

Case: Express Electrical Distributors Limited v Beavis and Ors [2016] EWCA Civ 765, 19 July 2016

Synopsis: A validation order under s127 IA 1986 should only be made in relation to an insolvent company if there is some special circumstance which shows that the disposition in question will be or has been for the benefit of the general body of unsecured creditors, such that it is correct to disapply the pari passu principle.

Topics covered: s127 IA 1986/validation, validation orders, pari passu principle

The Facts

The appellant, Express Electrical Distributors Limited, appealed against the decision of District Judge Obodai who had refused to make a retrospective validation order in respect of a payment of £30,000 made by Edge Electrical Limited (Edge) to the appellant in the period between the filing of a winding-up petition by a third party creditor and the making of the winding-up order against Edge.

The original facts were that the appellant provided electrical goods to Edge. The appellant's payment terms provided for payment to be made at the end of the month following the month of delivery. The evidence showed there was a course of conduct to pay due sums on the last possible date or, in some cases, after the due date. The appellant became concerned about Edge's financial position and placed a credit hold on its account, which was later relaxed. On 22 May 2013, a third party creditor issued a winding-up petition; on 29 May 2013 Edge paid the appellant £30,000 and received a further £13,000 of goods on credit. Of the payment made, only £25,1260.43 was actually due for payment and all sums were paid at an earlier date than would have been expected based on the parties' previous course of conduct. On 15 July 2013 a winding-up order was made in respect of Edge.

The liquidators were not represented as they had run out of funds but they supported the original findings of the District Judge.

The Decision

The appeal was dismissed.

1. The court approved the Practice Direction for Insolvency Proceedings [2014] BCC 502 at para 11.8 (concerning validation orders) that *"The court will need to be satisfied by credible evidence either that the company is solvent and able to pay its debts as they fall due or that a particular transaction or series of transactions in respect of which the order is sought will be beneficial to or will not prejudice the interests of the unsecured creditors as a class"*.

2. The court considered the judgment of Buckley LJ in *Re Gray's Inn Construction Co. Ltd* [1980] 1 WLR 711 CA and determined that the comment in that case that “a disposition carried out in good faith in the ordinary course of business at a time when the parties were unaware that a petition had been presented” should usually be validated had been overstated, could not be taken at face value and should not be viewed as a rule in itself.

3. The correct test to apply is to consider whether there is some special circumstance which shows that the disposition in question will be or has been for the benefit of the general body of unsecured creditors, such that it would be correct to disapply the *pari passu* principle.

4. The same principles apply whether considering a retrospective application or a prospective application. It was not necessary to decide in the present case whether only that evidence which would have been available for a prospective application should be considered, or whether the case could be looked at with the benefit of hindsight, although the court noted the view of Buckley LJ in *Re Gray's Inn Construction* that the latter view was the better one.

5. In the current case, the payment of £30,000 to the appellant was not in the interests of the general body of creditors. The goods had already been supplied by the appellant to Edge; the goods supplied to Edge after the date of payment were not to perform a contract particularly profitable to Edge nor were they essential to Edge carrying on its business at a profit.

6. The court accepted that the appellant was not aware of the winding-up petition. However, the court determined that even if it was wrong to make the negative comments it did on Buckley LJ’s “good faith disposition” exception in (2), in the present case it would not apply. This was because the payment to the appellant was not in the ordinary course of Edge’s business as the invoiced sums were settled on earlier dates than usual and in some cases the monies were not even due.

Comment

This case provides a useful summary of existing case law on the scope and applicability of validation orders in respect of insolvent companies, as well as clarifying some of the more opaque parts of Buckley LJ’s *Gray's Inn Construction* judgment. It is clear that the court will not depart from the *pari passu* principle except in special circumstances. Further, those special circumstances must be those of the insolvent debtor (such as the payment or disposition being necessary for the insolvent debtor to achieve a profit on a transaction for the benefit of creditors) rather than those of the creditor (such as the creditor being caused hardship by changing its economic position without knowledge of the petition).

Despite its negative comments on Buckley LJ’s “good faith disposition” test, the court left open the possibility that a validation order could be obtained in some circumstances based on lack of knowledge of the petition: the court suggested that one such circumstance might be where a director of the company, knowing about the winding-up petition, suppresses that information and deceives someone into dealing with the company, although the court refused to express a view on the outcome of such a case.



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