Tayside and Fife Insolvency Group

Legal Update | 2016

David Logan, Advocate

I am going to talk today mainly about s242 of the Insolvency Act 1986. As you will know this section allows transactions which took place before the company went into insolvency to be challenged if not for adequate consideration.

When I agreed with John to do this talk I had 2 irons in the fire re s242. Firstly, that week, there had been a hearing in the Supreme Court on the scope of s242 and secondly, the following week, I myself had done a debate on the relevancy of a claim under s242 for a liquidator in Aberdeen Sheriff Court.

Regrettably, as of yesterday, both those irons are still in the fire so I cannot yet direct you to the relevant decisions but this simply improves the opportunity for speculation!

S242

For ease of reference the relevant provisions are:

> (1) Where this subsection applies and—
>
> (a) the winding up of a company has commenced, an alienation by the company is challengeable by—
>
> (i) any creditor who is a creditor by virtue of a debt incurred on or before the date of such commencement, or
>
> (ii) the liquidator;
>
> (b) [a company enters administration] [1] , an alienation by the company is challengeable by the administrator.
>
> (2) Subsection (1) applies where—
>
> (a) by the alienation, whether before or after 1st April 1986 (the coming into force of section 75 of the Bankruptcy (Scotland) Act 1985), any part of the company's property is transferred or any claim or right of the company is discharged or renounced, and
>
> (b) the alienation takes place on a relevant day.

There are defences in subsection (4)

> "…but the court shall not grant such a decree if the person seeking to uphold the alienation establishes—
>
> (a) that immediately, or at any other time, after the alienation the company's assets were greater than its liabilities, or
>
> (b) that the alienation was made for adequate consideration, or
>
> (c) that the alienation—

(i) was a birthday, Christmas or other conventional gift, or

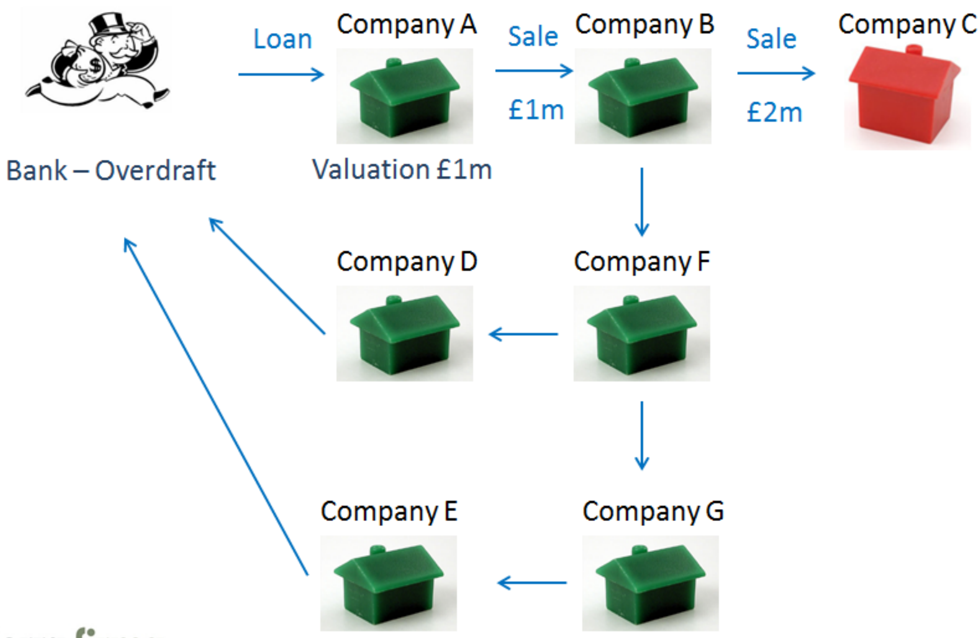
(ii) was a gift made, for a charitable purpose, to a person who is not an associate of the company, which, having regard to all the circumstances, it was reasonable for the company to make:

Provided that this subsection is without prejudice to any right or interest acquired in good faith and for value from or through the transferee in the alienation."

The Supreme Court case

The Supreme Court case was a rehearing of the decision in *Joint Administrators of Oceancrown Ltd-v-Stonegale Ltd* 2015 SCLR 619

The facts are complicated:



The interesting point is that it was not disputed that the purchases from F-G and D-E were for the appropriate value. The problem was not the consideration but the source of the funds which had arisen from what was being deemed a fraud by the director of companies A and B.

In the Supreme Court, Alan Summers QC argued that the administrators had sought the wrong remedy, that to go anywhere near the transactions between F&G and D&E it was necessary to firstly reduce the transaction between A&B and this was no longer possible because it was accepted that C was a bona fide third party purchaser whose title was protected by the section.

Although the case is not yet formally decided I can be very confident of the result because Mr Summer's opponent was not called upon to speak in the Supreme Court. What is less clear is how they have reached the conclusion that they did. In the Outer House the Lord Ordinary had held that there had effectively been no consideration paid for the properties belonging to D & E and the Inner House agreed. They said:

> "We would accept what Lord Drummond Young said in *Jackson v The Royal Bank of Scotland plc 2002 SLT 1123* at 1128D: "if the transaction as a whole appears commercial it should generally be assumed that the consideration is adequate". That, however, has no application here. The transactions under consideration were devices for the diversion of assets from creditors, facilitated by a misrepresentation to the banker of the companies which were involved. They were accordingly not commercial transactions. Nothing therefore can be assumed and if, despite their non-commercial nature they are to be said to have had the result that adequate consideration passed, then that had to be proved. That the defenders singularly failed to do."

Looking at this with the Insolvency Practitioner's hat on it seems to me that this is a considerable opportunity. If it is possible to "follow the money" and strike down transactions using that money then the scope of s242 is going to be considerably widened. Inevitably, with opportunity comes responsibility. If such an amplified interpretation of s242 becomes accepted then there may well be more of a duty on the insolvency practitioner to pick their way through the tangled webs that these people weave. My Aberdeen case, that I will come to, may well be an example of that.

One of the alternatives to s242 where the money can be stuck on an individual is of course s212, the traditional misfeasance action. In that context I should briefly mention the decision of Sheriff Principal Stephen in *Glasgow and Weir Blacksmiths Ltd (in Liquidation)-v-Glasgow* [2016] SCEDIN 20*,* issued on 29th February 2016.

In that case there had been a group of companies that were in trouble. The director, Mr Glasgow, had allowed payments due to the Blacksmith company to go to other companies in the group who were thought to have an even greater need of the funds. The Sheriff at first instance found that there was no dishonesty on the part of Mr Glasgow but that he still had a responsibility in terms of s212 to contribute to the loss that the Blacksmith company had suffered and the Sheriff Principal agreed.

Counsel for the appellant tried quite a clever argument that the money had been directed to an associated company called "windows" who were in turn creditors of the Blacksmith company and had therefore reduced the debt to them by the same amount.

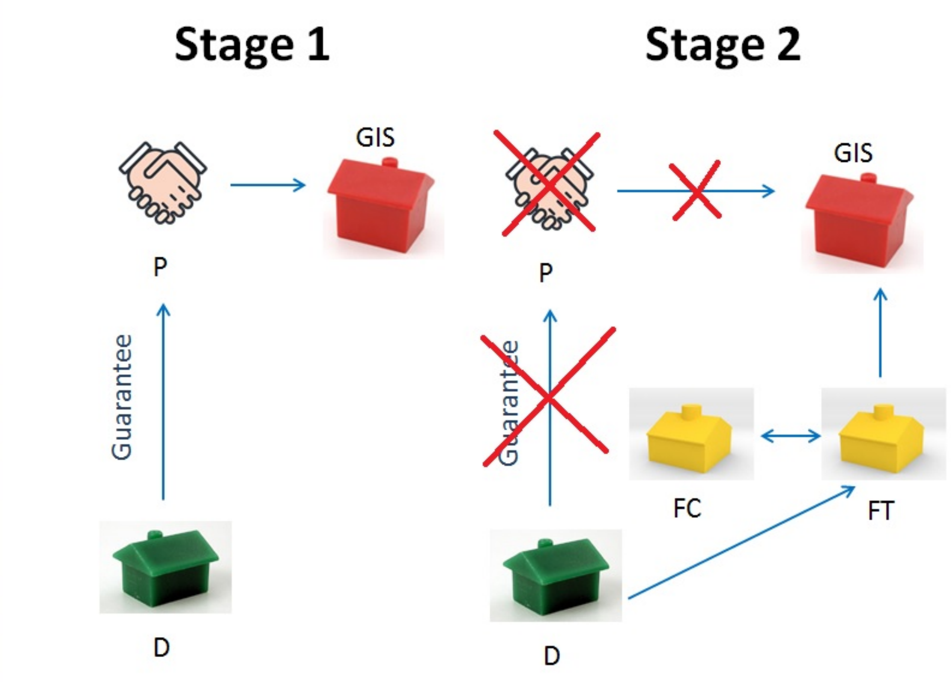
This followed on from the case of *Derek Randall Enterprises Ltd* 1990 BCC 749 where it was successfully argued that money put in a special account which the Bank was able to seize and set off on insolvency did not cause a loss to the company. In the present case, however, the fact that the debt due to Windows had been reduced by that amount was an assertion by the appellant that was not accepted. I have to confess that I find this part of the decision quite hard to follow. This was an appeal following an order to pay under s212. How that order fell to be made before the question of whether the company had suffered a loss is not clear to me or from the judgment. It may be that this case will go further.

My Aberdeen case

Returning to the central theme of s242 I want to mention my case in Aberdeen. It is at a debate in relation to a preliminary point but the facts again need some explanation. The first thing that is interesting about this case is that although it is an action for reduction of a standard security and guarantee it is in the Sheriff Court, not the Court of Session. This follows the bringing into force of the Courts (S) Act 2015.

There is an even more complicated background but for present purposes the relevant facts are these:

- D had guaranteed a factoring agreement by what was then an associated company called GIS.
- GIS switched hands to a group including FT.
- FT lent GIS about £1.5m and D guaranteed that loan.
- The loan was used, in part, to repay the factoring arrangement to P discharging that guarantee.



At the debate it was argued that s242 did not cover guarantees, an argument I frankly did not understand and which in my view ran counter to *Jackson-v-Royal Bank of Scotland plc,*2002 SLT 1123, a decision of Lord Drummond Young in the Outer House which dealt with a guarantee.

Much more interesting questions await, however.

Firstly, does the granting of a guarantee create a liability for the company at the point of its creation or at the time that it is called upon?

Secondly, on the facts of this case the defenders are seeking to argue that D was not insolvent at the time that the guarantee was granted. They seek to argue this on the basis of accounts which purport to show that. The management accounts of the company showed a materially different picture and the position of the liquidator is that the accounts did not give a true and fair view of the company.

Thirdly, it is argued that all that effectively happened was that one guarantee was replaced by another. I say that is not true for at least 2 reasons. Firstly, the guarantee in favour of P was the guarantee of a factoring agreement which covered GIS's invoices in the north sea. At any given time 2x the value of any advances made by P were assigned so it would only be if there was a major default on the invoices after a payment to account had been made that any claim would arise. In contrast the guarantee for FT was for a straightforward loan and it was a loan that was secured by the granting of a standard security over the heritable assets of D.

For me, this raises a genuinely interesting question which is more for accountants than lawyers. If it is the case that a contingent liability is created at the granting of the guarantee (as it must be) how do you account for it? Is it dependent on the risk? Or the security of the principal debtor? Or simply on the amount? I would be genuinely interested in hearing the views of accountants on this.

What my Aberdeen case is an example of is of a liquidator trying to unpick a very complicated arrangement which has the practical effect of putting the heritable assets of D beyond the reach of its own creditors. I am hopeful that the Supreme Court will say that this is fine and that one should not be overly picky about how we get there.

In conclusion I think that recent events are showing s242 to be a more powerful and useful tool in the IP's tool kit than has been thought to be the case hitherto. The Courts are approaching these provisions and s212 in a way that is sympathetic to creditors and seeking to protect creditors rather than getting in their way. Such cases are inevitably fact specific but I think that IPs may be obliged to be a little braver in making these claims going forward.

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30th March 2016