournment would not resolve that.

Regulation 17 allows a creditor to ask a debt advisor, within 20 days of the MHCM being put into place, to review the MHCM for any unfair prejudice or material irregularity (the latter including having funds to pay the debt) but the debt advisor should not cancel the MHCM if the debtor's personal circumstances would make the cancellation unfair or unreasonable. If the MHCM is not cancelled the creditor may apply to the County Court which is what happened here.

The Court decided that the matter could be heard in the High Court rather than a County Court as there were already proceedings opened (the petition) in the High Court.

The direction required more evidence of the mental health issues than was required in the application for the MHCM.

The creditor argued that as the petition had been expedited due to a risk of dissipation of assets the MHCM unfairly prejudiced the petitioning creditor by conflicting with the expedited petition.

The Judge found that the debtor had done nothing during the 60 days of the BSM and then changed debt advisor without explanation, albeit he was entitled to do so.

The Court considered the two reasons why the MHCM should be cancelled:

1. **Material irregularity** – rejected as there was no evidence of ability to pay the petition debt;

2. **Unfair prejudice** – this is not defined in the Regulations. In this case the Court found that the stifling of the bankruptcy petition prejudiced the creditor(s) and was unfair. 14 factors were listed and considered in arriving at that decision. The Court found that the debtor, despite his mental illness, was capable of engaging in complex litigation and seeking to refinance his businesses. The medical evidence was wholly inadequate.

On the basis of a finding of unfair prejudice the MHCM was cancelled.

Creditors will be comforted to see that a MHCM can be successfully challenged, especially when it stands in the way of a justifiable action by a creditor.

Kaye v Lees [2022] EWHC 3326 (KB)

The applicant had obtained and enforced charging orders following litigation which he had won. The sale of the charged property took place while a Mental Health Crisis Moratorium ("MHCM") was in place and, after the sale had taken place, the Court ordered that the sale was null and void.

The creditor applied for the MHCM to be cancelled but did so outside of the strict time limits set out in the regulations. The Court found that unless creditors apply for a cancellation within those time limits, the Court has no jurisdiction to cancel the MHCM. Regulation 17(3) and (4) state that any request for a review must be made within 20 days of either (a) the date the moratorium started; or (b) if the request arises following inclusion in the moratorium of an additional debt (pursuant to regulation 15), within 20 days of the day the debt was included. If the review is successful the moratorium must be cancelled. If the review does not succeed, the creditor may apply to the court (reg 19). Any such application must be made within 50 days of the date the moratorium started (or the additional debt was added).

The 2020 Regulations establish a scheme for the time within which review proceedings may be initiated, may be determined by the debt advice provider, and for any subsequent application to a court. The language used is prescriptive. The Court could see no reason to go behind the ordinary and clear meaning of those words.

The creditor also applied for leave to take enforcement action during the MHCM on the basis that he was a subrogated secured creditor, having paid off the mortgage on the property when he sold the property under the terms of the charging order. The Court agreed that he was a subrogated creditor but found that possession of the debtor's property was to her detriment and so the Court was compelled to decline the application.

The Court did pass comment on the medical evidence which the Court had seen but whilst expressing reservations that the debtor actually qualified for the MHCM, absent any certainty over the full medical evidence the debt advisor had seen, that did not assist the application being heard.

This case will come as a surprise, and a warning, to creditors who must engage with the MHCM process very quickly, and certainly within the tight statutory deadlines, if they are to avoid losing their rights to challenge what is happening.

About the author: Mark Sands, Head of Insolvency at Apex Litigation Finance

Mark Sands has spent his entire career in the insolvency profession, for many years focusing on contentious insolvency cases and has earned a reputation for dealing with complex personal insolvency cases. Mark is a Past President of the Insolvency Practitioners Association ("IPA") and is the current chair of the Personal Insolvency Committee of R3. Mark has shown an interest in the evolution of mental health issues in insolvency matters and presented with Louis Doyle KC on that topic at the IPA Personal Insolvency Conference in November 2022, on which this article builds. Mark is head of insolvency at Apex Litigation Finance Limited, a litigation funder with no minimum funding requirements and a desire to provide innovative and flexible funding solutions to the insolvency profession and beyond.

PSV 1982 LIMITED – v – LANGDON

Case Note: liability under s.217 of the Insolvency Act 1986

Andrew Grantham KC

The decision of the Court of Appeal in ***PSV 1982 Limited v Langdon* [2022] EWCA Civ 1319** answers two fundamental questions in relation to Section 217 of the Insolvency Act 1986:

- The status in proceedings brought under Section 217 of a judgment obtained against the company in proceedings to which the Section 217 defendants were not themselves parties.
- The time at which liability is incurred by the company for the purposes of Section 217 in a claim where judgment for damages was obtained.

The Legislative Context

Section 217 applies where a person is involved in the management of a company using a prohibited name, contrary to Section 216 of the 1986 Act.

Section 216 applies to a person, who was a director or shadow director of a company ("the liquidating company") in the 12-month period_beginning with the liquidating company entering insolvent liquidation ("the 12-month period")[1] . In this article I shall refer to such a person, for convenience, as a/the "prohibited name person".

Insofar as relevant, Section 216(3) makes it a criminal office for a person in the five years beginning with the liquidation of the liquidating company, without the leave of the Court or in prescribed circumstances[2], to:

- Be a director of a company using a "prohibited name" ("prohibited name company");
- Be directly or indirectly concerned or take part in the formation or management of the prohibited name company.

Section 216(2) defines a "prohibited name" as a name by which the liquidating company was known at any time during the 12-month period or as a name which is so similar to such a name as to suggest an association with the liquidating company.

It will be immediately apparent that the primary target of Section 216 is the so-called "phoenix company" but as the Court of Appeal has already made clear in ***Ad Valorem Factors Ltd v Ricketts***[3], the prohibition is not confined to that situation.

Insofar as material, Section 217 imposes personal liability for "all the relevant debts of a company" if at any time a prohibited name person is involved in the management of a prohibited name company and defines "relevant debts"[4] as "such debts and other

[1] *By virtue of Section 216(1) IA 1986*
[2] *Those circumstances are prescribed in Rule 22 of the Insolvency Rules 2016*
[3] *[2003] EWCA Civ 1706, [2004] 1 All ER 894, at [18]*

liabilities of the company as are incurred at a time when that person was involved in the management" of the prohibited name company.

The expression "relevant debts of a company" has been interpreted by the Court of Appeal to mean debts and liabilities of a company while the prohibited name person was involved in the management of the prohibited name company and that company was using the "prohibited name"[5] .

It follows that the time at which the prohibited name company incurs a debt or liability may be highly significant. If a liability is incurred by the prohibited name company before it starts to use the prohibited name, the prohibited name person will not be liable under Section 217.

By Section 217(2) where a person is liable under Section 217, such liability is joint and several with the company and any other person liable.

The definition of "liability" is provided in Rule 14.1 of the Insolvency Rules by which, "liability" is defined as being "a liability to pay money or money's worth".

The Facts of *PSV v Langdon*

PSV v Langdon was decided on the basis of assumed facts[6].

The assumed facts can be summarised as follows.

In October 2015 a Mr France purchased a yacht, "Elusive", from Discovery Yachts Sales Limited ("DYSL"). DYSL sold yachts built by an associated company, Discovery Yachts Limited ("DYL").

In August 2016, Mr Langdon became a director of DYL and DYSL.

Mr France took delivery of Elusive in January 2017. It suffered from various issues.

Mr Langdon was a majority shareholder and director of Discovery Yachts Group Limited ("DYGL"). He remained a director of DYGL at all relevant times. In April 2017 DYGL purchased the shares in DYSL and the business and assets of DYL. He also resigned as a director of DYL.

In September 2017, DYGL entered into the alleged "September Agreement", pursuant to which DYGL procured that certain repairs would be undertaken to Elusive.

On 12 October 2017 DYL was placed into insolvent liquidation. Mr Langdon had been a director of DYL within the 12-month period and continued to act as a director of DYGL. Mr Langdon admitted that "Discovery Yachts" was a prohibited name with effect from that date.

Mr Langdon did not apply for the leave of the Court for DYGL to use its name and he could not rely upon any other exception in Rule 22 of the Insolvency Rules 2016. Accordingly, and as Mr Langdon admitted, DYGL began using a prohibited name during October 2017 and that from that date he was in breach of Section 216.

In January 2018, DYGL acted in breach of the September Agreement.

In April 2018 Mr France and his company ("the Assignors") brought proceedings in the Commercial Court against DYSL and DYGL. Mr Langdon was not a party. Shortly prior to trial, DYGL entered into administration. However, permission was given to continue the claim against it. The trial proceeded without participation by or on behalf of DYSL or DYGL. However, live evidence was given on behalf of the Assignors, the claimants in those proceedings, which resulted in a judgment in December 2019 ("the Judgment") and consequential orders in that month and in June 2020 ("the Consequential Orders"). Throughout that time, Mr Langdon remained a director of DYGL.

In March 2020, the Assignors assigned the benefit of the liabilities to PSV.

Proceedings were commenced by PSV, which relied on the Judgment and Consequential Orders to establish the liability of DYGL to the Assignors.

By the Defence, Mr Langdon raised two relevant defences:

- First, he disputed that DYGL was in breach of any contract: that is he disputed that DYGL had incurred any liability to the Assignors; and
- Second, he said that even if DYGL had incurred a liability, it was not a relevant liability because it would have been incurred in September 2017,

[4] By Section 217(4) a person is involved in the management of a prohibited name company if he is a director or directly or indirectly concerned in its management.
[5] See ***ESS v Sully* [2005] EWCA Civ 554, [2005] BCC 435**, at [81] – see also ***Glasgow City Council v Craig* [2008] CSOH 171; [2010] B.C.C. 235** at [21]
[6] The assumed facts included facts that Mr Langdon did not admit. In particular he did not admit the September Agreement or that DYGL acted in breach of any contract.

before DYGL had begun to use a prohibited name.

The parties agreed that preliminary issues should be tried on the basis of assumed facts.

The issues came before Mr Robin Vos, sitting as a Deputy Judge of the High Court[7]. He held that:

- Once a liability had been established in proceedings against the prohibited name company, the defaulting director, in this case Mr Langdon, automatically became responsible for that liability (provided the other requirements of Section 217 were met)[8].
- DYGL's liability arose on the assumed facts at the time of breach of contract in January 2018, not when the September Agreement was made[9].

Mr Langdon obtained permission to appeal.

The Decision in the Court of Appeal

The Status of the Judgment and Consequential Orders

The Court held that the Judgment and Consequential Orders established the liability of the Company in proceedings brought against Mr Langdon under Section 217 notwithstanding the fact that he was not a party to the proceedings against the Company.

Asplin LJ, giving the only reasoned judgment of the Court, held that:

> *"[37]…the natural and ordinary meaning of the language used in section 217(1) is quite clear. A person is personally responsible for the relevant debts of a company if the remainder of the requirements in section 217 are met and the person is jointly and severally liable for those debts with the company and any other person who is liable for them."*

She proceeded to hold, relying on the analysis of Lewison J (as he then was) in *First Independent Factors & Finance Ltd v Mountford*[10] and His Honour Judge Purle QC in HM Revenue and Customs Commissioners v Yousef[11] , that the purpose of Section 217 was to protect creditors and to widen the pool of people from whom the creditor may recover its debt[12] . On that basis she held[13]:

> *"A director who contravenes section 216, in addition to the criminal penalty contained in that section, becomes personally responsible for the company's debts and liabilities if they are incurred whilst there is a contravention of section 216. It seems to me that the words are quite clear and no question of a doubtful penalty arises."*

She also held that there was no question of a stranger being bound by a judgment to which he was not a party and the rule in ***Hollington v Hewthorn***, as explained in ***Ward v Savill*** [14] had no application. That was because Section 217 itself provided that the director became liable for the relevant debts of the prohibited name company. The Consequential Orders created the judgment debt against DYGL. They were the source of the debt and spoke for themselves without any need to have regard to the findings of fact or reasoning against DYGL[15]. Not only did they establish the amount of the debt but also that it was a "relevant debt" for the purpose of Section 217(3). They were made when Mr Langdon was a director of DYGL.

When is a relevant debt/liability incurred?

The Court held that the DYGL's liability was a relevant debt because it was incurred at the time of the Consequential Orders, at which time Mr Langdon was a prohibited name person. In any event, the underlying liability for damages for breach of contract was incurred at the time of breach[16].

The Court held that DYGL's liability was incurred for the purposes of Section 217 at the time of the Consequential Orders because the underlying liability was subsumed into those orders. On that basis, the judgment debt was a relevant debt because at the time of those orders Mr Langdon was a prohibited name person. That was certainly the case in relation to the interest and costs element of the Consequential Orders, which only arose at the time of those orders[17].
Even if that analysis did not apply in relation to the damages element, the liability for damages arose

[7] [2021] EWHC 2475 (Ch), [2021] Bus. L.R. 1422 , [2022] B.C.C. 44, [2022] B.P.I.R. 820
[8] See [46]: although Mr Langdon was not DYGL's privy and so was not bound by an issue estoppel or otherwise precluded from challenging the Judgment.
[9] See [101] – [103]
[10] [2008] EWHC 835 (Ch), [2008] BCC 598 at [17]
[11] [2008] BCC 805 at [33]
[12] At [41]
[13] At [41]
[14] [2021] EWCA Civ 1378
[15] Asplin LJ referred to Phipson on Evidence (19th ed.) at para 43-02 and Green v New River (1792) 4 TR 590, 100 ER 1192
[16] See [44], [48] and [49
[17] See [48]

at the date of the breach of contract. Relying on the analysis of Lord Diplock in ***Photo Production Ltd v Securicor Transport Ltd***[18], the Court held that while the source of the secondary obligation to pay damages for breach of contract was the contract itself, the obligation did not arise until the date of breach. A liability to pay money or money's worth for the purposes of IR 14.1(6) only arose at that time, in January 2018[19]. That was more consistent with the purpose of Section 217 and Section 217(2)[20].

The decision in R***e Milwall Football Club and Athletic Co (1985) plc***[21] was concerned with the proper construction of a defined term, "moratorium debt" in a CVA. It was of no assistance in addressing the time at which liability was incurred for the purpose of Section 217.

The Practical Consequences of the Decision

There are four obvious implications.

First, a prohibited name person, who, in order to avoid liability under Section 217, wishes to challenge the liability of the prohibited name company against which proceedings have been brought, has three options. Insofar as he is able, he may cause the prohibited name company to defend proceedings brought against it. If he is not able, but judgment has yet to be entered, he should apply to be joined as a defendant in the proceedings brought against the company as an interested party. Alternatively, if judgment has been entered he should apply under CPR 40.9 to set aside the judgment as a party affected by it.

Second, it reinforces the importance of a prohibited person causing an application to be made for leave of the Court to use the prohibited name within 7 days of the liquidating company going into insolvent liquidation, in accordance with Rule 22.6. If within the prescribed six-week period[22], leave is not obtained, he or should consider resigning his or her position in the prohibited name company. If he or she fails to do so, there is a real risk of personal liability even if the prohibited name company enters into no new contracts. Breach of an existing contract will suffice, as will incurring a judgment debt.

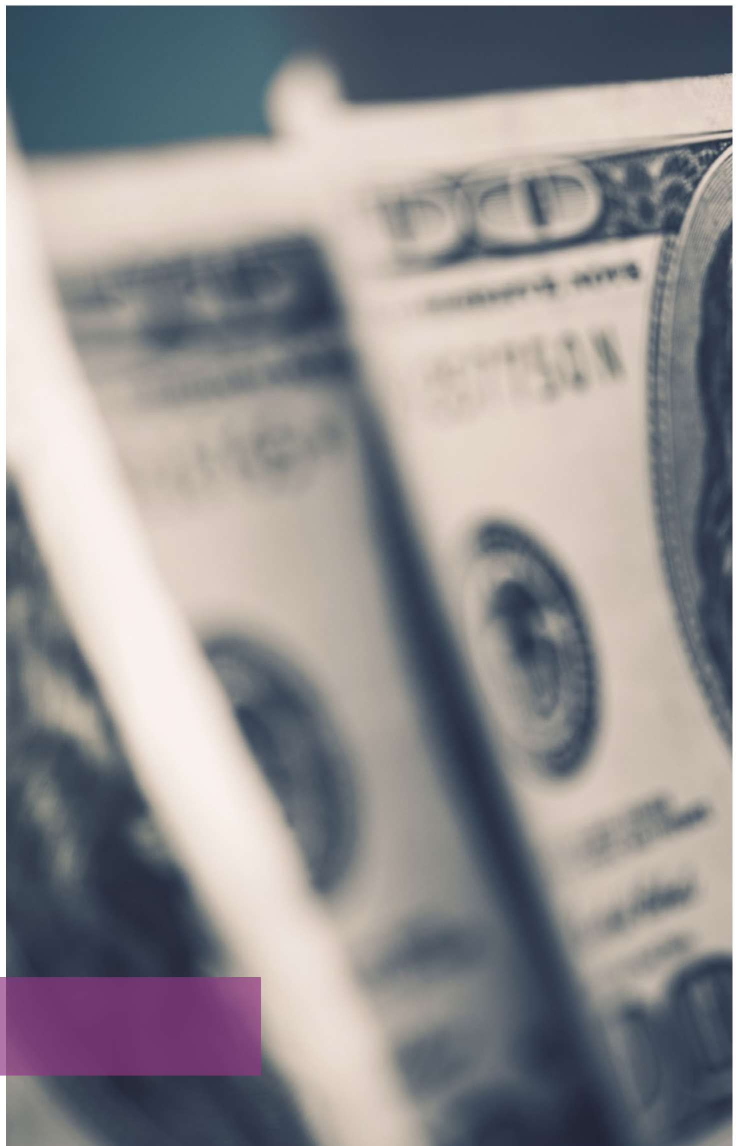
Third, a judgment creditor of a prohibited name company, even if insolvent, will have a valuable asset, the value in which can be realised by itself relying upon Section 217 or assigning the benefit of the judgment debt."

Fourth, in cases in which no judgment is entered against the prohibited name company, liability for damages for breach of contract is incurred at the time of the breach not the entry into the contract, the breach of which gives rise to the liability.

PSV 1982 Limited v Langdon is likely to be regarded as a significant case addressing Sections 216 - 217 of the Insolvency Act 1986 and potentially of wider significance in particular as to the time at which liability is incurred for the purpose of insolvency proceedings.

[18] [1980] AC 827, at 848H
[19] See [52]
[20] See [55] – [56]
[21] [1999] BCC 455
[22] Referred to in Rule 22.6 IR 2016

AFTER THE DUST HAS SETTLED: THE CREDITOR DUTY IN SEQUANA AND SOME UNANSWERED REAL-WORLD QUESTIONS



Louis Doyle KC

The Supreme Court's long-awaited judgment in ***BT1 2014 LCC v Sequana* and others [2022] UKSC 23 [2022] WLR 709** prompted the inevitable welter of seminars – remote and in person – articles, case notes and updates, perhaps surprisingly given the narrowness of the point in issue and, by reason of the narrow scope of the argument, the host of issues that remained completely untouched by the Supreme Court. One task for the truly dedicated in surveying the instantly mushrooming commentaries on the judgment was trying to find anything that said something different and credible. This short article looks at some of those unasked questions and what might be answers.

A brief recap of the problem and how we got here

By way of brief recap, in ***BTI 2014 LCC v. Sequana SA* [2019] EWCA Civ 112 at [220] to [222]**, following ***Liquidator of West Mercia Safetywear Ltd v. Dodd* [1988] BCLC 250**, the Court of Appeal recognised that, at common law, consideration of creditor interests could be an element in the duties of directors. Reconciling the duty to promote the success of the company under s.172(1) of the 2006 Act (in which the factors to be considered by directors in promoting the success of the company do not include the interests of creditors) with a <u>duty</u> to consider creditor interests presents difficulties. In particular, the wording of s.172(3) – which provision, interestingly, Patten LJ had described in ***Bilta (UK) Ltd v. Nazir* [2014] EWCA Civ 968 at [22]** as being no more than a statutory recognition of the decision in ***West Mercia*** - posed a difficulty in identifying when that duty was triggered. Of the four possibilities suggested on the authorities, the weight of judicial expression indicated that the duty was capable of being triggered when a company's circumstances fell short of actual, established insolvency (see **[195]**). Since directors might not know, nor be expected to know, that a company is insolvent until some point after it had occurred, a test falling short of actual, established insolven-

cy is justified. On the authorities, the Court of Appeal considered that the duty is triggered - such that the interests of creditors become paramount - at the point at which the directors knew or should have known that the company was or was likely to become insolvent. In that context, following ***Bilta,*** the view of the Court of Appeal was that "likely" means probable, and not something lower, such as the threshold test for the likelihood of achievement of purpose on the exercise of discretion in making an administrative order ***(Re Harris Simons Construction Ltd*** **[1989] 1 WLR 368 (Hoffmann J))**.

Establishing the trigger of the creditor duty matters for at least two reasons, as identified by the Court of Appeal in Sequana at [143]:

"This court's decision in West Mercia establishes two propositions. First, the shareholders of an insolvent company cannot ratify the acts of directors taken in disregard of the interests of creditors , and, as a necessary corollary, it is incumbent on the directors of an insolvent company to have regard to those interests. Second, the rationale is that, because of the company's insolvency, its assets are in a practical sense the assets of the creditors, pending its liquidation or return to solvency."

On appeal, the Supreme Court upheld the Court of Appeal's view as to the existence of the creditor duty. As the Court of Appeal confirmed, the duty is not one owed to creditors but as what amounts to a modification to s.172 of the 2006 Act.

So, when is the creditor duty triggered?

According to the Supreme Court, the creditor duty is triggered when a company is insolvent, bordering on insolvency, or when an insolvent liquidation or administration is probable . A real risk of insolvency, therefore, alone, is not a sufficient trigger for the duty. Neither is the trigger absolute; as Lord Briggs put it at **[173]**, *"practical common-sense points strongly against a duty to treat creditors' interests as paramount on the onset of what may be only a temporary insolvency"*. In practice, this might mean that, as can happen in the commercial world, a company finds itself insolvent but in circumstances where it is apparent to the directors – but to what threshold? – that the insolvency will be transient only based on identifiable factors with a good degree of certainty that will serve to return the company to solvency.

Is there a requirement for knowledge on the part of the directors?

In ***Sequana,*** this point was necessarily *obiter* (because, as an issue, it was not relevant to the facts of the case or the overall outcome). Clearly, however, the Court could see the obvious practical importance of dealing with the point. The majority of the Court held that, in each case, the triggering of the creditor duty depends on what the directors knew or ought to have known . The minority left the point open. Lord Reed was less certain as to the requirement for knowledge, and preferred simply to indicate that, *"It should be borne in mind that directors are under a duty to inform themselves about the company's affairs … and the rule in West Mercia will itself incentivise directors to keep the solvency of the company under careful review."* Lady Arden expressed no view on the point in the absence of full submissions.

The content of the creditor duty

The content of the creditor duty was dealt with more briefly by the Court, but the point is one raising its own issues. Lord Briggs explained that essentially there is a time before liquidation is inevitable that directors are obliged to *"consider creditors' interests, to give them appropriate weight, and to balance them against the shareholders' interests where they may conflict. Circumstances may require the directors to treat shareholders' interests as subordinate to those of the creditors."* This chimes with the view ex-

[1] ***Colin Gwyer & Associates Ltd v. London Wharf (Limehouse) Ltd*** **[2003] 2 BCLC 153 at [74],** referred to in ***Sequana*** **at [168]** with other authorities where the relevant company was clearly insolvent. In ***Gwyer,*** Mr Leslie Kosmin QC, sitting as a Deputy High Court Judge, considered at **[74]** that, *"When a company is insolvent or of doubtful insolvency or on the verge of insolvency and it is the creditors' money which is at risk, the directors, when carrying out their duty to the company, must consider the interests of creditors as paramount and take those into account when exercising their discretion."*

pressed a decade before by Mr John Randall QC, sitting as a Deputy Judge in ***Re HLC Environmental Projects Ltd*** **[2014] BCC 337 at [92(a)]:** *"(a) Where the duty extends to consideration of the interests of creditors, their interests must be considered 'paramount' when taken into account in the directors' exercise of discretion".*

However, in the recent judgment in ***Aston Risk Management Ltd v Jones & Others*** **[2023] EWHC 603 (Ch) at [177]** His Honour Judge Cawson KC, sitting as a Judge of the High Court, pointed out that Para 92(a) of the judgment in ***HLC Environmental*** requires some clarification in light of the ***Sequana*** judgment in the Supreme Court. Having identified the differing views as to the point at which the duty triggers (as summarised for the majority by Lord Briggs JSC at **[203]**), the Judge pointed out at **[179]** that the majority of the Supreme Court (Lord Reed PSC, Lord Hodge DPSC, and Lord Briggs and Lord Kitchen JJSC) rejected the suggestion that creditors' interests should necessarily become paramount. In their view, when the duty to have regard to the creditors' interests arose, the directors were required to take into account and give appropriate weight to the interests of the company's creditors, and to balance those interests against the shareholders' interests where they might conflict. Lady Arden considered that, once the duty arose, it was a duty not to materially harm the creditors' interests. However, whichever of these approaches was correct, once an insolvent liquidation or administration became inevitable, the creditors' interest became apparent in that, in those circumstances, the shareholders ceased to retain any valuable interest in the company.

Thus, the weight to be given to creditor interests is not absolute. Generally speaking, the scale will tip towards the interests of creditors as a company's position worsens . The point was articulated by Lord Reed at **[11]**:

"Where the modifying rule applies, the company's interests are taken to include the interests of its creditors as a whole. The duty remains the director's duty to act in good faith in the interests of the company. The effect of the rule is to require the directors to consider the interests of creditors along with those of members. The weight to be given to their interests, insofar as they may conflict with those of the members, will increase as the company's financial problems become increasingly serious. Where insolvent liquidation or administration is inevitable, the interests of the members cease to bear any weight, and the rule consequently requires the company's interests to be treated as equivalent to the interests of its creditors as a whole."

The specifics of what is not said in ***Sequana*** will be apparent, as will be the scope for further argument on appropriate facts. It might be the case, for example, that in certain circumstances the public good might outweigh creditor interests or the interest or interests of another class or classes of stakeholders are afforded priority, possibly by reason of a strong connection between decision making directors and the members of the class of creditors.

What is the effect of a breach of the creditor duty?

This point was not before the Court of Appeal or considered in the Supreme Court. Any sort of definitive answer to it must await an appeal to one of those courts. It would seem to follow, however, that once the creditors' interests duty is triggered, any payment caused to be made must be considered against the context of the facts, but that, generally speaking, any transaction which is not plainly for the benefit of creditors is, it is suggested, very likely (at least) to constitute a breach of duty, as would give rise to a claim by the company against the errant director(s) for equitable compensation. Aside from the language used to articulate the relevant test, the analysis of Mr John Randall QC at first instance in ***Re HLC Environmental Projects Ltd*** **[2014] BCC 337 at [89]** remains good law:

"The underlying principle is that the directors are not free to take action which puts

[2] To like effect in ***Sequana*** in the Court of Appeal at [162], *"In Official Receiver v. Stern [2001] EWCA Civ 1787, [2002] 1 BCLC 119 Sir Andrew Morritt V-C, giving the judgment of this court (the other members being Buxton and Arden LJJ), said at [32] that the normal principle that the shareholders may waive or ratify a breach of duty by the directors did not apply "if the company is insolvent", citing in support West Mercia and the passage from Street CJ's judgment in Kinsela quoted by Dillon LJ"*

[3] See Lord Reed at **[83]** and **[88],** Lord Briggs at **[191], [192]** and [199] and Lord Hodge at **[247].**

[4] See Lord Briggs at [203], Lord Hodge at [238] and Lord Reed at [90].

at real (as opposed to remote) risk to the creditors' prospects of being paid, without first having considered their interests rather than those of the company and its shareholders. If, on the other hand, the company is going to be able to pay its creditors in any event, ex hypothesi, there must be no such constraint on the directors."

Consistent with the above, what might otherwise be characterised as ordinary or normal commercial payments have been held in at least three cases to be a breach of duty by reason of the payer company being insolvent or of doubtful insolvency. This, it is suggested, is in line with the judgment and reasoning in ***Sequana.***

In ***Re DKG Contractors Ltd* [1990] BCC 903** a director had procured payment to himself (in respect of services rendered) during a period when the company was of doubtful insolvency. The payments amounted to a breach of duty because (at **908C**):

"The company's assets were not preserved for general creditors. The method of operating, particularly at a time when the company was of doubtful insolvency, meant that the general creditors were competing on unfair terms with one creditor, who was always likely to be paid ahead of the rest. I therefore conclude that it was a breach of the directors' duties to make the payments …"

In ***Re Cityspan Ltd* [2007] 2 BCLC 522 at [30] to [32]** the directors were held liable for breach of fiduciary and common law duties in causing payments to be made for their benefit where the company was no longer trading or in a position to generate revenue to meet its liabilities to creditors and the position of creditors was detrimentally affected by the making of the payments.

In ***Vivendi SA v. Richards* [2013] BCC 771,** where the directors were aware of the company's financial vulnerability (or dubious solvency) [152], but made a series of payments pursuant to purported commercial transactions, Newey J (as he then was) held the directors to be in breach of fiduciary duty because the directors were [165], "seeking to extract CH3's [the company's] remaining cash from the company before it failed and, hence, to thwart the company's landlords rather than to benefit them."

[5] See the judgments of Lord Reed at **[81]**, Lord Briggs at **[176]** and Lord Hodge at **[247]**

[6] ***HLC Environmental*** involved a director who caused certain payments to be made without giving any consideration to the interests of creditors when he should have done, as the company was insolvent, having net liabilities, no live projects or revenue stream, and no realistic prospect of gaining any. As no intelligent and honest man in the director's position would have concluded that making the payment was for the benefit of the creditors, the director was found to have acted in breach of duty.

Louis Doyle KC was leading counsel for the successful claimants in the Aston Risk Management case at the liability trial in Manchester before HHJ Cawson KC in February 2023 following which a number of interim payments under CPR 25.2 and 25.3 were ordered. The quantum trial is listed for November 2023.

Doyle, Keay & Curl's Annotated Insolvency Legislation

The eleventh edition of the above text, written by Louis Doyle KC, Professor Andrew Keay and Jospeh Curl KC, assisted by a team of specialist contributors and editors, was published in March 2023. The new edition is fully updated. The first two named authors are members of Kings Chambers and have been responsible for the text since its first publication in 2005.

CLICK HERE TO VIEW

Jonathan Fletcher-Wright and **Rory Goodson** tried their luck at passing as undergraduate students whilst visiting the University of Birmingham last month! We think they just about got away with it!

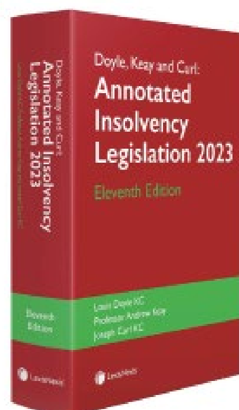
10% Discount

Doyle, Keay and Curl: Annotated Insolvency Legislation Eleventh Edition

Edited by *Louis Doyle KC, Professor Andrew Keay* and *Joseph Curl KC*

Expert insight and practical guidance on key insolvency legislation

With a leading author team, *Doyle, Keay and Curl* provides practical guidance on the key primary and secondary insolvency legislation. In addition to the complete texts of the key statutory provisions, each is annotated with detailed analysis and commentary, providing practitioners and academics with everything they need within a single portable volume.



This clear, logical and easy to follow title includes the following key cases and developments:

- *Amicus Finance Plc; Re Smile Telecoms Ltd; Re Houst Ltd* – recent cases on the new Part 26A restructuring plan
- *Carton-Kelly v Darty Holdings SAS* – the largest ever preference action arising from the Comet liquidation
- *Re Edengate Homes (Butley Hall) Ltd* – the circumstances in which a dissentient creditor may challenge office-holder decision-making
- *Re MBI & Partners Inc* – witness immunity for statements made during a s.236 examination
- *Hughes v Howell* – what counts as an "offer" for the purposes of s.271(3)
- *Michael Wilson & Partners Ltd v Sinclair* – remedy against debtor's property under s.285(3)(a)

Publication date: 22nd March 2023

Order now for ~~£330~~ £297
lexisnexis.co.uk/kc10

LexisNexis

Want updates straight to your inbox?

If this is not your own copy of Kings Insolvency and you wish to receive your own, simply email your contact details to info@ kingschambers.com with "Kings Insolvency" in the subject line.

If you no longer wish to receive Kings Insolvency news please email the same address.

If you want to add the name of any third party to the distribution list for Kings Insolvency please send email details to info@kingschambers.com with "Kings Chambers Insolvency" in the subject line. All such requests are accepted on the basis that the party so named consents to their details being provided to us for that purpose.

Feedback

If you have any comments or queries in relation to the content of Kings Chambers Insolvency please contact Louis Doyle KC, ldoylekc@kingschambers.com

For all clerking enquiries please contact:

Gary Young
Chief Clerk
Telephone: 0161 819 8801
Email: gyoung@kingschambers.com

Harry Young
Senior Clerk
Telephone: 0161 819 8803
Email: hyoung@kingschambers.com

Brandon Singh
Clerk
Telephone: 0161 819 8257
Email: bsingh@kingschambers.com

Louie Morrissey
Clerk
Telephone: 0161 819 8298
Email: lmorrissey@kingschambers.com

KINGS
CHAMBERS