Legal Q&A

Mike Pavitt and **Shelley White** answer your insolvency queries.

Q I am the compulsory liquidator of a company that, after presentation of a relevant petition but before its advertisement, transferred (to the brother of one of its directors) a valuable minority shareholding in another company. When challenged, the brother (who continues to hold other shares and a directorship in that other company) claimed the transfer was in repayment of a debt owed to him by the company and both he and the director denied that the company was insolvent at the time. The current market value of the shares is much less than when they were transferred out and the director is now bankrupt and his estate is of nil value. The brother has now offered (two years since the transfer) to simply transfer the shares back or to buy them at market value, in full and final settlement of any claims against him and/or against the director. How should I approach the brother's offer?

A You seem to have concluded that there is little practical merit in your pursuing the director, but that the brother may be worth powder and shot. Your approach to the brother's offer should therefore reflect the strength of your possible routes to recovery against him, and of course your ability to fund those routes.

The share transfer to the brother is likely to have been a transaction at an undervalue or preference to a connected person under ss238-240 Insolvency Act 1986 (IA) but, despite the statutory TUV presumption weighing against the brother, these claims might not be straightforward, for example in terms of establishing that the transfer happened at a relevant time. Careful evidence gathering and analysis would be required and the availability of a conditional fee pursuit post LASPO and/or third party litigation funding and/or insurance might be uncertain.

In order to best serve the interests of creditors, therefore, we would suggest that you put your focus, initially at least, on s127(1) IA. The transfer was almost certainly a void disposition of the company's property and it is difficult to see how the brother could claim it should be validated by the court. The Court of Appeal has helpfully reaffirmed (*Express Electrical Distributors Ltd* v. *Beavis* [2016] EWCA Civ 765) that the circumstances in which a recipient of a post-petition disposition could hope to validate such a transaction would be exceptional indeed, and that ignorance of the petition and good faith generally would be no defence.

"Careful evidence gathering and analysis would be required and the availability of a conditional fee pursuit post LASPO and/or third party litigation funding and/or insurance might be uncertain."

It is all very well to say the transfer was void, however, but can s127(1) actually deliver an effective remedy on its own? Judicial opinions have varied as to the proper nature of s127(1), and its sister provision in bankruptcy s284, with the registrars, for example, often treating such applications as claims for money had and received. If that approach were adopted in your case, it might be that the best you could hope for from s127(1) alone would be the return of the shares at whatever value they now hold, and perhaps an account of any dividends declared and paid out on them since the transfer. That would imply that the brother's offer may be a reasonable one.

However, on considering these issues recently (albeit in the context of s284: see *Eatisham Ahmed* [2016] EWHC 1536 (Ch)) the High Court followed a much more purposive tack, finding that the void disposition jurisdiction gave the insolvency practitioner a free-standing right to recover any loss suffered as a result of the disposition, on the basis of a breach of trust. In that case the relevant respondents were not ordered to return the shares (which the trustees would have been under a duty to sell anyway) but to compensate the bankruptcy estate for the loss in value of the shares while they were holding them on trust. Moreover, it was found that as the title of the applicants had relation back to the date of the transfer, that was the effective date for valuing the shares so as to assess the loss, and as the disposition was to associates who were shareholders and directors of the company in question, they should be valued on a fair value basis, rather than a market value basis.

Applying this analysis to the brother's offer, and accepting of course that every case must be viewed on its own merits and that it is always sensible to take specific legal advice in such circumstances unless the amounts involved are trivial, his offer perhaps will not seem that reasonable at all. Arguably he should be accounting to you for the loss in value of the shares against an historic share valuation prepared for the date when the shares were first transferred and, on the basis of the value of the shares, to him rather than the market at large, and then he can keep hold of the shares. We would suggest that you consider entering into further negotiations with the brother on that basis (but without prejudice to your other potential remedies) and if his offer is not increased appropriately that you take advice with regard to funding and pursuit options in the round.

Q I am a nominee of a debtor who I have assisted to prepare IVA proposals and the non-interim order procedure is being adopted. I did not think the proposals or reports would therefore need to be filed at court but more than one of my older colleagues disagree. Who is correct?

A On the face of it this should be a straightforward question, but we can understand why you and your colleagues may be struggling with it. We agree that the relevant provisions of the Act and rules, and relevant professional guidance, are not as clear or helpful as they could be.

Your primary frame of reference is, of course, s256A IA, which sets out no obligation on any party to file the proposals with the relevant court. We then look to the relevant insolvency rules, which are now rr5.14A and 5.14B, the old rule 5.15 (which used to provide for filing of the nominee's report, notwithstanding no interim order was being sought) having »

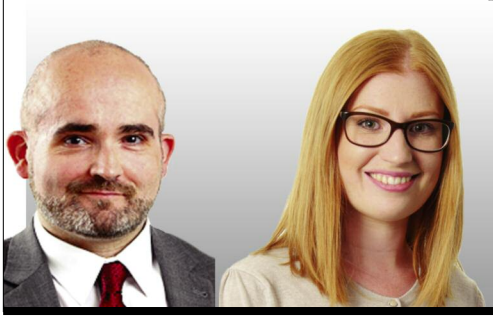
been revoked in 2010. These deal with court jurisdiction, but only in the context of a formal application needing to be made (eg for the replacement of the nominee). It follows that the proposals would only need to be filed, to assist the court, in the event that such an application is being made.

The obligation to file the chairman's report likewise only applies if there has been an interim order (see for example r5.27(3)). We are aware that some IPs still adopt the historic procedure of filing the proposals and nominee's report and/or chairman's report with the relevant court, whether out of habit or an abundance of caution. Some may be fuelled in this by paragraph 2.5 of SIP12 suggesting that the chairman's report should 'include such further information (if any) as the chairman thinks it appropriate to make known to the court', but it seems now to be beyond any real doubt that this is unnecessary. Only the Secretary of State needs to be informed, and then only of an approved IVA (r5.29).

This is of course in keeping with current legislative moves to remove personal insolvency from the purview of the court, and whatever we may think of that, it would be inconsistent if the law were to impose an obligation to engage with the court when incepting an IVA whilst having entrusted debtor bankruptcy to an adjudication procedure. There appears to be nothing in the new insolvency rules (at least in their latest draft) that would alter this position.

> It would be inconsistent if the law were to impose an obligation to engage with the court when incepting an IVA whilst having entrusted debtor bankruptcy to an adjudication procedure.

In answer to your question, therefore, we suggest that it is you who are correct in your interpretation of the applicable law, but your colleagues' caution is well founded and based on established principles. □



MIKE PAVITT is lead corporate restructuring and insolvency partner at Paris Smith LLP.

SHELLEY WHITE is a solicitor at Paris Smith LLP.

REVIEW

False Assurance

This is the ICAEW's first foray into film-making and, whilst it doesn't represent an immediate challenge to Hollywood, it's a cracking good tale.

It's about an audit – but including blackmail, bribery, bullying, bonuses, cybercrime, client relationship stress – oh, and the basis of valuation of intangible assets. All human life is here and no-one, with the possible exception of one of the audit juniors, comes out of it with their reputation unscathed.

The storyline follows two years in the life of D-Merton, a manufacturer of radar systems that are mainly sold overseas. There's heavy competition but the company has come up with a game-changing new version of its system. But there are delays in implementation and the the customers aren't buying the earlier versions – why not? How can they be 'persuaded' to buy?

The company has a number of legacy IT systems, which are looking both a bit creaky and potentially insecure – but a replacement would need an increase in existing banking facilities at a time when trading has dipped.

No am-dram in sight

Stemming from this basic story, the film examines (*inter alia*) the relationship of the auditors with the management and indeed

within the audit firm, the role of the non-executive directors, the stresses brought on by potential breach of banking covenants and what happens when corners are cut…

The quality of the acting is remarkable – no question here of amateur dramatics – and it makes a real difference to the credibility of the scenarios being played out. One aspect that particularly came across was the role of non-executive directors and what an enormously difficult position they find themselves in when management is being less than open.

A sticky end?

Relevance to insolvency practitioners? Well, by the end of the film, the company is definitely teetering on the edge of insolvency – I'm fairly sure it's only a matter of time before the bank requires an IBR. It's a case study to provoke discussion about the reactions of accountants, auditors and directors to stressful situations – so it's very much about scenarios that, if the principals don't get it right, may lead to them needing the advice of an IP.

The ICAEW are rather coy about how much it costs to get hold of a copy – to quote them:

'Pricing is based on firms taking either a UK or global training licence depending on size of firm/network. Workshops around the film are also being run by ICAEW's Academy for directors as well as customised training for boards of directors and senior management teams.' The ICAEW can be contacted for more information.

So I think the answer is to negotiate hard – if this is the sort of thing you might find useful, it's worth a try! □

PHILLIP SYKES is the head of London restructuring and recovery at RSM.