SMES, DIRECTORS & SHAREHOLDERS

Defending claims that you removed company assets pre-insolvency

15 frequently asked questions

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1 What insolvency proceedings can lead to claims for recovery of assets?

Proceedings issued to reclaim assets disposed of as a result of pre-insolvency transactions may be referred to as 'antecedent' claims. Antecedent claims are typically sought against directors or associates of directors following the company being placed into liquidation or into administration, although such proceedings can be issued against any recipient of company property.

Administration is a form of insolvency proceedings that are used where the company's business is sought to be rescued (quite often by current management) or where this would lead to a better recovery for secured creditors. Administration proceedings are usually followed by liquidation proceedings or alternatively dissolution of the company.

Liquidation proceedings normally arise as a result of the presentation of a winding up petition by a creditor or the placing of a company into a creditor's voluntary liquidation by directors and the company itself. Following the appointment of a liquidator, the liquidator has a duty to reclaim all assets of the company, all interests which the company may have an entitlement to and such compensation and damages that may arise as a result of claims arising pre or post liquidation (including antecedent recoveries).

It is not unusual when directors are considering placing a company into insolvency that an Insolvency Practitioner will appear friendly but, once appointed, the appointed administrator/liquidator has a statutory duty to examine what additional recoveries may be made from third parties, including directors.

One such transaction which may precede insolvency is where an asset is transferred for either a nil value or a value which is below its market value. Such transactions are often referred to as transactions at an undervalue ("TUV").

2 Who can be sued for a TUV?

Any person receiving such assets below their market value (i.e. at an undervalue) can be subject to a claim by an appointed liquidator or administrator for such damages as would restore the position that the company would have been in had it not entered into that transaction.

This can often mean that friends, relatives, spouses or other connected individuals (such as employees and suppliers) could be sued by an appointed liquidator or administrator and such action may also lead to legal costs and interest additionally being sought against that individual. However, such reclamation powers generally do not exist in respect of wages paid during the pre-insolvency trading period.

3 Can directors be sued for a TUV?

Directors can be sued for a TUV where it is shown to be something which occurred as a breach of the director's duties or where they receive the asset.

Where the director did not receive the asset, the conventional remedy is to seek an order under Section 212 of the Insolvency Act 1986 (misfeasance) requiring that the director repay, restore or account for the money or property or any part of it or contribute such sums to the company's assets by way of compensation in respect of the transaction.

More commonly, the recipient and director are the same individual and therefore this claim is not always necessary (as it would just be a standard TUV claim).

However a director may be pursued where the recipient of the TUV transaction cannot be traced or the identity of the recipient is uncertain

4 What is a claim for a TUV?

A TUV claim may be made Section 238 of the Insolvency Act 1986 and is defined under subsection (4) as follows:

1. **The company makes a gift to that person or otherwise enters into a transaction with that person on terms that provide for the company to receive no consideration, or**
2. **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.**

This legislation enables the office holder (which is usually either the administrator or liquidator) to issue an application for the following order (subsection (3)):

"as it [the court] thinks fit for restoring the position to what it would have been if the company had not entered into that transaction".

A TUV transaction can be anything as innocent as a gift of a company car or money paid to a spouse/partner and the remedy is usually repayment of the market value of the asset transferred or the difference between the price paid and the market value, plus interest and legal costs.

5 What if I gave assets of the company away to pay a debt?

The removal of assets and transferring them to a creditor may not be a transaction at an undervalue but, subject to certain statutory criteria, may constitute a payment to a creditor in breach of the prohibition on preferring one creditor to another in the event of insolvency.

We recommend you see our article on preferring creditors to answer any queries you have in this respect.

6 What key factors identify a TUV?

A TUV does not have to occur just prior to insolvency. It can occur sometime beforehand and, simply put, is a disposal of a company's asses for less than their market value.

To show that a TUV has occurred there must be some evidence that the company's assets have been depleted or the general financial health of the company has worsened as a result of the transaction.

The transfer of company assets for no value, in the expectation that the company will enter into liquidation or administration and thus these assets will just be used to pay creditors, is the reason for the existence of this remedy. In the period leading up to insolvency the directors have a duty to act in creditors' interests and safeguard the assets of the company for the purpose of subsequent distribution to creditors via the insolvency process, and without this remedy there would be no redress for wronged creditors of the company (acting via the appointed administrator/liquidator).

Most commonly the claim is brought by a liquidator, as unsecured creditors' interests are of less concern in administration proceedings.

7 Do I have to look at all transactions by the company then?

The answer to this is no.

There are certain transactions which will not provide grounds for recovery proceedings to be taken for a TUV by reason of the passage of time, the financial state of the company or the purpose of the transaction.

The TUV legislation is intended to prohibit transactions which appear on the face of it to be deliberately avoiding the purpose of insolvency proceedings and which are intended to deprive creditors of company assets which are realised for their benefit in insolvency proceedings. The legislation is not intended to forever leave a burden with regard to company transactions which were perfectly legitimate at the time or, especially in the case of small to medium sized companies, were entered into legitimately by the company acting under the authority of well-intended directors.

8 What period is covered by a TUV claim?

Under Section 238(2) of the Insolvency Act 1986 the grounds for an application for damages for a TUV may only be made, "where the company has at a relevant time (defined in Section 240) entered into a transaction with any person at an undervalue, the office holder may apply to the court for an order under this section".

Section 240(1) of the Insolvency Act 1986 defines "the relevant time" in respect of TUVs as follows:

1. **In the case of a transaction at an undervalue... which is given to a person who is connected with the company (otherwise than by reason only of being its employee), at a time in the period of 2 years ending with the onset of insolvency (which expression is defined below),**
2. **...at a time between the making of an administration application in respect of the company and the making of an administration order on that application, and**
3. **...at a time between the filing with the court of a copy of notice of intention to appoint an administrator under paragraph 14 or 22 of Schedule B1 and the making of an appointment under that paragraph.**

The relevant time period for a TUV in most cases will be under sub-section (a) above, in the period of 2 years ending with the onset of insolvency.

9 What is the onset of insolvency?

Under Section 240(3) of the Insolvency Act 1986 the onset of insolvency is defined for TUVs as follows:

1. **…the date of an application to appoint an administrator,**
2. **…following filing with the court of a copy of a notice of intention to appoint under [an administrator]…, the date on which the copy of the notice [of appointment] is filed,**
3. **…by reason of an administrator of a company being appointed otherwise than as mentioned in paragraph (a) or (b), the date on which the appointment takes effect,**
4. **…the date of commencement of a winding up. Accordingly the "onset of insolvency" is not determined by any financial position but rather the commencement of insolvency proceedings or the date of appointment of an administrator or liquidator of the company.**

The "commencement of winding up", where a company has been placed in liquidation, is determined according to whether the company has been placed into a compulsory liquidation (where a winding up petition has been presented at court and a winding up order subsequently made) or a voluntary liquidation (where the company and its directors have placed the company into liquidation).

The commencement of a winding-up is defined in each of these circumstances as follows:

1. **For compulsory liquidations – under Section 129 of the Insolvency Act 1986, on the basis that no previous insolvency proceedings were commenced against the company, the winding up of a company is deemed to commence at the time of presentation of the petition for winding up.**
2. **Voluntary liquidation – under Section 86 of the Insolvency Act 1986 a voluntary winding up is deemed to commence at the time of the passing of the resolution for voluntary winding up. This is usually the same date as the shareholders' meeting to commence the winding up and the creditors' meeting when the resolution to wind up the company was affirmed by creditors and the liquidator appointed.**

10 What if my company was solvent or doing well at the time of the TUV?

Despite being within the relevant period prior to the onset of insolvency, a TUV must also satisfy another statutory requirement that the company must have been insolvent at the time of the transaction.

Solvency is an elastic term that may be interpreted differently either as a result of your perspective (for example employee/creditor/director), the intended short-term trading future of the company and/or what the hopes and expectations for the company are or were.

However there is a strict statutory definition which states that such a transaction is not a TUV (in breach of Section 238 of the Insolvency Act 1986) unless the company:

1. **Is at that time unable to pay its debts within the meaning of Section 123 in Chapter VI of Part 1V [of the Insolvency Act], or**
2. **Becomes unable to pay its debts within the meaning of that Section in consequence of the transaction [at an undervalue].**

Section 123 of the Insolvency Act 1986 defines "unable to pay its debts" as evidenced by one of the following events:

1. **If a creditor serves a statutory demand on the company for a sum exceeding £750 and this remains unpaid for 21 days thereafter; or**
2. **A county court judgment is handed down against the company and it is unpaid; or**
3. **If it is proved to the court that the company is unable to pay its debts as and when they fall due for payment.**
   (these three are commonly referred to as the "Cash Flow Test")
4. **If it is proved to the satisfaction of the court that the company's assets are less than its liabilities then this is also demonstrative of a company being "unable to pay its debts" – this is commonly referred to as the Balance Sheet Test.**

11 Can I show that the company was solvent at the time and therefore defend a TUV claim?

The statutory test above is quite restrictive and would be determined almost solely upon the documentary evidence available to the court in litigated proceedings. The liquidator/administrator must prove insolvency to be successful. Additionally, the liquidator/administrator may seek to demonstrate that the company became insolvent as a result of the transaction, rather than being insolvent beforehand, to be successful in his/her TUV claim.

Only one of the above statutory tests of insolvency need to be proved to the court for a TUV claim to be successful and to defend such matters you will have to consider both the balance sheet evidence for the company (which is usually shown by a review of its management accounts) and consider the profit and loss account for the cash flow test – the easiest way of doing this is to review the creditors claiming against the company at the time.

Further, where the TUV transaction was with someone connected or associated to the company, there is a standard presumption of insolvency of the company. This means that the above comprehensive evidence of insolvency is not required to be provided to the court for the claim to be successful. The reason for this is that the risk in such circumstances is so severe that the court requires evidence to rebut this presumption. In these circumstances the burden of proof is reversed and the connected or associated person targeted will bear the responsibility to prove that the company was solvent.

12 What is a connected or associated person?

Under Section 249 of the Insolvency Act 1986 a person is connected with a company if:

1. **He is a director or shadow director of the company or an associate of such a director or shadow director, or**
2. **He is an associate of the company;**

And "associate" has the meaning given by Section 435 [of the Insolvency Act 1986].

Section 435 of the Insolvency Act 1986 goes into great detail when considering whether a person is associated to a company. In summary an "associate" is usually a director's spouse or civil partner, any relation of a spouse or a civil partner, it may include an employee (although there are certain statutory exceptions for employees in recognition of the little relationship that may exist in larger companies between the employee and the company/its directors) or may comprise any person with control of a company if the directors of that company are accustomed to acting in accordance with that associated person's directions or instructions (in a similar fashion to a shadow director).

An "associate" can also refer to a friend of a controlling person or director or spouse of a director of the company, in an identical manner to that described above with regard to some who is shown to have control or where they are able to influence decisions made by the company.

This area is of course quite grey and each case will fall on its own merits and we recommend that you seek legal advice in this respect.

13 What if the transaction was entered into in good faith or for the company's benefit?

There are of course unusual circumstances where a TUV may occur but which is justified as being in the company's interests. An example could be bonuses paid to employees or guarantees by the company of group liabilities where there is no noticeable immediate benefit to the company as a result of such transactions.

Under the Insolvency Act 1986 Section 238(5) the court is required not to make an order requiring restoration of the alleged pre-TUV position where it can be shown that the transaction was entered into for good faith and for the purposes of carrying on its business and at the time there were reasonable grounds for believing that the transaction would benefit the company. The claimant will normally be required to demonstrate that the TUV was not entered into in good faith.

Obviously, as with all such matters, the use of this defence is dependent on subjective factors and we recommend you seek advice in the event that you wish to gain the benefit of such a defence where proceedings are threatened. It mirrors a similar protection provided by Section 1157 of the Companies Act 2006, which relieves company directors from liability for acts done in contravention of the companies legislation but where it is demonstrated that they acted with honesty and integrity.

However, this "get out" is not as accessible for connected or associated persons (Section 241(2A)(a) of the Insolvency Act 1986). Where the recipient of a TUV is connected or an associate it is automatically presumed that such a person did not receive the benefit of the transaction in good faith

and thus (as with the insolvency test) the burden of proof will be reversed and there will be a need to prove this as part of any defence, rather than the claimant having to prove that the defendant did not receive such assets in good faith.

14 What orders may be made against me in the event a TUV claim is successful?

Under Section 238(3) of the Insolvency Act 1986 the court shall, on such an application,

"make such order as it thinks fit for restoring the position to what it would have been if the company had not entered into the transaction".

This effectively means the person may be liable to repay the benefit acquired i.e. the difference between the market value and the amount paid or alternatively the entire market value of the asset or goods received and subject to the transaction (where s/he received such assets for nil value).

Specifically, under Section 241(1) of the Insolvency Act 1986, a court may order the following:

1. **Require any property to be so vested if it represents in any persons hands the application either of the proceeds of sale of property so transferred or of money so transferred,**
2. **Require any person to pay, in respect of benefits received by him from the company, such sums to the office-holder as the court may direct,**
3. **Provide for any surety or guarantor whose obligations to any person were released or discharged (in whole or in part) under the transaction, or by the giving of the preference, to be under such new or revised obligations to that person as the court thinks fit,**
4. **Provide for security to be provided for the discharge of any obligation imposed by or arising under the order, for such an obligation to be charged on any property and for the security or charge to have the same priority as the security or charge released or discharged (in whole or in part) under the transaction.., and**
5. **Provide for the extent to which any person whose property is vested by the order in the company, or on whom obligations are imposed by the order, is to be able to prove in the winding up of the company for debts or other liabilities which arose from, or were released or discharged (in whole or in part) under or by, the transaction.**

In addition to the above, should a TUV claim be successful in court, then the defendant may also have to pay interests and the legal costs of such a claim (and the legal costs may be greatly inflated by reason of any funding arrangement between the administrator/liquidator and his/her solicitors, which could double the fees normally recoverable).

In the event the defendant is unable to repay back the monies subject to such an order, then s/he may have any or all of their personal assets subject to charges (for example a charging order may be sought immediately against any property the defendant owns) or orders requiring that such assets be used to repay the sums sought under the application (for moveable goods). quite often this can mean charges over their residential homes (and any other property) or, ultimately, bankruptcy.

15 What about transactions defrauding creditors?

A transaction defrauding creditors is defined by Section 423 of the Insolvency Act 1986, being circumstances where a TUV has occurred and the court is satisfied that the transaction was entered into for the purpose:

1. **Of putting assets beyond the reach of a person who is making, or may at some time make, a claim against him, or**
2. **Of otherwise prejudicing the interests of such a person in relation to the claim which he is making or may make.**

This is an anti-avoidance provision which is designed to eliminate any risk that the statutory remedies of recovery of company assets deliberately removed to avoid creditors' claims are not prejudiced by the passage of time, as no time limit exists for recovery under this section (unlike with a TUV).

Should you have any query with any of the above questions or desire to seek further advice in any of these matters please do not hesitate to contact us at **www.franciswilksandjones.co.uk**

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