

Undoing company transactions: How far back can they go?

13 frequently asked questions



INTRODUCTION

When a company is placed into either administration or liquidation, the appointed administrator or liquidator has a duty to investigate the affairs of the company during the period before it was placed into that insolvency process and bring claims against directors or third parties for damages arising from such transactions, if they were legally unacceptable.

These transactions are commonly referred to as “antecedent transactions”, i.e. a transaction that occurred beforehand, and the appointed administrator or liquidator can challenge the legitimacy of any such transactions which occurred pre-insolvency.

However, there are certain defences to claims that such transactions should be undone, including that the transaction did not occur within a specific period of time prior to the commencement of insolvency (the “relevant time”), the parties were not connected or associated (see our booklet entitled “What is an associate?” for more information) or that there is evidence that the transaction was entered into in good faith.

Here we will deal with the requirement for such transactions to have occurred within the relevant time for such a claim to be viable.

1 What is the relevant time?

The relevant time is established by firstly finding the date of commencement of insolvency and then working your way back. The commencement of insolvency is dependent on:

- 1. The type of insolvency process;**
- 2. How the insolvency process was instigated;**
- 3. Who (usually a creditor) instigated the insolvency process.**

The relevant time will also depend upon who are the parties to the transaction (i.e. the identity of the party with whom the company dealt with) and whether they were associated with the company.

The relevant time will depend on the type of claim brought, which is defined by the legislation. Generally, the more serious or fraudulent the transaction, the longer the relevant time.

2 How is this affected by different insolvency processes?

As stated above, the type of insolvency process will determine the date of commencement of insolvency and thus the point from which the relevant time period is calculated (working backwards).

For a majority of cases, these fall into two categories – administration and liquidation.

The legal position as regards the relevant time for each of these insolvency processes is set out below.

3 What is the relevant time when a company is placed into administration?

The method of how a company is placed into administration determines the commencement of insolvency and thus the end date for the relevant time period.

There are various methods by which a company can be placed into administration and the commencement of insolvency will be determined differently according to each method as follows:

- 1. If a company is placed into administration by the making of an administration order by the court, the commencement of insolvency is the date on which the application is made to the court and the relevant time is calculated by working back from that date.**
- 2. If a company is placed into administration out of court by the appointment of an administrator by the company itself or by the holder of a qualifying floating charge (i.e. a secured creditor, usually the bank) over the company's property, the commencement of insolvency is the date on which a copy of the notice of intention to appoint an administrator is filed at the court.**
- 3. Where there are no charge holders (in the case of a company appointment) or no prior charge holders (in the case of an appointment by the holder of a qualifying floating charge), an out of court appointment can be made immediately by filing in court a notice of appointment of the administrator. In these circumstances the insolvency commences on the day this notice is filed at court and the relevant time is calculated by working back from this date.**

4 Companies in liquidation

The method of how a company is placed into liquidation also affects the date of commencement of insolvency (and thus the relevant time working backwards).

There are various methods by which a company can be placed into liquidation and the difference is set out as follows:

- 1. For companies that were placed into administration and the administration is subsequently converted into a liquidation, the commencement of insolvency is determined by how the administration proceedings were instigated (see above).**
- 2. For companies that are placed into liquidation by reason of a winding-up order having being made following the presentation of a winding-up petition (usually by an unsecured creditor) the commencement of insolvency is the date which the winding-up petition was filed at the court office (even though not served on that date).**
- 3. Where the directors or the company place the company into a voluntary liquidation, the commencement of insolvency is the date when the shareholders passed a resolution to place the company into voluntary liquidation (unless a winding-up petition has already been presented – see our previous point which explains the date when the insolvency is deemed to have commenced upon presentation of a winding-up petition resulting in a winding-up order).**

5 What decides the relevant time period?

The relevant time period is vital for you to be able to understand whether a transaction can be caught by a claim brought by a liquidator or administrator.

The relevant time period is determined by the type of claim brought, the identity of the party who entered into the transaction with the company and the date of commencement of insolvency.

Section 240 of the Insolvency Act 1986, as regards company transactions, defines the relevant time period for claims that a transaction is an undervalue transaction or a preference (the most common type of insolvency claim).

By way of example of a relevant time period, if the commencement of insolvency was 1 July 2020, and the claim being brought was against a party associated with the company and had a relevant time of two years, then in these circumstances all transactions after 30 June 2018 could be subject to such a claim.

We deal with the calculation of the relevant time period by reference to the type of claim below.

6 Does it matter who were the parties to the transaction?

As stated above, the calculation of the relevant time period also depends on who entered into the transaction with the company. This can be a person, company or any other entity and may be a connected party who received the benefit of the transaction (which could be the directors, their spouses or friends) or an unconnected third party.

Often directors will also face proceedings (even where they did not receive the benefit of the transaction) by way of a claim brought for misfeasance.

This is the equivalent post-insolvency of a claim by a company against its directors for a breach of their fiduciary duties. We refer to our booklet entitled "Misfeasance" which deals with this subject.

If the recipient party is associated or connected to the company, the relevant time period is longer (usually two years) as there is a presumption that such transactions have a greater opportunity to be manufactured between associated or connected parties.

If the receiving party is not connected or associated to the company, then the relevant time period is shorter (usually 6 months) as there is less suspicion where unconnected parties deal with each other at arm's length.

In respect of a definition of a connected party or an associated party, please see our booklet entitled "What is an associate?" for more information.

7 Does the type of claim affect how far back the can go?

As stated above, the relevant time applicable to any claim by a liquidator or administrator seeking to undo or reverse a pre-insolvency transaction is largely dependant on the type of claim.

For some types of claim the relevant time is defined separately by the Insolvency Act 1986. For others, the definitions are found elsewhere.

Brief details of these differences, by type of claim, are set out below.

8 What is relevant time for a transaction at an undervalue?

If a company transferred an asset for less consideration than the asset's true market value, or for no consideration at all, the administrator or liquidator can challenge the transaction provided it occurred within the relevant time of commencement of insolvency.

In these circumstances the relevant time is six months for non-connected parties and two years for connected/associated parties working back from the date of commencement of insolvency.

For more details on this type of claim, and other available defences, please see our booklet entitled "Transactions at an undervalue".

9 What is relevant time for transactions involving preference payments?

An administrator or liquidator may challenge a transaction if it appears that the company paid a specific creditor (or group of creditors) in priority to other unsecured creditors or placed that creditor(s) in a better position in the event that the company was placed into insolvency.

The administrator or liquidator can argue that in those circumstances the company has preferred that creditor over the company's other creditors.

As with transactions at an undervalue, the relevant time is 6 months for non-connected parties and two years for connected/associated parties working back from the date of commencement of insolvency.

For more details on this type of claim, and other available defences, please see our booklet entitled "Preferring creditors".

10 What is relevant time for a transaction defrauding creditors?

If the company has entered into a transaction at an undervalue for the purpose of putting an asset beyond the reach of a creditor to frustrate an actual or potential claim that a creditor has against the company, the transaction can be challenged by the administrator, liquidator or even a creditor.

This is a more serious claim than a claim to set aside or restore the position following a transaction at an undervalue (see above), although most of the circumstances and evidential requirements are very similar to claims that the company has entered into a transaction for no consideration or at an undervalue.

There is of course liability by the receiving party under this section and by the directors, who can be made accountable for entering into such a transaction on behalf of the company.

For transactions defrauding creditors, the relevant time is limitless and thus there is no time limit preceding the commencement of insolvency in which the transaction must have taken place, although statutory limitation rules (usually six years) may apply if the transaction is communicated to suffering parties and nothing is done until much later.

11 What is relevant time for an action to avoid a floating charge?

If, within a period of 12 months before the commencement of insolvency, the company granted a floating charge to a creditor, the floating charge can be challenged by the subsequently appointed administrator or liquidator if there were no new monies/goods advanced or credited in favour of that creditor or alternatively where part of the sums due under the charge exceeded the new monies/goods advanced post creation.

A floating charge is debt secured over the company's assets generally, but not fixed against any specific asset (to enable the company to continue trading whilst the company exists – for example where it is granted over stock, book debts or cash at the bank).

If the company granted a floating charge in favour of a connected/associated persons, the relevant time is two years before commencement of insolvency.

If the company granted a floating charge in favour of an unconnected person, the relevant time is 12 months before commencement of insolvency, which is generally the rule with banks (who are not generally considered as connected).

12 What is a void transaction?

For companies that are placed into compulsory liquidation following the presentation of a winding-up petition, if the company disposes of any asset after the presentation of that petition (even where not served) then the disposition of this asset is automatically void.

Accordingly the relevant time is the period between the winding-up petition being filed at court (i.e. the commencement of insolvency) and the winding-up order being made.

There is no difference whether the other party is connected with the company or not, as the transaction is void automatically and proceedings issued by a liquidator will normally be brought merely to declare the void nature of the transaction (and suitable recompense, if appropriate).

The straightforward nature of such a claim should disincentivise any defence of such proceedings, as the court will simply examine the factual background and there will be little legal argument.

However, the company can seek an exception to this where an application is made to court to seek consent to such a disposal (known as a validation order). If the court does authorise any such disposal following the company's application, then the transaction will not be void.

Please see our web page "Winding-up petitions" which deals with this area, and the article "Transfer of assets pre-insolvency" which provides commentary on the void nature of these transactions and the approach to seeking a validation order.

A further alternative defence may be where the asset was disposed of in good faith at a full market value and the disposal did not prejudice the company or its creditors. However, this defence will largely depend on the circumstances of the transfer.

13 What are the consequences if the transaction falls within the relevant time?

Where a claim is brought in respect of a transaction which falls within the relevant time, the court can make various orders to undo the effect of the transaction.

In theory the transaction is reversed, but in practice the court will order a restoration of the position (pre-transaction) by way of an award of a fixed sum.

In such circumstances it is likely that interest on the sums sought may also be allowed (at 8% per annum, going back to the date of the transaction), which can be substantial and can sometimes comprise a sum equal to or larger than the claim value itself.

The court may also award legal costs in addition to the sum sought from the defendant director (or third party) as a result of the original transaction and, for individuals, this can lead to severe financial consequences for themselves personally (potentially including the loss of the family home and bankruptcy).

However, even where the transaction falls within the relevant time, there are various other defences that are available (see the articles referred to above which can be downloaded from our website).

The key with these claims, if faced, is to seek legal advice immediately and attempt to narrow the issues and even potentially reach a settlement with the liquidator or administrator (if no realistic defence exists) that is affordable and commercially acceptable.

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