The Liquidation Process and Unsecured Creditors: Using the Resulting Trust to Restore the Balance

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Abstract:

Ever since the formation of limited companies became permissible, unsecured creditors have faced a Sisyphean struggle to regularly recover substantial levels of the debts owed to them should corporate creditors enter insolvency. These low recovery rates result in many issues for lenders, including large losses, and in some cases, the insolvency of the lender themselves.

The causes of these low return rates are long established and clearly demarcated. They consist of the existence and widespread use of security interests - which remove the majority of the company's assets upon insolvency occurring - and the statutory priority of distribution, which ensures that parties other than the unsecured creditors have their debts discharged first by the liquidator from the already insufficiently resourced asset pool.

English insolvency law has sought to provide some protection to the unsecured creditors through the anti-deprivation and personal liability provisions of the Insolvency Act 1986, which are intended to protect the integrity of the insolvent company's asset pool. However, as concluded by this thesis, these provisions fail to afford adequate protection as a consequence of their substantive, evidential and remedial limitations, potentially resulting in the distributable assets being misappropriated and out of the reach of unsecured creditors.

This thesis therefore analyses the limitations of the existing anti-deprivation and personal liability provisions before concluding as to how and why they fail to adequately protect unsecured creditors. This is done through a doctrinal and theoretical analysis of the provisions, before these conclusions are then tested empirically in two case studies.

Given the inadequate protection provided by the Insolvency Act, this thesis then analyses the resulting trust – on which little analysis has been conducted in the context of insolvency – to determine whether it is capable of assisting unsecured creditors to increase their liquidation return rates. This increase is achieved through returning assets beneficially owned by the company to the company, or by preventing parties from becoming unsecured creditors in the first place by removing assets beneficially owned by

them from the company. This analysis too will adopt a doctrinal and theoretical methodology, and it is concluded that the resulting trust is able to assist should the requisite factual matrices occur.

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Thomas v Thomas (1842) 2 QB 851

Tinker v Tinker [1970] P 136

Tinsley v Milligan [1994] 2 AC 340

Toovey v Milne (1819) 2 B & Ald 683

Trade Credit Finance No(1) Ltd v Bilgin [2004] EWHC 2732 (Comm)

Trevor v Whitworth (1887) 12 App Cas 409

Tribe v Tribe [1995] 4 All ER 236; [1996] 1 Ch 107 (CA) 129

Turner v Jacob [2006] EWHC 1317 (Ch)

Tuthill v Equine FX Ltd [2013] EWHC 1207 QBD

Twinsectra Ltd v Yardley [2002] 2 A.C. 164; [2002] UKHL 12

Twinsectra v Yardley [1999] Lloyd's Rep Bank 438

Twinsectra v Yardley [2000] WTLR 527

United Overseas Bank ltd v Iwuanynwu [2001] All ER (D) 40

Vajpeyi v Yijaf [2003] EWHC 2339

Vandervell v IRC [1967] 2 AC 291

Wade v Paget (1784) 1 Bro CC 363

Wallach v SS for Trade and Industry [2006] EWHC 989 (Ch)

Westdeutsche Landesbank v Islington [1996] AC 669

Wheeler v Smith (1860) 1 Giff 300.

Wilkes v Spooner [1911] 2 KB 473

Williams v Williams (1863) 32 Beav 370

Wilson v Masters International Ltd [2010] BCC 834

Winkworth v Edward Baron [1986] 1 WLR 1512

Wisniewski v Central Manchester Health Authority [1998] PIQR P324

Withers v Harrison-Welch [2012] EWHC 3077 (QB)

Wodzicki v Wodzwicki [2017] EWCA Civ 95.

Wray v Steele (1814) 2 Ves and B 388

Yugraneft v Abramovich [2008] EWHC 2613 (QBD)

Legislation and Statutory Instruments:

Access to Justice Act 1999

Companies Act 2006

Consumer Credit Act 1974

Enterprise Act 2002

Equality Act 2010

Insolvency (Amendment) (No.2) Rules 2002

Insolvency (England and Wales) Rules 2016

Insolvency Act 1986

Insolvency Act 1986 (Prescribed Part) Order 2003

Judicature Act 1873

Judicature Act 1875

Land Registration Act 2002

Late Payment of Commercial Debts (Interest) Act 1998

Late Payment of Commercial Debts Regulations (2002)

Law of Property Act 1925

Limitation Act 1980

Preferential Payments in Bankruptcy Act 1897

Prompt Payment Code

Small Business, Enterprise and Employment Act 2015

Trustee Act 2000

Trusts of Land and Appointment of Trustees Act 1996

Chapter 1: Introduction

This thesis is a study of the relationship between unsecured credit and the liquidation regime through a circumspect examination of the position of unsecured creditors within the liquidation process, and the role of the resulting trust in securing the position of a company's unsecured creditors. In order to carry out an examination of these essential elements of this research, first and foremost, it is imperative that the role of credit in our modern society, and the effects non-repayment of such credit may cause, are clearly explained.

Credit, the provision of money or goods by one party without immediate reimbursement by a second party[1], was characterised in the seminal work of the Cork Committee as "the lifeblood of the modern industrialised economy."[2] In the U.K., a large majority of companies rely on credit as a means of maintaining financial stability[3]. These borrowers are able to raise the necessary funds from a number of sources, including trading businesses and large financial institutions. Given the aforementioned importance of credit to the corporate economy, it is imperative that an assessment is carried out on the impact of the English insolvency regime on the interests of unsecured creditors and the lack of redress to solve these issues.

This chapter therefore adopts the following structure. Section 1 establishes the available insolvency regimes, the effect these regimes have on unsecured creditors, and the justifications for this thesis focusing on the liquidation process. Section 2 sets out the causes of the unsecured creditors' poor position within the liquidation process. Section 3 critiques the debate on secured credit and whether its existence can be justified. Section 4 reviews the comments of the legal and political community on the issues of unsecured creditors and the insolvency regime and concludes there is a desire for reform to be

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[1] Shorter Oxford English Dictionary, Volume A-M, 6th edn, (Oxford: OUP, 2007)

[2] Cork K, *Report of the Review Committee on Insolvency Law and Practice,* (1982) Cmnd 8558 at 10; Diamond AL, *A Review of Security Interests in Property,* (1989) HMSO 2; see also Hutton W, *The State We're In*, (London: Random House, 1995); Picketty T, *Capital in the Twenty-First Century*, (Cambridge, Massachusetts: HUP, 2013)

[3] The number of registered companies in the U.K. in September 2017: Companies House, *Incorporated Companies in the U.K: July to September 2017* (3,961,786 companies); see also Kershaw D, *Company Law in Context,* 2nd edn (Oxford: OUP, 2012) at 6

initiated. Section 5 analyses the use of secured credit and how it has been utilised as a means of ensuring partial or full discharge of debts. Section 6 sets out the scope of this thesis. Section 7 details this thesis' methodology, whilst Section 8 sets out the research aims of this thesis and an overview of the subsequent chapters.

Section 1: The Insolvency Process and Creditor Return Rates

Companies are able to negotiate for, and acquire, credit in two distinct legal forms that greatly affect the rights of the providers of credit should the borrower become unable to meet their obligations. The first form of lending is unsecured credit, where the extender of credit does not acquire a right to seize or sell company assets should they breach their contractual obligations, and instead merely receives a personal claim to sue for payment[4]. The second form, secured credit, however, grants the lender a legal or equitable right[5] that should the borrower become unable to meet their obligations under the agreement, the creditor can seize or sell the asset. These rights ensure priority[6] over unsecured and (some) preferential creditors in any liquidation process[7]. Consequently, a holder of a security interest is placed in a much more favourable position compared to that of an unsecured creditor should insolvency occur, as they are able to use identifiable company property to discharge any outstanding debts, whereas the unsecured creditor must resort to enforcing their debts in the courts though a breach of contract[8].

Both forms of credit are regularly used by U.K. companies. This is illustrated empirically in research undertaken by the British Business Bank[9] (Figure 1) which covers the period 2011-2016 and SMEs, and Zurich[10] which covers 2016.

[4] Hudson A, *The Law of Finance,* (London: Sweet and Maxwell, 2009) at 864
[5] Cranston R, *Principles of Banking Law,* (Oxford: OUP, 1997) at 432
[6] Finch V and Milman D, *Corporate Insolvency Law: Perspectives and Principles,* 3rd edn, (Cambridge: CUP, 2017) at 73
[7] McKendrick E, *Goode on Commercial Law,* 5th edn (London: LexisNexis, 2016) at 623-624
[8] McCormack G, *The Priority of Secured Credit: an Anglo-American Perspective,* (2003) JBL 389, at 395; Armour J, *The Law and Economic Debate About Secured Lending: Lessons for European Lawmaking?*, (2008) 5 ECFR 3 at has concluded that the advantages of secured credit outweigh any social costs
[9] British Business Bank, *Small Business Finance Markets 2016/17,* at 12
[10] Zurich, *SMEs Owed £225bn from Late Payments,* http://insider.zurich.co.uk/risk-management/smes-owed-225bn-from-late-payments/

Figure 1: British Business Bank

ESTIMATES OF THE FLOW & STOCK OF EXTERNAL FINANCE FOR UK SMES £ BILLIONS (a)

		2011	2012	2013	2014	2015	2016	
Bank lending stock £ billions *Source: Bank of England*	Outstanding Amount (b)	**189**	**176**	**166**	**167**	**164**	**164**	to end Nov 16
Bank lending flows £ billions *Source: Bank of England*	Net flows	-	**-6**	**-2**	**-2**	**2**	**3**	to end Nov 16
	Gross flows	-	**38**	**43**	**53**	**58**	**54**	to end Nov 16
Other gross flows of SME Finance								
Private external equity investments £ billions *Source Beauhurst (e)*		**1.28**	**1.49**	**1.53**	**2.32**	**3.58**	**2.50**	to end Sep 16
	Number of reported deals	**462**	**706**	**972**	**1309**	**1408**	**880**	
Asset finance flows £ billions *Source: FLA (f)*		**11.4**	**12.2**	**12.9**	**14.4**	**15.8**	**16.8**	to end Nov 16
Peer-to-Peer Business Lending flows £ billions *Source: AltFi Data (g)*		**0.02**	**0.06**	**0.20**	**0.59**	**1.01**	**1.31**	to end Dec 16

From Figure 1, it can be seen that U.K. SMEs had credit liabilities of £167 billion to banks in 2014, £164 billion in 2015, and £164 billion again in 2016 - averaging £165.5 billion owed per annum. Asset finance also provided SMEs with an additional £14.4 billion, £15.8 billion and £16.8 billion in 2014, 2015 and 2016 respectively. The insurance group Zurich has also established that U.K. lenders made an additional £225 billion available to companies in the form of unsecured trade credit[11]. These high levels of bank lending and asset finance, which do not take into account the U.K's larger companies (who borrow even greater amounts), in conjunction with the £225 billion owed through trade credit[12], clearly illustrate the continuing prevalence of credit in the U.K. to enable companies to continue operating.

However, should a creditor become unable to meet their contractual obligations and repay the loan capital and interest, they are declared insolvent[13]. Although a simple enough proposition, two tests exist in English law for determining whether a company is unable to pay its debts[14]: the cash flow test, where a company is unable to pay its debts as they become due, and the balance sheet test, where a company's assets are insufficient to meet

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[11] Zurich, *SMEs Owed £225bn from Late Payments,* (2016) - http://insider.zurich.co.uk/risk-management/smes-owed-225bn-from-late-payments/

[12] The Bank of England concluded that trade creditors made up 80% of all business transactions - Bank of England, *Finance for Small Firms: Seventh Report,* (2000)

[13] Van Zwieten K, *Goode on Principles of Corporate Insolvency Law,* 4th edn (London, Sweet & Maxwell, 2018) at 2

[14] There are two tests for determining whether a company has become insolvency under s123 Insolvency Act 1986. These are the cash flow test and balance sheet tests. See Van Zwieten K, *Goode,* (No.13) at 113-176

its credit obligations should they be called in. Should this occur, creditors face the prospect of losing both the loan capital and any interest payments due, as a declaration of insolvency signifies the company's assets are insufficient to cover all of its debts[15]. This prospect is particularly acute for unsecured creditors because, as outlined above, unlike secured creditors, they do not acquire any rights to seize company assets upon default of the loan obligations, and so are only entitled to the company's remaining, and by definition insufficient, unsecured assets[16]. Examples of this phenomenon affecting unsecured creditors include the high-profile insolvencies of HAB Housing[17], retailer T.M. Lewin and the restaurant chain Carluccio's. However, two standout examples illustrate the potential losses best, and include JJB Sports, where only 0.34p per pound of debt was recovered by unsecured creditors when it entered liquidation[18], and Jinn, which entered administration owing £100,000s to couriers and only having £186,873 in assets[19].

To deal with the fall out of a company becoming insolvent, English insolvency law prescribes that there are several regimes for resolving the debts owed by the company to its debtors[20].

The CVA enables a comprise to be reached for the satisfaction of the company's debts or a scheme of arrangement of its affairs to be entered into, and allows borrowers and creditors to either agree to discharge some of the debt owed, create a long term repayment plan, or renegotiate existing contracts on more favourable terms for the company that enable its continued trading – thereby enabling a greater return rate to creditors[21].

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[15] Hudson A, *The Law of Finance,* (No.4) at 863

[16] McCormack G, *Secured Credit Under English and American Law,* (Cambridge: CUP, 2004) at 5

[17] Jones R, *Grand Designs Host Kevin McCloud's Housing Firm at Risk of Insolvency,* 14th August – The Guardian https://www.theguardian.com/money/2020/aug/14/grand-designs-kevin-mccloud-hab-housing?fbclid=IwAR3SYYSmnCVNLhYe80sN1U6Le7lUy46fAxKuocrbM7dvFAdAoKKqBnwDi9g

[18] Law Commission, *Consumer Prepayments on Retailer Insolvency Summary,* (2016) at 4

[19] Matthew Field, *Delivery Firm Collapse Leaves 1,800 Couriers out of Pocket*, 2nd December 2017 http://www.telegraph.co.uk/technology/2017/12/02/delivery-firm-collapse-leaves-1800-couriers-pocket/

[20] Insolvency Act 1986

[21] Walters A and Frisby S, *Preliminary Report to the Insolvency Service into Outcomes in Company Voluntary Arrangements*, at 19

However, although the CVA regime has many positives features for creditors, it does not regularly result in high levels of unsecured creditor returns or customers being retained. Almost half of unsecured creditors recovered nothing from the CVA[22], and 33% only recovered between 1%-29%[23]. Moreover, only 10% of cases result in the CVA actually being completed, and 53% result in the dissolution of the company or the adoption of an alternative insolvency regime[24] - meaning valuable customers were lost to the unsecured creditors in the majority of cases. Although these figures strongly indicate the CVA is not a successful mechanism, the impact of the insolvency regime on the general body of unsecured creditors (all unsecured creditors in England) is strongly muted by its low uptake levels, with only 346 occurring in 2016, 292 in 2017 and 355 in 2019 – forming only 1.55% of all U.K. insolvency cases in 2017. Hence, as a consequence of their infrequency, their unfair impact upon the general position of the unsecured creditor is extremely limited, and so will not be form part of this thesis' analysis.

Another insolvency regime is the long-established administrative receiver[25], which enables the administrative receiver to take possession of the insolvent company's property that is subject to a debenture and deal with it for the benefit of the charge holder. Upon the appointment of the receiver, although the assets remain the property of the company, legal control of the assets passes to the receiver who is free to control the property for the benefit of the secured creditor[26].

Though the administrative receiver was seen by many as being an effective regime for dealing with insolvent companies[27], many others concluded that the regime placed too much control over the insolvency process in the hands of secured creditors. These concerns were firstly founded on the obligations of the administrative receiver; for although they were under a duty to report their actions to the general body of creditors, they were under no obligation to listen or act upon their concerns, meaning the unsecured creditors were universally ignored in favour of the secured creditors, and received no right

[22] 49% percent recovered zero; Walters A and Frisby S, *Preliminary Report to the Insolvency Service into Outcomes in Company Voluntary Arrangement*, at 25
[23] 14% recovered 1%-9%, 10% recovered 10%-19% and 7% recovered 20%-29%; Ibid, at 25
[24] Ibid, at 5
[25] See *Re Maskelyne Bristish Typerwriter Ltd* [1898] 1 Ch 133 as an example.
[26] *Re Joshua Shaw & Sons Ltd* [1989] BCLC 362
[27] See generally Swain V, *Taking Care of Business,* (1999) Insolvency Bulletin 9; Frisby S, *Making a Silk Purse out of a Pig's Ear – Melforth v Blake and Ors,* (2000) vol 63(3) MLR 413

to challenge the actions of the receiver[28]. A second issue was administrative receivers themselves, and their position as private professionals. As they were dependent on being appointed by the holders of security interests – usually banks and other financial institutions – their primarily concern was with ensuring future appointments, and so to improve their employability, they acted solely in the interests of the secured creditors at the expense of the general body of creditors[29]. This need to prioritise the interests of the secured creditor would result in the majority of the company's assets being sold off to cover the secured debts, and little to nothing being made available to unsecured creditors[30]. In response to these concerns, the then Labour Government, through the Enterprise Act 2002, abolished the appointment of administrative receivers by new debenture holders from September 2003[31], which has had a devastating impact upon their use, with only 2 being appointed in 2017; a drop from 11 in 2015[32]. Hence, as administrative receivership is now rarely used with annual cases now in single digits, and despite the indisputable unfairness they caused to unsecured creditors, the contemporary impact on the unsecured creditors is even less than that of the CVA, and so will not form part of the analysis of this thesis.

Alternatively, insolvent companies can be placed into administration, an insolvency regime intended to achieve greater fairness for secured creditors by placing an independent expert in charge of a distressed company with the objective of rescuing it[33]. Should an administrator be appointed, they have three objectives that differentiate them from administrative receivers[34]: 1) to rescue the company as a going concern[35], 2) to achieve a better result for the company's creditors as a whole than would be likely if the

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[28] Ferran E, *The Duties of an Administrative Receiver to Unsecured Creditors,* (1988) 9 Co Law 58; DTI/Insolvency Service (2001) *Insolvency - A Second Chance* at 9

[29] Finch V and Milman D, *Corporate Insolvency,* (No.6); the prioritisation of secured creditors' interests can be seen in statistics of RBS receiver appointments – of the 418 appointments in 1992, 50% ended in the break up and sale of the company's assets; DTI Consultative Document on Company Voluntary Arrangements (1993); Hunter M, *The Nature and Functions of a Rescue Culture,* [1999] JBL 491 at 508

[30] Frisby S, *Interim Report to the Insolvency Service on Returns to Creditors form pre- and post-Enterprise Act Insolvency Procedures,* (2007) at 34. It was found that 95% of unsecured creditors received nothing from the receivership regime.

[31] Enterprise Act s250 which inserts s72A into the Insolvency Act 1987

[32] Insolvency Service, *Insolvency Statistics: October to December 2017*

[33] Cork K, *Report,* (No.2) at para 498

[34] Ibid, Sch B1 para 3

[35] Meaning the 'company and as a much of the business as possible'; Explanatory Notes to the Enterprise Act 2002 (ch 40)

company were wound up, and 3) to realise property in order to make a distribution to one or more secured or preferential creditors. Thus, unlike the administrative receiver, the administrator cannot act solely in the interests of the secured creditors, and unsecured creditor protection is reinforced as administrators must disclose their justifications should they be unable to act in the unsecured creditors' interests[36].

By imposing these objectives, and preventing the administrator from working solely in the interests of the secured creditors[37], the number of creditor constituencies who have their interests protected is increased, and the unsecured creditors' position is enhanced (at least theoretically)[38]. However, the effectiveness in the shift in practitioner focus from the secured creditors to the general body has been questioned due to the continuing professional position of the administrator – as they are still potentially appointed by institutional secured creditors, who are again sources of future work, they will act in a manner that keeps institutional lenders happy[39].

Despite these reforms, only a marginal improvement in the return rates of unsecured creditors has been forthcoming, with 75% of administrations resulting in no return to unsecured creditors and only 21% of creditors recovered between 1-50% of debts owed[40]. However, the overall impact on the general body of U.K. unsecured creditors is once again limited, as only 1,289 administrations took place in 2017, down from 2,009 in 2013[41] - accounting for just 6.84% of 2017 insolvency cases. Hence, the administration regime, given its ingrained objectives of maximising the position of the unsecured creditor and its limited application, is also beyond the scope of this thesis.

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[36] Sch B1 para 3(1)(a) Insolvency Act 1986

[37] However, the administrator may still be appointed by the secured lender, and lead to a repeat of the concerns raised in connection with administrative receivership: Sch 16 paras 14-18 Enterprise Act 2002. See also M Stevenson, *The Enterprise Bill 2002 – A Move Towards a Rescue Culture?,* [2002] 18 ILP 155 at 157

[38] Finch V and Milman D, *Corporate Insolvency,* (No.6) at 327; Stubbins M, *What Kind of World Are We Living In? Creditor Wealth Maximisation, Contractarianism or Multiple Values in the Post-Enterprise Act 2002 Insolvency Regime?,* (2019) 32(2) Insolvency Intelligence 78

[39] Swain C, *A Move Towards a Stakeholder Society?,* [2003] 19 ILP 5 at 7-8; Zhao J and Wen S, *The Legitimacy of Unsecured Creditor Protection Through the Lens of Corporate Social Responsibility*, (2013) JBL 868 at 875-87. See also McCormack G, *Control and Corporate Rescue – an Anglo-American Evaluation* (2007) ICLQ 515 at 529-533

[40] Frisby S, *Interim Report,* at 32

[41] Insolvency Service, *Insolvency Statistics: October to December 2017*

Instead, this thesis will focus on the liquidation regime, the process adopted in the overwhelming majority of insolvencies. Whilst the alternative insolvency regimes have sought to assist in rescuing companies, liquidation involves the realisation of a company's assets and the distribution of any proceeds to creditors, and is triggered either by the company itself[42] or by its creditors[43]. Although both forms of liquidation have different rules regulating their use, they share many common elements, including the powers of the liquidator[44]. Both forms of liquidation also involve the creation of liquidation committees[45] to oversee the liquidation process, with 5 unsecured creditors appointed with the power to demand that creditor meetings be called and to remove the liquidator from their position should they be deemed to not be acting in their general interests of the creditors[46]. These committees provide creditors with a mechanism for protecting their interests from those of the secured creditors. Similarly, both forms place the liquidator under a duty to secure, realise and distribute the assets of the company's creditors[47] in order to fairly discharge some or all of the company's debts rateably – the central tenet of the liquidation process. The liquidator himself is, as with receivers and administrators, an authorised insolvency practitioner, and so the same concerns as to their favouring secured creditors to acquire future employment[48] are aroused, except where they are appointed to compulsory liquidations, where their position as officers of the court[49] require them to act with 'scrupulous fairness and impartiality'[50].

The impact of the liquidation process, which unsecured creditors are bound to follow[51], on return rates is unequivocal, with unsecured creditors recovering little from the insolvency process. In the period 98/99[52] it was found that on average 66% of all insolvencies resulted in less than 10% of liabilities being discharged to all creditors who took part in the liquidation of the company, with unsecured creditors recovering only 7 percent of debts owed (see Figure 2). Whilst these findings cannot be said to represent

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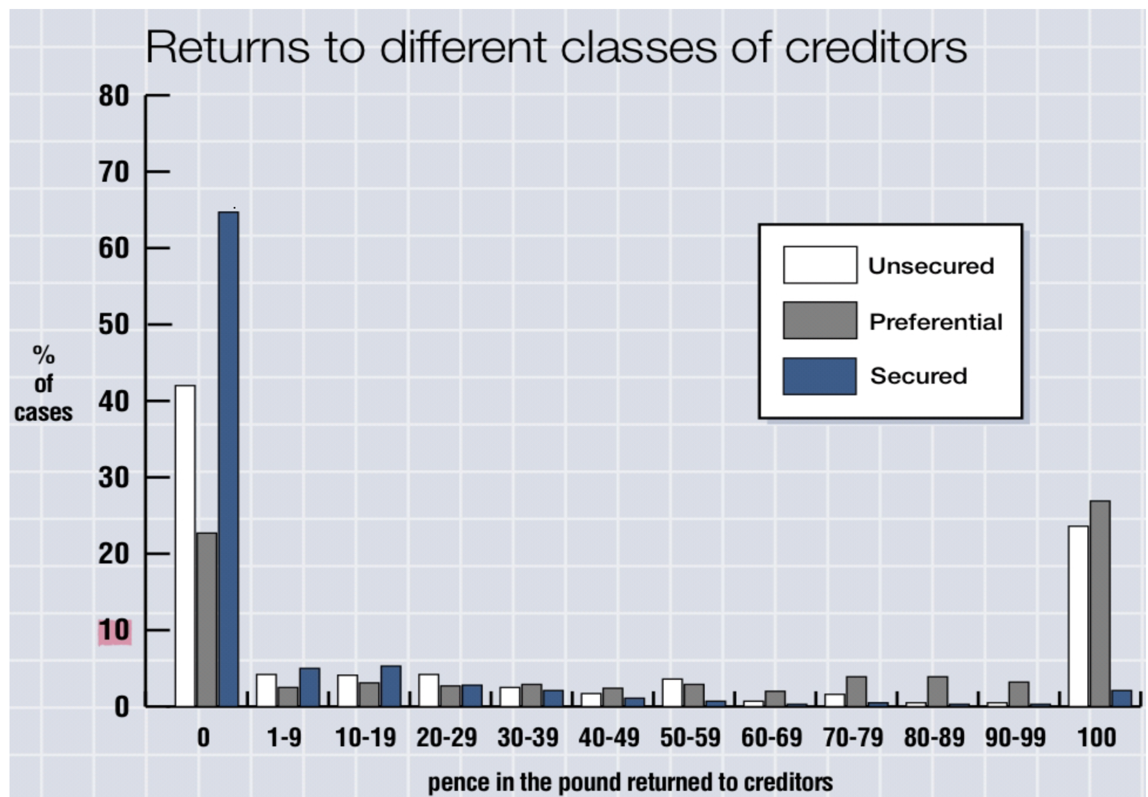
[42] S84(1)(b) Insolvency Act 1986
[43] Ibid, S124(1)
[44] Ibid, Sch 4
[45] Ibid, Ss 101 and 141
[46] Ibid, ss 171 and 172
[47] Ibid, ss 107 and 143
[48] Especially as insolvency practitioners can operate as administrators, receivers or liquidators
[49] *Re Oasis Merchandising Ltd* [1998] Ch 170 at 186
[50] *Re Contract Corp, Gooch's Case* (1872) LR 7 Ch App 207, at 213
[51] S153 Insolvency Act 1986
[52] R3, *9th Survey of Business Recovery in the UK (1998-1999),* at 18

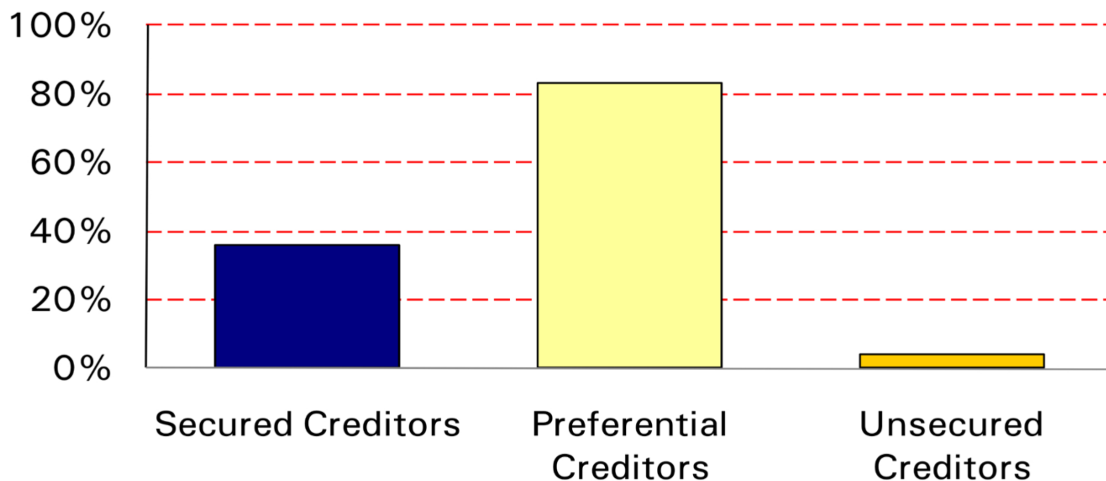
the current returns recovered by unsecured creditors because of their age, more recent research[53] (Figure 3) shows that return rates have not altered. It was discovered that of the average £1.2 million owed to unsecured creditors by insolvent companies, the average recovery rate was less than 4% – or £48,000. Thus, unsecured creditors receive similar low return rates from the liquidation process as they do with the other insolvency regimes[54].

Figure 2[55]:



[53] Office of Fair Trading, *The Market for Corporate Insolvency Practitioners* (2010), at para 3.3
[54] One commentator has derisively referred to the level of unsecured creditor returns as 'crumbs': Zhao J and Wen S, *The Legitimacy of Unsecured Creditor Protection,* (No.39) at 869
[55] Chart 16, R3, *9th Survey of Business Recovery in the UK (1998-1999),* at 18

Figure 3[56]:



Source: Companies House data, based on 500 records

However, the key contrasting feature of the liquidation process with the alternative insolvency regimes, and why it is the subject of analysis by this thesis, is the volume of liquidations when compared to the alternatives. For whilst there were only 1,289 administrations and 292 CVAs in 2017, there were 17,243 liquidations – 91% of all insolvency cases. Hence, a much greater percentage England's unsecured creditors – indeed nearly all unsecured creditors affected by the insolvency process – are affected by liquidation when compared to the alternative regimes, and so any thorough analysis of the unsecured creditors' position, or how that position can be improved, must be focussed on the liquidation process and the overwhelming majority of creditors.

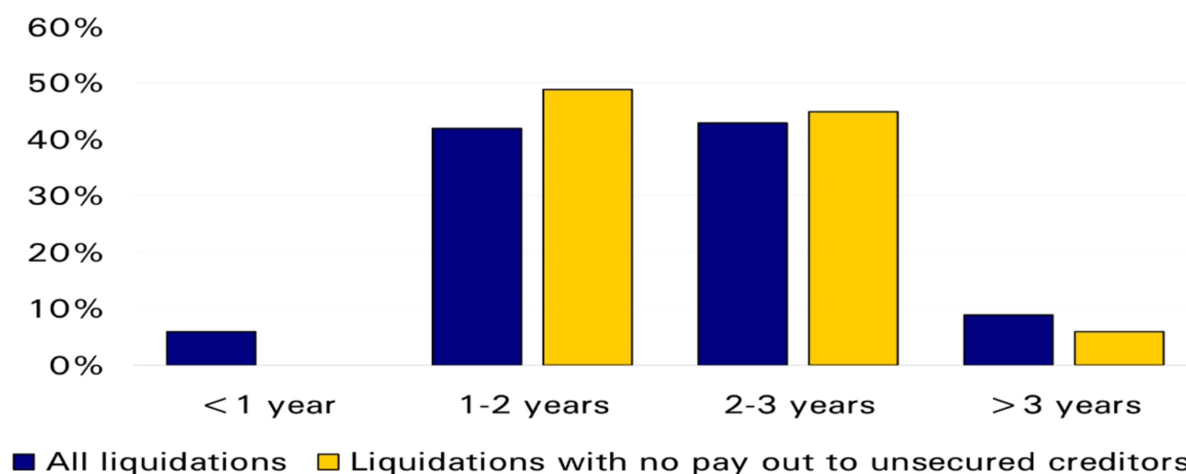
Before considering the causes of low unsecured creditor returns from the liquidation process, it also imperative to establish the wider effects of liquidation on the unsecured creditor other than just the low return rates. It has been established that these creditors also suffer psychologically from decreased confidence that they will recover any of the loan capital or interest payments due from the borrower. It was established that 55% of unsecured creditors surveyed expected to receive nothing from the liquidation process[57] - a figure considered optimistic because only 20% of liquidations resulted in a dividend

[56] Office of Fair Trading, *The Market*, (No.53) at para 3.3
[57] Office of Fair Trading, *The Market,* (No.53) at 4.58

being paid at all[58]. Compounding the problem further is the length of time it takes for the 20% of unsecured creditors to receive their dividend payments (Figure 4), as it was found that in 40% of cases unsecured creditors are compelled to wait 2/3 years before receiving any payment at all[59] - meaning unsecured creditors are placed in an unenviable position should liquidation occur; being compelled to wait several years for a payment they are unsure will be ever be made, and so must presume no payment will be forthcoming.

Figure 4[60]:

Figure 7: Graph showing length of liquidations following administration



Source: Companies House data, based on 147 liquidations following administration

The fate of the unsecured creditor must also be contrasted with the favourable position of those creditors that acquire a security interest[61], who can recover the majority of the loan capital[62]. The data[63] shows that secured lenders recovered 36% of liabilities owed through

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[58] Zhao J and Wen S, *The Legitimacy of Unsecured Creditor Protection,* (No.39) at 873
[59] OFT, *Corporate Insolvency In-Depth Interview with Creditors*, A Report for the OFT, prepared by Marketing Sciences, June 2010; Office of Fair Trading, *The Market,* at 4.107, where 48% of liquidations were completed within 2 years and 91 per cent within 3 years.
[60] Office of Fair Trading, *The Market,* (No.53) at para 4.110
[61] A full definition of a security interest is provided in Section 2 of this chapter
[62] Fletcher I, *The Law of Insolvency,* 5th edn (London: Sweet and Maxwell, 2017) at 749; for a definition of a security interest see Section 2.
[63] The OFT's findings were again supported by historical research undertaken by R3, who found that secured creditors recovered an even greater amount, 53 pence in the pound: R3, *9th Company Survey of Business Recovery in the UK,* (1999) at 18

the insolvency process[64] - a 9 times increase on the unsecured creditor returns. This does not, of course, include those secured creditors that were able to realise their security before the beginning of the liquidation process, who will recover even greater amounts by realising the market value of the assets[65]. Secured creditors, unlike unsecured creditors, are therefore able to minimise their losses from a company's insolvency and occupy a much securer position. This discrepancy, as set out in Section 3, is difficult to justify.

Finally, it is important to note the impact of the 2007-2008 Financial Crisis and the worsening of the U.K. economy[66], with data collected by the Insolvency Service establishing a clear pattern between the deterioration of the economic and the increase in liquidations. Using recent and historical data[67], it can be seen that pre-Crisis in 2004, when the economy was relatively strong, a total of 12,192 liquidations took place in the U.K.. This remained stable until 2008, the most turbulent year of the Financial Crisis, when there was a sudden spike in the number to 15,535. The following year, 2009, saw 19,077 new liquidations, with the number remaining at 16,000 up to 2012. In the figures for 2016, the rate easily remains above the pre-Crisis levels of 2004, with 14,820 liquidations. Deloitte also found that recently in 2018, as a result of decreased consumer spending and commodity price rises, the number of retail failures reached a five year high in 2017[68]. It is therefore clear that when there is a worsening of the economy the number of liquidations increases. With this increased rate of liquidations during troubled economic times, a greater number of unsecured creditors lose substantial amounts by only receiving 4p in the pound.

Given the large amounts of unsecured credit being made available to companies by institutional and trade creditors, and the low return rate these creditors regularly encounter upon the borrower entering liquidation, it is imperative to next establish and analyse the

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[64] Office of Fair Trading, *The Market,* (No.53) at 3.3

[65] Oditah F, *Assets and the Treatment of Claims in Insolvency,* (1992) 108 LQR 459 at 468

[66] The recent Covid-19 pandemic, and its knock-on financial impact, is still occurring at the time this thesis is being written. Consequently, it is not possible include these impacts, although it is predicted to have a similar, if not more drastic, impact on the U.K. and world economy.

[67] Insolvency Service, Insolvency Statistics April-June 2017 Tables, https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/632531/Q2_2017_Tables.xlsx

[68] Deloitte, *Retail Administrations Increase for the First Time in Five Years,* 8th January 2018 https://www2.deloitte.com/uk/en/pages/press-releases/articles/retail-administrations-increase-first-time-in-five-years.html . It was found the rate increased by 28 percent from the previous year.

cause of these low return rates, which requires analysis of the *pari passu* principle and the exceptions to its implementation.

<u>Section 2: Pari Passu, the Statutory Priority of Distribution and Proprietary Rights of Creditors</u>

The Insolvency Act 1986 is the legal framework of English corporate insolvency. Giving effect to the recommendations of the Cork Report[69], and being updated by the Enterprise Act 2002 to implement a 'rescue culture' within the legal insolvency framework[70], the legislation formally sets out the substantive law relating to the liquidation process.

Central to the legal framework of the liquidation process, and expressly stated in the Insolvency Act 1986, is the principle of *pari passu* distribution of company assets[71]. The principle is enunciated in s107 Insolvency Act 1986, and clarified in the Insolvency Rules 2016, r14.12:

> "Debts other than preferential debts rank equally between themselves in the winding up and, after the preferential debts, shall be paid in full unless the assets are insufficient for meeting them, in which case they abate in equal proportions between themselves."

The purpose of this principle is to ensure that all creditors are treated equally whilst the company is being wound up[72]. Accordingly, the assets are shared *pro rata* in respect to the amounts owed to them[73], and should they be insufficient to discharge a company's debts, each of the creditors' claims will rank equally, and they shall recover a proportion of the company's assets equal to the percentage of the overall debt owed[74]. In practice,

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[69] Cork K, *Report,* (No.2)
[70] DTI/Insolvency Service, *Insolvency - A Second Chance,* (2001)
[71] Fletcher I, *The Law of Insolvency,* (No.62) at 3-4; R Calnan, *Proprietary Rights and Insolvency,* 2nd edn, (Oxford: OUP, 2016) at 3; See Van Zwieten K, *Goode,* (No.13) at 291; Cork K, *Report,* (No.2) at 1220; Finch V, *Is Pari Passu Passe?,* (2000) IL 194; Cranston R, *Principles,* (No.5) at 436
[72] See Chapter 4 for full analysis
[73] Venessa Finch, *Security, Insolvency and Risk* (1999) 62 M.L.R. 633, 634; Milman D, *Corporate Insolvency: Law and Practice,* 3rd edn (London: Sweet and Maxwell, 1999) at 90
[74] Finch V, *Is Pari Passu Passe?* (No.71)

when applied in its ‘strong’ form[75] between all of an insolvency company’s creditors, it results in the debts owed to each individual creditor being transferred into a proportion of the total amount owed by the company, and each creditor recovering their respective percentage of the total debt owed from the company’s total assets. Each creditor is therefore treated uniformly[76], and acquires an equitable share of the insolvent company’s remaining assets, meaning application of *pari passu* is to the advantage of the unsecured creditors as it ensures they at least receive something from the liquidation process[77].

This equitable method of sharing out assets among creditors is said to be supportable on two grounds. The first is the need for an orderly liquidation process[78]. By treating everyone equally, creditors are not incentivised to try and jump the queue and discharge the whole of the debt owed to them at the expense of others[79]. The second is fairness[80]. As all creditors are in same the position of being owed money by a debtor who has defaulted on their contractual obligations, it is only fair that they are all treated the same[81]. This was made clear by the House of Lords in *British Eagle*, where it was held that creditors could not contract out of the *pari passu* principle[82].

However, as evidenced above, *pari passu* distribution of assets among creditors rarely occurs should a company enter the liquidation process[83] - whilst secured creditors on average recover 36% of debts owed, unsecured creditors only recover an average 4% of

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[75] Finch V and Milman D, *Corporate Insolvency Law,* (No.6) at 511. ‘Strong’ *pari passu* is defined as the principle applying to the body of creditors generally, rather than within the different classes of creditor.
[76] Mokal does however question the ‘fairness’ of *pari passu* by arguing that it is similar to access to a building – access to a building is provided "equally" to all by way of a steep staircase does not necessarily prevent those using wheelchairs from being treated unfairly.” Mokal R, *Priority as Pathology: The Pari Passu Myth,* (2001) 60 CLJ 579 at 607
[77] Zhao J and Wen S, *The Legitimacy of Unsecured Creditor Protection,* (No.39) at 873
[78] Van Zwieten K, *Goode,* (No.13) at 8; Finch V, *Is Pari Passu Passe,* (No.71)
[79] Hudson J, *The Case Against Secured Lending,* (1995) 15 International Review of Law and Economics 47 at 54
[80] Van Zwieten K, *Goode*, (No.13) see Chapter 2; Fletcher I, *The Law of Insolvency,* (No.62) at 3-4
[81] Cork K, *Report,* (No.2) at 191-199
[82] *British Eagle International Airlines Ltd v Compagnie Nationale Air France* [1975] 1 WLR 758. See also *Re Maxwell Communications Corporation plc (No2)* [1994] 1 All Er 737 at 750. The Supreme Court has, however, recently adopted a more flexible approach to the restriction, but refused to allow creditors to contract out of *pari passu:* see *Belmont Park Investments Pty Ltd v BNY Corporate Trustee Services Ltd* [2010] UKSC 38
[83] Mokal R, *Priority as Pathology,* (No.76) at 589

debts. Hence, 'In practice, however, this objective [*pari passu* distribution] is seldom, if ever, attained.'[84]

The principal cause of *pari passu's* non-application is another tenet of insolvency law: the statutory priority of distribution[85]. This regime, set out in the Insolvency Act 1986, creates several classes of creditor that have their debts discharged before the general body of unsecured creditors[86], meaning little can then be made available for rateable distribution to non-preferential creditors once the process is concluded[87]. The order of distribution is as follows:

1. The costs and expenses of the liquidation[88];
2. Preferential debts[89];
3. The prescribed part of the company's assets subject to a floating charge that must be made available to unsecured debts[90];
4. Debts secured by a floating charge[91];
5. Unsecured debts[92].

The first class of creditor to be paid is the liquidator and any expenses incurred in carrying out his functions during the liquidation, as they rank above all other claims subject to the insolvency process[93]. This includes the remuneration of the liquidator and liabilities incurred by the liquidator under post-liquidation contracts[94].

The level of liquidation expenses incurred through the liquidation process are generally high and quickly drain the company's assets[95]: the fees incurred in the high-profile British

[84] Cork K, *Report,* (No.2) at 1396; See also Mokal R, *Priority as Pathology*, (No.76) who provides an in-depth rebuttal to the proposition that *pari passu* is central to the English law of insolvency.
[85] Mokal R, *Priority as Pathology,* (No.76) at 587
[86] Van Zwieten K, *Goode,* (No.13) at 295-296
[87] The assets of a company in liquidation, owing to the definition of insolvency above, must be insufficient to cover all of the debts owed to creditors.
[88] Ss175, 115 and 175(2)(a) Insolvency Act 1986
[89] Ibid, at S386
[90] Ibid, at S176A
[91] Ibid, at S176ZA
[92] Ibid, at S72(2)(f)
[93] Ibid, at ss115 and 176ZA
[94] *Re Tokosho Finance Plc* [2002] 1 WLR 671
[95] Zhao J and Wen S, *The Legitimacy of Unsecured Creditor Protection,* (No.39) at 873-874

Homes Store insolvency alone are currently projected to reach £3.5 million[96], and annual liquidator fees for the U.K. total £350 million per annum[97]. Thus, within the priority of distribution, the liquidation expenses, whose size may constitute a significant proportion of the company's liquidation asset pool, "erode or exhaust" a significant amount of what would otherwise "be available to creditors, particularly unsecured creditors"[98] and prevent a large portion of the company's remaining assets fall inside the reach of the *pari passu*[99] principle and the hands of unsecured creditors.

The second class to be paid under the statutory scheme are the preferential creditors set out in Sch 6 Insolvency Act 1986, which includes employee remuneration, pension scheme contributions, social security contributions and levies on coal and steel production. It has been found that within the average liquidation, preferential creditors were only owed £25,000[100] – a relatively low sum when compared to the average £600,000 owed to secured creditors. Thus, although preferential creditors do prevent assets from being rateably distrusted, in all but the lowest value insolvency[101] do they substantially alter the returns for unsecured creditors, and so are not a meaningful exemption to *pari passu*.

It is the floating charge, however, that has the most significant impact on the non-application of the *pari passu* principle, which can be granted over the company's entire undertaking and gives secured creditors priority over unsecured creditors[102]. Such was their negative impact prior to the Enterprise Act, Goode even reached the conclusion that the floating charge should be abolished[103]. Following the reforms[104], however, the floating charge holder is now bound by the liquidation process, and only able to exercise

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[96] Letter from Duff and Phelps Ltd to Frank Field MP dated 21st December 2016, https://www.parliament.uk/documents/commons-committees/work-and-pensions/Correspondence/Duff-Phelps-to-Frank-Field-re-insolvency-fees-21-12-2016.pdf

[97] Office of Fair Trading, *The Market,* (No.53) at 3.8

[98] Insolvency Service, *Consultation on Reforms to the Regulation of Insolvency Practitioners,* (February 2011), para.2.22.

[99] Zhao J and Wen S, *The Legitimacy of Unsecured Creditor Protection,* (No.39) at 869

[100] Office of Fair Trading, *The Market,* (No.53) at para 3.7

[101] The average insolvent company owes £1.8 million: ibid, at 3.3

[102] Armour J, *Floating Charges: All Adrift?,* (2004) CLJ 560

[103] Goode R, *Commercial Law in the Next Millennium,* (London: Sweet and Maxwell, 1998) at 67-68

[104] The right was abolished by s250 Enterprise Act 2002, which inserted s72A into the Insolvency Act 1986

his power of sale after the payment of liquidation expenses and preferential creditors has been deducted from the crystallised pool, ensuring these creditors, if not unsecured creditors, recover a substantial percentage of the debts owed to them[105].

The Enterprise Act reforms also sought to improve the position of unsecured creditors by acting upon the comments of Lord McNaghten[106] calling for unsecured creditors to be given preferential status. Although not going so far as to give them preferential status, the Act did introduce the 'prescribed part', requiring the liquidator to 'make a prescribed part of the company's net property available for the satisfaction of unsecured debts.'[107] It requires that 50% of the first £10,000 subject to a floating charge and 20% of all subsequent assets up, to a maximum pool of £600,000 is set aside for unsecured creditors[108]. However, the implementation of the prescribed part is hamstrung by the number of exceptions it is subject to, which includes the requirement that the net property of a company meet the prescribed minimum value or that the liquidator is of the opinion that making the distribution would be disproportionate to the benefits[109]. These exceptions conspire to substantially minimise the effectiveness of the prescribed part [110], with creditor return rates only increasing by 0.4% as a consequence of its implementation[111]. Recently in the liquidation of British Home Stores, where creditors were left with outstanding debts of over £1 billion[112], any application of the prescribed part would have resulted in £600,000 being made available to unsecured creditors from the company's floating charges – or 0.04% of the debts owed[113]. Thus, the floating charge can, and does, prevent high value assets from being made available to unsecured creditors.

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[105] The OFT established that preferential creditors, on average, recovered 83% of the debts owed to them: Office of Fair Trading, *The Market,* (No.53) at para 3.3
[106] [1897] AC 22 HL at 53
[107] S176A Insolvency Act 1986
[108] Insolvency Act 1986 (Prescribed Part) Order 2003 para 3
[109] S176A (3) Insolvency Act 1986
[110] Walters A, *Statutory Redistribution of Floating Charge Assets: Victory (Again) to Revenue and Customs,* (2008) CL 129
[111] Mokal R, *Priority as Pathology,* (No.76) at 618; see also the 11th Company Survey from R3, where it was predicted that return rates would either be flat or increase by 5% (at 11 Chart 19). The OFT have established, however, that the return rate has in fact fallen.
[112] Hudson A, *BHS and Reform of Company Law,* (2016) Company Lawyer 364 at 366
[113] However, the prescribed part had no application to BHS' insolvency owing to the asset make-up of the company - *Notice of Progress Report in Voluntary Winding Up, BHS Group,* March 2020 at 2

Compounding the problems created for unsecured creditors by the statutory priority of distribution is the use of security interests granting proprietary rights that prevent assets from being made available for distribution[114]. These interests are legal or equitable mechanisms that provide creditors with *in rem* rights over an asset[115] should the borrower become unable to meet their obligations under the agreement, and ensures priority[116] over unsecured and (some) preferential creditors in any liquidation process[117]. Thereby, they prevent the liquidator from acquiring control of the asset, and have a devastating effect on the unsecured creditor, as "Every new property right, every added security interest, every proprietary restitutionary remedy, every equity has eroded his stake in the insolvency process."[118]

Section 3: The Justifications of Secured Credit

Given the palpable effects of the statutory priority of distribution and security interests on the unsecured creditor, their fairness, particularly in relation to the law's allowance of the security interest, has been questioned.

The first ground in the debate is bargain theory[119], where it is argued that the parties' entitlement to contract for preferential treatment at the expense of others during the liquidation process is justified on the grounds that other creditors have elected not to take such precautions[120]. Put another way, it is argued that the unsecured creditors have impliedly consented to the security interest by continuing to lend in the knowledge that other parties have priority[121]. Strong support for this position can be found judicially in several instances, with respected members of the judiciary such as Hoffman J (as he was

[114] Oditah F, *Assets and the Treatment of Claims in Insolvency,* (1992) 108 LQR 459 at 468
[115] Cranston R, *Principles,* (No.5) at 432
[116] Finch V and Milman D, *Corporate Insolvency Law,* (No.6) at 73
[117] McKendrick E, *Goode,* (No.7) at 623-624
[118] Van Zwieten K, *Goode,* (No.13) at 110
[119] Goode R, *Is the Law too Favourable to Secured Creditors?,* (1983) 8 Can Bus LJ 53 at 57; Hudson J, *The Case Against Secured Lending*, (No.79) at 55; Finch V and Milman D, *Corporate Insolvency,* (No.6) at 539
[120] Hudson J, *The Case Against Secured Lending,* (No.79) at 55
[121] McCormack G, *The Priority of Secured Credit: an Anglo-American Perspective,* (No.8) at 400

then)[122], Nourse LJ[123] and Lord McNaghten[124] all espousing support over the last couple of centuries.

However, bargain theory fails to take into account the inequality of bargaining power of the parties involved in the creditor-debtor relationship[125]. This is because although large institutional lenders have the financial and staffing resources to insist upon the inclusion of a security interest, smaller creditors, who on average only lend £3,000[126], face prohibitive legal costs when drawing up security interests on an *ad hoc* basis, or must contend with market conditions that prevent them from acquiring security interests[127]. This imbalance in economic resources, therefore, prevents a level playing field on which all creditors may exercise their freedom of choice, and causes discrimination against involuntary unsecured creditors.

The second justification put forward is that of notice[128]: that so long as other creditors can establish the existence of a security interest, they can act accordingly and protect themselves[129]. This thesis has also been challenged, and it is argued that the information asymmetries that exist between institutional lenders (who have access to colossal amounts of data at a cheap price) and trade creditors (who only have access to order histories, the trade presses, and who cannot reasonably afford to consult the relevant registers) prevent the universal application of this theory[130]. LoPucki has therefore concluded that unsecured creditors "contract under varying levels of coercion with varying levels of awareness"[131]. Moreover, they also concluded that because many creditors, such as tort victims, do not consent to their status[132], they cannot have known of the company's pre-existing security interests and so are 'victimised'.

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[122] *Re Brightlife Ltd* [1987] Ch. 200 at 209
[123] *Re New Bullas Trading* [1994] 1 B.C.L.C. 485.
[124] *Salomon v Salomon* [1897] A. C. 22 at 52.
[125] Hudson J, *The Case Against Secured Lending,* (No.79) at 55
[126] The average owed to unsecured creditors is £3,000: Office of Fair Trading, *The Market,* (No.53) at para 4.57
[127] Finch V and Milman D, *Corporate Insolvency Law,* (No.6) at 540
[128] Goode R, *Is the Law too Favourable,* (No.119) at 57
[129] McCormack G, *The Priority of Secured Credit: an Anglo-American Perspective,* (No.8) at 400
[130] Hudson J, *The Case Against Secured Lending,* (No.79) at 56; Goode R, *Is the Law too Favourable,* (No.119) at 63
[131] LoPucki L, *The Unsecured Creditor's Bargain,* (1994) 80 Va L.Rev 1887, at 1893
[132] Ibid, at 1896

The 'notice' argument is further weakened by the state of the present law, where although mortgages and charges are required to be registered[133], retention of title clauses and pledges are not – creating the false impression to potential lenders that the assets subject to these security interests are still owned outright by the company and will be available for distribution should liquidation occur[134]. This is seen most clear in Chapter 6 Section 4, where the resulting trust is not included on the companies register owing to it being operation of law. Consequently, even if a creditor did attempt to establish the financial health of the borrower, they could not acquire the full picture, and may unfairly be misled when supplying goods on credit[135].

Additionally, the notion that notice can protect creditors from procedural unfairness does not extend to substantive unfairness[136]. This was particularly acute before the Enterprise Act reforms, and the then frequent utilisation by charge holders of the administrative receiver, which resulted in the charge holder regularly appointing a particularly aggressive receiver to sell all of the assets subject to the charge, and act solely in his interest[137]. Although the Enterprise Act has sought to address this issue by abolishing the administrative receiver, similar outcomes can be seen contemporarily in the right afforded the mortgagee to sell the asset. For though the mortgagee is required to obtain the true market value of the land[138], and the courts will endeavour to investigate whether the true market value was obtained[139], they are under no obligation to wait for preferable market conditions[140], and so can sell the property at a price that fails to cover the outstanding mortgage debt. Equally fortuitous for secured creditors, if a mortgagee appoints a receiver, due to the receiver being the agent of the mortgagor[141], the mortgagee is not liable for their actions. As such, the mortgagee may recover instantaneously at a low price whilst causing substantive unfairness to the general body of creditors by substantially reducing the assets that can be made available for distribution.

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[133] Ss 4 and 51 Land Registration Act 2002; Part 25 (s 859-877) Companies Act 2006

[134] This is also known as the 'false wealth' impression: *Registration of Security Interests: Company Charges and Property Other Than Land – A Consultation Paper*, Law Commission Cmnd 164 at 2

[135] Ibid, at 2; Cork K, *Report,* (No.2) at 1631-65

[136] Finch V, *Security, Insolvency and Risk*, (No.73) at 662

[137] *Shamji v Johnson Matthey Bankers Ltd* [1991] BCLC 36

[138] *Palk v Mortgage Services Funding plc* [1993] Ch 330

[139] *Bishop v Blake* [2006] EWHC 831 (Ch)

[140] *Cuckmere Brick Co v Mutual Finance Ltd* [1971] Ch 949

[141] S109(2) Law of Property Act 1925

The final legal justification proffered in favour of secured credit is value[142], where it is proffered that when a creditor acquires security to the value of the loan provided, they are not prejudicing other creditors because they are not withdrawing more than they have put in[143]. Whilst this is potentially true where the security interest is limited to a single asset such as land, which does not drastically fluctuate in price and the relationship between loan capital and security interest is clear, where the interest extends to after-acquired property[144], no new 'value' is being added by the creditor and is instead being provided by an innocent third party. As noted by Hudson, this can result in a loan of £100 being secured by £1 million of assets[145] – £1 million that cannot be used to discharge the unsecured debts of those who supplied the £1 million of assets, and is instead used to reduce the losses of institutional lenders.

However, despite the flaws in the arguments surrounding the legal basis of security interests, there are strong economic advantages that assist in justifying their existence. First of these are the safeguards they offer creditors compared to those enjoyed by unsecured creditors[146]. As seen in Figure 3, unsecured creditors on average recover 9 times the level of debts compared to unsecured creditors. This has the result of reducing the risk to the borrower by providing them with priority over the unsecured creditors – providing them with a mechanism through which all or a large part of the loan capital can be directly recovered from the borrower's assets[147]. This, according to some, enables creditors to increase their profits by incentivising them to increase the amount they lend to riskier ventures with higher interest rates, as they can have confidence that all or some of the loan capital will be returned should the venture fail[148].

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[142] Goode R, *Is the Law too Favourable,* (No.119) at 60-63 - "In taking and enforcing his security the creditor is not withdrawing from the estate a single penny more than he paid in."
[143] Finch V and Milman D, *Corporate Insolvency Law,* (No.6) at 540
[144] The House of Lords in *Holroyd v Marshall* (1862) 10 HL Cas 191 held that a security interest could attach to after-acquired assets
[145] Hudson J, *The Case Against Secured Lending,* (No.79) at 57
[146] See generally: Finch V and Milman D, *Corporate Insolvency Law,* (No.6); McCormack G, *The Priority of Secured Credit: an Anglo-American Perspective,* (No.8); Gullifer G, *Goode on Legal Problems of Credit and Security*, 5th edn (Sweet and Maxwell: London, 2013); Van Zwieten K, *Goode,* (No.13) at 8; Hudson J, *The Case Against Secured Lending,* (No.79); Cranston R, *Principles,* (No.5); Cork K, *Report,* (No.2)
[147] Finch V and Milman D, *Corporate Insolvency Law,* (No.6) at 60
[148] Finch V, *Security, Insolvency and Risk,* (No.73) at 637

Notwithstanding the safeguards offered, by taking security lenders can make substantial cost savings – particularly through their ability to bypass the need to undertake legal action at all[149]. The majority of security instruments can be utilised without having to seek the permission of the court[150], which is in contrast to unsecured lenders, who must either pursue a claim through the courts or partake in the liquidation process, incurring the costs of the courts or the liquidator[151]. Hence, the debenture holders' ability to greatly reduce or obviate their legal and court fees when enforcing the borrower's loan obligations further increases their rate of return from the insolvency process.

The financial savings on offer to lenders are not limited to legal proceedings. In addition, the lender is able to reduce costs by avoiding the need to undertake a detailed financial investigation into, or monitor, the borrower[152]. As the lender is guaranteed to recover some or all of the loan capital due to the security interest[153], and provided the asset put up for security retains its value, the lender does not have to become concerned with the financial circumstances of the borrower. Indeed, by taking security, "The history of the borrower and the purpose of the loan [becomes] immaterial"[154]. Consequently, the institutional lender can reduce their costs even further by reducing the size of, or completely disbanding, the departments responsible for investigating clients, thereby reducing staff costs and maximising profits[155].

It must be noted, however, that the lack of monitoring by secured creditors can lead to "no general health check…being applied to the firm"[156], and creditors may lend to unsuitable borrowers. Meanwhile, those not providing secured credit "will still need to

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[149] Kripke H, *Law and Economics: Measuring the Economic Efficiency of Commercial Law in a Vacuum of Fact* (1985) 133 U. Pa. L. Rev. 929, at 948.
[150] McCormack G, *The Priority of Secured Credit: an Anglo-American Perspective,* (No.8) at 395
[151] Ss175, 115 and 175(2)(a) Insolvency Act 1986
[152] Hudson J, *The Case Against Secured Lending,* (No.79) at 54
[153] McCormack G, *The Priority of Secured Credit: an Anglo-American Perspective,* (No.8) at 396; Finch V, *Security, Insolvency and Risk,* (No.73) at 643
[154] See Fleisig H, *Economic Functions of Security in a Market Economy* in Norton and Andenas ed. *Emerging Financial Markets and Secured Transactions* (1998) 15 at 19.
[155] The sole reliance creditors can place upon security interests can be overstated, however. Whilst it is undeniable that lenders regularly utilise security, research conducted by Cosh and Hughes in *SME Finance and Innovation in the Current Economic Crisis* (2009) Centre for Business Research, University of Cambridge at 10 Chart 9, which shows a 38% increase in the number of lenders assessing the creditworthiness of their customer
[156] Hudson J, *The Case Against Secured Lending,* (No.79) at 54

monitor the position of the firm as best they can" and "need to continuously incur search costs"[157]. Hence, whilst secured creditors may be able to reduce monitoring costs, other creditors must still incur this financial burden, and so any economic advantages will be heavily weighted in favour of the creditor.

Hence, although the use of security interests may be justified on the grounds of pure economic efficiency[158] and the increased likelihood of credit being made available[159], the substantive unfairness these interests cause, and the poor position the liquidation process places unsecured creditors, has raised serious questions over whether English law is in need of reform to provide more adequate protection. Commentators, from the legal and political spheres, have raised doubts over the current regime's fitness and sought to propose potential solutions.

Section 4: Calls for Reform to the Position of Unsecured Creditors

One of the first attempts at comprehensively reviewing the U.K.'s insolvency regime was the Cork Report[160], which was given terms of reference to review, examine and make recommendations on the law and practice relating to U.K. insolvency, bankruptcy, liquidation and receiverships[161]. Upon its publication, Cork heavily criticised the then insolvency regime as being inadequate for the modern, industrialised economy of the 1980s, and made a number of recommendations that would later form the basis for the contemporary insolvency regime[162]. Cork also concluded that the unsecured creditor was unfairly treated due to their low return rates from the liquidation process[163], and made a number of specific recommendations to improve their position, which included the abolition of almost all preferential claims; the deferment of the debts owed to parent companies when a subsidiary in the group fails; and the imposition of a fund to be distributed to ordinary creditors formed by 10% of assets subject to floating charges. This final proposal caused the most discussion, and sought to limit the cataclysmic impact of

[157] Ibid, at 54
[158] Armour J, *The Law and Economic Debate About Secured Lending,* (No.8) at 4
[159] Ibid, at 5
[160] Cork K, *Report,* (No.2) at para 1
[161] Ibid, at 1-3
[162] Ibid, at 446-448
[163] Ibid, at para 1396

the floating charge had before the Enterprise Act reforms[164] by increasing "the dividends…payable to ordinary unsecured creditors, including trade suppliers."[165]

Even though its implementation was not instantaneous[166], the majority of the proposals made were adopted and received a statutory footing through the Insolvency Act 1986. Two recommendations that would not be incorporated in the new legislative regime, however, were the abolition of preferential claims[167] and the 10% fund derived from assets subject to the floating charge due to lobbying by the banking industry and the Government's reticence in reducing the operating flexibility of the banks[168]. Hence, although the Cork Report would substantially reform and improve the U.K.'s insolvency regime, the rejection of the unsecured creditor specific reforms would result in a failure to directly improve their position[169].

The Diamond Review[170], published 7 years after the Cork Report, sought to review the law on security interests in personal property, and after reviewing the existing legal regime, it was concluded that law's fragmented common law/Equity foundations and the regular occurrence of purchasers of property being unaware the property was subject to a security interest[171] were defective. To remedy this, it was recommended that sweeping reforms be implemented through the complete abolition of the present regime and replacement with a new law on security interests similar to that of the US and Canada. To complement this new American style security interest regime, a register was also proposed that would base priority on the date of filing and also allow registration before the creation of the interest[172]. The intention behind the reforms was to better protect creditors by forewarning potential creditors of the risks involved in extending credit to

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[164] "The floating charge has serious disadvantages, and is capable of working great injustice.': Ibid, at 105.
[165] Ibid, at 1532(b)
[166] The recommendations were not implemented for 4 years
[167] The continuation of the existence of preferential claims can be seen in Section 1.2 of this chapter
[168] McCormack G, *The Priority of Secured Credit: an Anglo-American Perspective,* (No.8) at 390-391; Milman D, *Ten Per Cent Fund,* (1999) (2) Insolvency Lawyer 47
[169] Tarling D, *The Unsecured Creditors' Raw Deal,* (2013) 34(9) C.L. 265 at 271
[170] Diamond A, *A Review,* (No.2)
[171] Ibid, at 2.
[172] Ibid, at 2

their customers. These reforms would, however, fail to find governmental support[173], with the existing regime, and the unsecured creditors' precarious position, being retained by the government as a result of a lack of constituent desire and high cost implications[174].

More contemporary calls for reform have not focused on the legal liquidation regime itself, and have instead sought to prevent unsecured creditors from having to participate in the liquidation process at all by ensuring prompt payment of debts. In response to the liquidation of Carillion, which has resulted in the debts of 30,000 suppliers going unpaid, many opposition politicians have called for all trade debts to be paid within 30 days, including former Liberal Democrat Leader Sir Vince Cable[175] and Labour peer Lord Mendelsohn[176]. Lord Mendelsohn, citing research from R3[177], has argued that by ensuring prompt creditor payment, 20% of insolvencies could be avoided, and that the existing legislation[178] and voluntary codes[179] were ineffective in ensuring prompt payment. As a result, he called for greater protections to be provided by looking "at ways to continue to add pressure through the system to encourage a resolution to late payments."

Another area that is currently under scrutiny is the protection of consumer prepayments to retailers, such as Christmas hamper businesses, which was the subject of a Law Commission Final Report[180]. The Law Commission, in response to the Farepak collapse that left tens of thousands of prepayment customers out of pocket as a result of its entry into liquidation, have put forward a number of recommendations to prevent this occurring in the future[181], and include the placing of prepayments into a trust, the granting of preferential status to consumers who have prepaid £250 or more in the six months before

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[173] Loi K, *Quistclose Trusts and Romalpa Clauses: Substance and Nemo Dat in Corporate Insolvency,* (2012) LQR 412 at 426
[174] Hansard, HC Debates Vol 189 col 482, April 24th 1992
[175] Cable V, *Sir Vince Cable: Carillion Chaos Demands Deal for Suppliers,* Evening Standard 18th January, https://www.standard.co.uk/business/sir-vince-cable-carillion-chaos-demands-deal-for-suppliers-a3743371.html
[176] Hansard, HL Debates Vol 788, 22nd January 2018
[177] R3, *Late Payment of and Other Business Failures Cause Over 1-in-5 Corporate Insolvencies,* https://www.r3.org.uk/index.cfm?page=1114&element=27579&refpage=1113&resultspage=1&type=&year=2016
[178] Late Payment of Commercial Debts (Interest) Act 1998 and Late Payment of Commercial Debts Regulations (2002)
[179] Prompt Payment Code
[180] Law Commission, *Consumer Prepayments on Retail Insolvency*, (2016) No 368
[181] Ibid, at 115-117

the company's insolvency, and improving information flows to consumers that protections are currently available to those who use credit cards to make the prepayments[182]. Although potentially wide ranging and beneficial to prepayment consumers by ensuring the return of some of the prepayment, the Government has yet to respond to the Law Commission's consultation[183], leaving its fate in limbo and prepayment creditors without enhanced protection.

Given the concern from the legal and political community for the position of the unsecured creditor within the liquidation process, and the number of attempts there have been to improve their position, it is important to analyse in detail the failings of the current legal regime and the parties being affected. This analysis is conducted in Chapters 3 and 4, before a potential solution is proposed in Chapter 5. Before this can be done however, it is necessary to establish how creditors themselves have sought to minimise or remedy the shortcomings of the present legal regime.

Section 5: The Scope of this Thesis

Consequently, because the existing real and quasi-security interests have proven effective in protecting the interests of secured creditors and minimising the effects of the liquidation process for these creditors, usually at the expense of the unsecured creditor[184], this thesis will seek to build upon the existing literature and analyse whether alternative, and as yet unconsidered, equitable mechanisms can be used to further secure the repayment of debts to creditors. In order conduct this research, it is necessary to analyse in detail how and why the existing liquidation legal regime fails to protect the interests of the unsecured creditor. To clarify the impact of the legislative shortcomings, analysis of the liquidation process in action is carried by conducting two cases studies involving companies that have entered liquidation: British Home Stores and Carillion Plc. The conclusions from these case studies will inform this thesis as to how creditors are impacted by the liquidation process, and identify potential means of remedying this. It is important to note, however, that the case studies are utilised only to evidence to shortcomings of the Insolvency Act 1986, and not to evidence the effectiveness of the

[182] S75 Consumer Credit Act 1974
[183] https://www.theyworkforyou.com/wrans/?id=2017-11-14.112978.h
[184] Armour J, *The Law and Economic Debate About Secured Lending*, (No.8) at 5

potential solution, owing to the nature of their factual matrices not giving rise to potential resulting trusts. This research on how the unsecured creditors' position can be improved, as set out in Chapters 5 and 6, will involve an analysis of the resulting trust and how it can be used to return assets to the company in liquidation or directly to parties themselves. If assets are returned to the now insolvent company, then they can be utilised to discharge the existing unsecured debts of company in liquidation and improve the position of the unsecured creditor. If assets in the possession of the company are subject to a resulting trust, then they can prevent a party from becoming a creditor in the first place.

Put concisely, the resulting trust will be analysed for two reasons. The first is that the property subject to such a trust is unencumbered by third party proprietary interests[185]. As any property returned to the company in liquidation will be under the sole ownership of the company[186], it will form part of the company's asset pool rather than its creditors' security interests[187], and so can be distributed rateably to unsecured creditors by the liquidator in accordance with the statutory scheme of distribution and be used to discharge debts owed to unsecured creditors. Alternatively, if property subject to a resulting trust is not returned to the company and is instead returned to potential creditors, the trust assets can be used to discharge the company's debts outside of the liquidation process[188].

The second reason is tightly aligned to the first, and concerns the property usually subject to a resulting trust. Although there are no restrictions on the property that can be subjected to a resulting trust, the existing literature shows that in many instances the property is of a high value, particularly as many examples of the resulting trust involve land[189]. The high value of the potential assets made available to creditors through the resulting trust is best illustrated in the recent and high-profile Supreme Court appeal of *Petrodel v Prest*[190],

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[185] See generally Tucker L, *Lewin on Trusts,* 19th edn (London: Sweet and Maxwell, 2015) chaps 7-9; Thomas G, Hudson A, *The Law of Trusts,* 2nd edn, (Oxford: OUP, 2010) chaps 26-26; McGhee J, *Snell's Equity,* 33rd edn, (London: Sweet and Maxwell, 2015)
[186] *National Provincial Banks Ltd v Ainswoth* [1965] AC 1175; *Westdeutsche Landesbank Girozentrale v Islington London Borough Council* [1996] AC 669 at 705
[187] s283(3)(a) Insolvency Act 1986
[188] *Ibid*, at S283(a); *Heritable Reversionary Company Ltd v Millar* [1892] AC 598; McCormack G, *Proprietary Claims and Insolvency,* (London: Sweet & Maxwell, 1997) at 2
[189] See Chapter 5
[190] [2013] UKSC 34

where £17.5 million of residential property was held to be subject to several resulting trusts, and *AAZ v BBZ*[191], where a resulting trust was imposed over high value property.

Although this thesis will seek to evaluate the effectiveness of the resulting trust, the constructive trust will not be evaluated due its limitations. Whilst this could potentially increase the size of the company's asset pool, the factual matrices applicable to companies in which the constructive could be imposed – bribery[192], unauthorised profits[193], unauthorised renumeration[194] or use of confidential information[195] - are restricted to instances of breach of fiduciary duty. As such, their application is limited mainly to instances of breaches of directors' duties: an occurrence that is difficult to prove[196]. Secondly, it is difficult to recover substantial sums for distribution, as those responsible for the misappropriation of property may dispose of the assets through purchases such as holidays, expensive dinners and home improvements – actions that are foreseeable given that the majority of assets subject to a constructive trust will be liquid assets. Due to the restrictions in the law of tracing concerning dissipation, unascertained goods[197] and inequitability to trace[198], it becomes extremely difficult to recover the misappropriated assets.

<u>Section 6: Research Questions and Thesis Layout</u>

The above sections of this chapter have considered the issues relating to unsecured creditors upon a company's liquidation, and the use of security interests to lessen these issues. It was also established that this thesis will analyse the resulting trust and whether it can increase creditor return rates. Thus, this thesis has three research questions:

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[191] *AAZ v BBZ* [2016] EWHC 3234 (Fam)
[192] *FHR Ventures LLP v Cedar Capital Partners LLC* [2014] UKSC 45
[193] *Keech v Sandford* (1726) Sel Cas Ch 61; *Boardman v Phipps* [1966] UKHL 2
[194] *Dale v IRC* [1954] AC 11
[195] *A-G v Guardian Newspapers Ltd (No2)* [1990] 1 AC 109
[196] See generally: Hannigan B, *Company Law,* 4th edn (Oxford: OUP, 2016), see Part II; Davies P and Worthington S, *Gower: Principles of Modern Company Law,* 10th edn (London: Sweet and Maxwell, 2016), see Chapter 16
[197] *Re London Wine Co (Shippers) Ltd* (1975) 126 NLJ 977
[198] *Re Diplock* [1948] Ch 465

1. To what extent does the English law of liquidation impact upon an insolvent borrower's unsecured creditors;
2. What role can the resulting trust, in the factual matrices that it is imposed, play in addressing any impact on unsecured creditors by the liquidation regime;
3. What advice can be provided, or recommendations proposed, to the relevant parties to provide more safeguards to unsecured creditors.

To answer these research questions, this thesis will conduct the analysis outlined above by meeting the following objectives:

- To analyse how and why the legal rules pertaining to the liquidation process impact upon on unsecured creditors;
- To investigate how the existing literature has proposed to improve the position of the unsecured creditor and analyse whether they have been effective in achieving this objective;
- To analyse whether the resulting trust is an efficient mechanism to increase unsecured creditor return rates; and
- To make a number of recommendations on how the resulting trust can be effectively utilised to increase return rates.

To accomplish these objectives, this study seeks to add to the existing literature by conducting research on the resulting trust in the context of the liquidation process. This research involves the doctrinal and theoretical analysis of the resulting trust and the application of the analysis' conclusions in Chapter 6. This research is original in character as the existing, limited literature has not analysed the potential beneficial effects of the resulting trust for unsecured creditors in the context of the liquidation process.

Section 7: Methodology

To achieve the objectives set in this chapter, this thesis uses both a doctrinal and theoretical methodology. It adopts a partially doctrinal approach as in order to establish how the law on liquidation impacts upon unsecured creditors, an analysis and interpretation of the existing legislation and case law is undertaken. It also adopts a partially theoretical approach because it seeks to understand the impact of the underlying

legal frameworks on the legal rules that regulate the liquidation process and the resulting trust. To test the doctrinal analysis of the case law, a number of case studies are utilised, and include real world examples of U.K. companies. Finally, this section sets out the range of sources that are required to conduct this analysis, the majority of which take the form of published case law.

Section 7.1: Doctrinal/Black Letter and Theoretical Analysis

The main methodology used by this thesis is doctrinal analysis. The principle reason for its adoption is that it is the methodology traditionally utilised by legal academics and practitioners when analysing the law[199]. It has been defined as:

> "Research which provides a systematic exposition of the rules governing a particular legal category, analyses the relationship between rules, explains areas of difficulty and, perhaps, predicts future developments."[200]

Doctrinal research therefore seeks to determine the legal rules pertaining to a particular area or areas, analyse the relationship between these rules, and comment on any difficulties or predictions that arise. Within this thesis' analysis of both the resulting trust and insolvency law the primary sources will be case law and statute and their interpretation, with academic commentary putting forward interpretations and competing interpretations of these primary sources. These rules, although set out in case law and binding, are not set in stone[201]. As a consequence, it is possible to put forward proposals for how the law relating to liquidation and the resulting trust should evolve by interpreting both the existing case law and statutes.

Doctrinal analysis is similar to theoretical research, which "fosters a more complete understanding of the conceptual bases of legal principles and of the combined effects of

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[199] Hutchinson T, Duncan N, *Defining and Describing What we do: Doctrinal Legal Research*, (2012) Deakin Law Review 17(1) 83, at 107; Chynoweth P, Chapter 3, *Legal Research in Advanced Research Methods in the Built Environment*, (London: Wiley, 2008) at 32

[200] Dennis Pearce, Enid Campbell and Don Harding ('Pearce Committee'), *Australian Law Schools: A Discipline Assessment for the Commonwealth Tertiary Education Commission*, taken from Hutchinson T, Duncan N, *Defining,* (No.199) at 101

[201] *Kleinwort Benson v Lincoln City Council* [1999] 2 AC 349 at 393

a range of rules and procedures that touch on a particular area of activity."[202] Theoretical research thus seeks to determine and better understand the theoretical underpinnings of an area of law, and then analyse the impact these theoretical underpinnings have on the legal rules that apply to a particular area[203]. The need to undertake theoretical research was put by Pattaro, who notes legal research only makes sense "when a certain philosophical position (or theory) is assumed, and will make no sense at all when another is assumed."[204]

Both methodologies are consequently seeking to better understand an aspect of the law, and then analyse the effect this has. The difference, however, can be explained simply: doctrinal research seeks to analyse the impact of the law on a real-world phenomenon, whereas theoretical research seeks to analyse the impact of a theoretical underpinning on the law itself. This may include the theoretical underpinnings of why a legal rule operates. Although doctrinal analysis will be the primary methodology adopted by this thesis, theoretical analysis will also be undertaken to understand the impact the conceptual frameworks of secured credit and the resulting trust have on the substantive law.

Section 7.2: Case Studies

This thesis uses two case studies[205] to test the theoretical conclusions reached in Chapter 3 regarding the shortcomings of the current liquidation legal regime and the negative consequences these have on unsecured creditors. Each case study evidences how unsecured creditors are impacted by the borrowing company's liquidation. The utilisation of case studies is appropriate owing to this methodology's effectiveness in answering 'how' questions[206], and this thesis asking two primary questions: how does the law on liquidation impact upon the body of unsecured creditors, and how can the resulting trust be utilised to improve liquidation return rates.

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[202] Dennis Pearce, Enid Campbell and Don Harding ('Pearce Committee'), *Australian Law Schools,* taken from Hutchinson T, Duncan N, *Defining,* (No.199) at 101

[203] Smith ATH, *Learning the Law,* 16th edn (London: Sweet and Maxwell, 2016) 4

[204] Pattaro, *A Treatise of Legal Philosophy and General Jurisprudence,* Vol 1 (Spain: Springer, 2005) 9

[205] Yin R, *Case Study Research: Design and Methods*, 4th edn (London: Sage, 2009)

[206] Ibid, at 9

The first case study utilised by this thesis is that of U.K. department store retailer British Home Stores (BHS). BHS, after its acquisition by Sir Philip Green in 2000, was initially a profitable company that declared £423 million in dividends in the period 2002-04, but became unprofitable in the period 2009-2014. It was sold to Retail Acquisitions Limited (RAL) for £1 in March 2015, and although there was a vague strategy to try and stem its losses, it entered administration on 25th April 2016 and liquidation in December 2016. This has resulted in 11,000 employees losing their jobs[207] and non-preferential unsecured creditors being owed £1,124,763,000[208].

The second case study is that of Carillion PLC. Carillion, the U.K.'s second largest construction company, carried out a number of construction and facilities management contracts for both the public and private sectors. Holding a number of unprofitable contracts, in September 2017 it revealed that in the preceding 6 months a loss of £1.15 billion had been incurred. A further profit warning was issued in November 2017, and the company's share price fell 50%, valuing the company at only £73 million with debts of roughly £900 million. Carillion was placed into liquidation on 15th January 2018 after government assistance was refused. Upon its entrance into liquidation, it had debts of £1.5 billion and 30,000 suppliers who had unpaid contracts with the company.

Both the BHS and Carillion case studies have been selected by this thesis for the same reasons. Firstly, because of their high-profile nature, extensive research and literature has been produced on both collapses. As a result of the liquidators' reports, the official Parliamentary enquiries and the extensive media coverage, sufficient evidence on the actions of the companies, and the impact of these actions, is widely available to this thesis for analysis. Secondly, because of the large size of the two companies, and the diverse nature of their bodies of creditors, the two case studies provide detailed evidence on the potential impact of the liquidation process on the diverse range of lenders that make up the body of a company's unsecured creditors. Finally, by analysing two companies in vastly different industries – retail and construction – it may be possible to establish whether the impact of the liquidation process is universal to unsecured creditors.

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[207] House of Commons Work and Pensions and Business, Innovation and Skills Committees, *BHS,* 20th July 2016 at 4

[208] Report to Creditors *BHS Limited (In Administration),* 6th June 2016 at 9.15

Section 7.3: Necessary Data and its Limitations

To analyse the impact of the resulting trust on an insolvent company's unsecured creditors, two sets of data are required. The first relates to the doctrinal analysis of the resulting trust. In order to analyse how and when the resulting trust may be imposed, it is necessary to critically review and interpret the existing law and determine whether any new interpretations can be put forward. To undertake this research, references to case law, statutory provisions and academic publications must be made, all of which are in the public domain or legal databases.

The second set of data needed is for the case studies. This requires a mixture of several sources of information, including government reports and statistical data.

In relation to data concerning the actions of the companies used in this thesis' case studies, it is possible to acquire this information from three key sources: Companies House records, Parliamentary enquiries and published judgments. The Companies House data includes insolvency practitioner reports and yearly financial statements which detail some aspects of the case studies' actions. However, the data included is limited to the liquidators' reports, and is only able to provide an outline of the companies' actions. Parliamentary enquiries, owing to the powers of House of Commons' select committees, are able to supply additional information on the companies and the impact of their failure on creditors. Published judgments also provide information not included in the liquidators' reports.

Section 8: Thesis Structure

In conducting the above research, this thesis adopts the following structure:

Chapter 2 analyses the predominant U.S. insolvency theories to determine whether they conclude whether unsecured creditor protection is justified and necessary. These theories and Creditor Wealth Maximisation, the Multiple Values Approach and Contractarianism. It also analyses two key texts on English insolvency law to determine whether or not unsecured creditor protection is justified and called for in English law.

Chapter 3 analysed the anti-deprivation and personal liability provisions of the Insolvency Act 1986 to determine whether they are effective in protection unsecured creditors. It analyses both the substantive provisions, their rates of utilisation and the available funding available to liquidators to commence litigation should a claim be available. It therefore analyses whether additional measures are necessary to assist unsecured creditors and the characteristics any assistance needs to possess.

Chapter 4 is a series of case studies that establish the impact of the liquidation process on the unsecured creditor. It establishes, through analysing two real world cases, how the shortcomings of the Insolvency Act 1986 impact upon creditors and which groups of creditors are affected. The two cases studies, Carillion Plc and British Home Stores, were chosen because of the readily available data and the diverse nature of their creditors.

Chapter 5 analyses the potential uses of the resulting trust in the context of the liquidation process and unsecured creditors. It reviews the 4 forms of resulting trust (automatic, purchase price, gratuitous transfer and *Quistclose)* and concludes how they can, theoretically, return assets to the company/unsecured creditors. It sets out both the potential legal and practical implications of these conclusions, and helps this thesis comprehend the resulting trust's potential impact on the liquidation process.

Chapter 6 builds directly upon Chapter 5 and analyses whether the resulting trust, beyond the theoretical conclusions reached in Chapter 5, is a practicable means of assistance for unsecured creditors. This includes analysing how the presumptions of resulting trust can be rebutted, the ability to trace, resulting trust liability and whether the imposition of a resulting trust is justifiable.

Chapter 7 concludes this thesis. The research questions raised in Chapter 1 are considered with reference to the findings of the previous chapters, and the role of the conclusion is to determine whether or not the research aims have been successfully achieved. It will also establish how this thesis can be used as evidence for the use of the resulting trust in non-domestic contexts.

Chapter 2: Justifying Existing and Potential Unsecured Creditor Protections

English insolvency law, as set out in Chapter 1, places the unsecured creditor at the centre of its legislative and jurisprudential regime. The unsecured creditor occupies this central position through their inclusion in the statutory priority of distribution and their exclusion from many of the company's assets by security interests. As will be seen in Chapter 3, English insolvency law also affords the unsecured creditor a prime position by creating a number of anti-deprivation and personal liability provisions designed to afford them protection. This is at the exclusion of secured creditors, who are unable to benefit from them.

Many strands of England's insolvency jurisprudence vociferously extol the centrality of the unsecured creditor, and the need for insolvency law to provide them with adequate protection, due to the concerns raised in Chapter 1. Even at the embryonic stages of share limited companies, Lord McNaghten in the paradigmatic House of Lord Judgment of *Salomon v Salomon*[209] stated that he and many of his fellow peers were in favour of, although unable to confer, unsecured creditor protections:

> "I have long thought…that the ordinary trade creditors of a trading company ought to have a preferential claim on the assets in liquidation and in respect of debts incurred within a certain limited time before the winding-up."[210]

Hoffmann J, as he was then, also effusively affirmed the role of liquidators in protecting unsecured creditors, noting that "Liquidators differ from receivers in so far as they act primarily in the interests of unsecured creditors and members whereas receivers look to the interests of the secured creditor who appointed them"[211].

[209] [1897] AC 22
[210] Ibid, at 53
[211] *Re Potters Oil Ltd (No2)* [1986] 1 WLR 201

Owing to the continued protection afforded to secured creditors, when reviewing English insolvency law in the early 1980s, Sir Kenneth Cork authoritatively concluded unsecured creditors were in need of protection. Throughout the Review, Sir Kenneth repeatedly reinforced this conclusion[212]. He began by noting that insolvency, and liquidation in particular, were "concerned exclusively" with ensuring unsecured creditors received the proceeds from the sale of the company's uncharged assets to the exclusion of all of interested parties, including the security interests[213]. Cork also concluded that the general body of creditors were the primary party insolvency law is concerned with, and that they required this because "the general body of the insolvent's creditors, each of who is affected…by the common disaster [the onset of insolvency]."[214] Therefore, "his interest [that of the unsecured creditor] in those proceedings ought to be, so far as is consistent with the claims of his fellow creditors, as fair and reasonable as circumstances will permit, to compensate for the loss of his individual rights."[215]

Support for unsecured creditor protection has also enjoyed widespread academic acceptance in England. Indeed, Prof Goode has included creditor protections, and maximising their returns from the liquidation process, as objectives in his vision of insolvency law[216]. This is despite, as is explored below, Goode taking a somewhat restrictive interpretation of insolvency jurisprudence and favouring protecting pre-insolvency rights over those constituents who are worst hit by the liquidation of a company.

Others have tried to realign insolvency law's focus away from outright protection of unsecured creditors, and have attempted to present it as having a broader function of protecting the wider community - thereby safeguarding through indirect methods. Such endeavours include the work of Anderson[217], who argues that insolvency law should be structured so that the insolvent company is dealt with in such a way that meets the general needs of society and the economy. Anderson also recognises, however, that this aim

[212] This is analysed in detail in Section 2 of this chapter.
[213] Cork K, *Report,* (No.2) at para 17
[214] Ibid, at para 232
[215] Ibid, at para 232
[216] Van Zwieten K, *Goode,* (No.13) at 74-75. This is analysed fully in Section 2 of this chapter
[217] Anderson H, *The Framework of Corporate Insolvency Law,* (Oxford: OUP, 2017)

should not stifle economic activity[218]. Thus, by maintaining economic activity, the unsecured creditor is protected by ensuring that a market is preserved in which to operate and continue doing business, potentially overcoming the losses sustained through the liquidation.

Finally, it has been recognised that central to such protection is the equality and fairness between creditors[219], seen in the form of the *pari passu* principle[220]. Despite the numerous exceptions that exist to the principle, the courts have repeatedly reaffirmed[221] its continued fundamental importance to insolvency law[222]. Hence, although policy considerations have prevented the full application of the principle, the desire to treat creditors equally by preventing any one of them obtaining an unfair advantage, and the subconscious psychological effect this has on the law, mean that creditor protection remains integral to insolvency law.

However, the recognition that unsecured creditors should be protected does not address the issue of whether the protection is justified. Indeed, many of the pronouncements calling for unsecured creditor protections take it as gospel that they are deserving of protection, and fail to set out *why* the protection is justified beyond the simple low return rates. Consequently, owing to this thesis' exploration of whether or not the resulting trust can enhance unsecured creditor protection, it is necessary that it is established that unsecured creditor protection, and the legal community's adoption of such measures, is justified generally, and that this thesis is vindicated in analysing potential increases in the protection afforded them. For if creditor protections cannot be justified, this thesis' analysis will have little practical application.

In arguing that current, and prospective, unsecured creditor protection is theoretically justified, this chapter is split into two sections. The first analyses the theories put forward

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[218] Ibid, at 3
[219] Milman D and Durrant C, *Corporate Insolvency: Law and Practice,* 3rd edn (London: Sweet and Maxwell, 1999) at 1; McCormack G, *Secured Credit under English and American Law,* (Cambridge: CUP, 2004) at 5
[220] Van Zwieten K, *Goode,* (No.13) at 121-122
[221] *Officeserve Technologies Ltd* [2017] EWHC 906 (Ch) at 10
[222] Keay A and Walton P, *Insolvency Law: Corporate and Personal,* 4th edn (Bristol: LexisNexis, 2017) at 6; *Re Lines Bros Ltd* [1983] Ch 1 (CA) 20E; *Re Atlantic Computer Systems Plc* [1992] Ch 505 (CA) 527H

by leading American academics on the overarching theories of insolvency law. These deal with the purpose of insolvency, and so inform whether it is intended to offer unsecured creditors protection, and it is concluded that the three primary theories all provide convincing justifications. American theories are analysed owing to a dearth of Commonwealth commentary, primarily as a result of English law's practical and functional evolution[223]. Second, the functional view of English insolvency law, espoused by Goode and Cork, and the purposes of English insolvency law are analysed to again determine whether creditor protection is central, and it is again demonstrated that unsecured creditor protection forms a key component of English insolvency law.

Section 1: Underlying Theories of Insolvency

Attempts to provide insolvency law with a cohesive and unified theoretical framework began in the United States in the mid-1980s, and many disparate and contradictory conclusions, as set out below, were drawn. The impetus for such advances sprang from sharp changes to the U.S. economy, as it entered a recession and correspondingly the number of insolvent companies and individuals greatly increased[224]. Although England would experience similar economic conditions in the 1980s and 1990s[225], owing to the U.K.'s piecemeal and pragmatic insolvency regime[226], English scholars have assuaged engaging in such discussions. This is because it was concluded that an overarching theory was unnecessary to understand this area of the law[227], and so it is the U.S. theories that predominate this area.

[223] See Van Zwieten, *Goode,* (No.13) at 89; Keay A and Walton P, *Insolvency Law,* (No.222) at 24; and Finch V and Milman D, *Corporate Insolvency Law***,** (No.6)
[224] Jackson T, *Bankruptcy, Non-Bankruptcy Entitlements, and the Creditors' Bargain,* (1982) 91 Yale LJ 857; Warren E, *Bankruptcy Policy,* (1987) 54 University of Chicago Law Review 775 at 776. In between 1980 and 1982 commercial insolvencies would rocket from 43,694 to 69,300 – American Bankruptcy Institute, *Total Business and Non-Business Filings by Year (1980-2017)*
[225] Through events such as Black Wednesday and the recession of the early 1990s
[226] See Cork K, *Report,* (No.2); Cork K, *Cork on Cork,* (London: MacMillan, 1988) at 202-203; White Paper, *A Revised Framework for Insolvency Law* (HMSO, 1984), Cmnd. 9175; White Paper, *Insolvency – A Second Chance* (DTI, July 2001), Cm.5234; Stubbins M, *What Kind of World,* (No.38) at 78-79
[227] Keay A and Walton P, *Insolvency Law,* (No.222) at 24; Van Zwieten, *Goode,* (No.13) at 89; McCormack G, *Apples and Oranges? Corporate Rescue and Functional Convergence in the US and UK*, (2009) 18 Int. Insolv. Rev. 109 at 116.

Within the U.S. movement, three main theories have been developed that cover a wide spectrum of opinion[228]. The most prominent and influential[229] theory has been that of Creditor Wealth Maximisation, put forward in several publications by Prof Jackson and his co-authors[230]. Put simply, the approach requires insolvency law to be predicated on the single purpose of maximising the return rates to secured and then unsecured creditors. At the opposite end of the theoretical spectrum is the Multiple Values Approach put forward by Elizabeth Warren[231], which rejects this strict approach to insolvency priorities and calls for a flexible system in which each insolvency is treated on its own merits, and losses should be distributed to those who can withstand them the best, and assets distributed to those who are in the greatest need. In between these two extremes lies Korobkin's Contractarian approach[232], which seeks to provide order and stability whilst also protecting those in need by amending the insolvency rules. Given that all of these theories *prima facie* affect the position of unsecured creditors by either providing them with additional or fewer assets, the remainder of this section will analyse these competing theories and conclude whether or not they provide a justification for unsecured creditor protection, either within insolvency law or outside of it[233].

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[228] Other published insolvency theories, which are similar to those analysed in this chapter, include: Gross K, *Taking Community Interests into Account in Bankruptcy: An Essay,* (1994) 72 Wash ULQ 1031; Clark R, *The Duties of the Corporate Debtor to its Creditors,* (1977) 90 Harv LR 505; Carlson D, *Bankruptcy Theory and the Creditors' Bargain,* (1992) 61 U Cin LR 453; Flessner, *Philosophies of Business Bankruptcy Law: An International Overview* in Ziegel J, *Current Developments in International and Comparative Corporate Insolvency Law* (Oxford: OUP,1994); Shuchman, *An Attempt at a 'Philosophy of Bankruptcy'* (1973) 21 UCLA L Rev 403.
[229] Mokal R, *The Authentic Consent Model: Contractarianism, Creditor's Bargain, and Corporate Liquidation,* (2001) 21 Legal Studies 400 at 401-402
[230] See Jackson T, *Bankruptcy, Non-Bankruptc,* (No.224); Jackson T, *Of Liquidation, Continuation, and Delay: An Analysis of Bankruptcy Policy and Nonbankruptcy Rules,* (1986) 60 Am Bankruptcy LJ 399; Jackson T and Scott R, *On the Nature of Bankruptcy: An Essay on Bankruptcy Sharing and the Creditors' Bargain,* (1989) 75 (2) VLR 155; Baird DG and Jackson TH, *Corporate Reorganisations and the Treatment of Diverse Ownership Interests: A Comment on Adequate Protection of Secured Creditors in Bankruptcy,* (1984) 51 University of Chicago Law Review 97
[231] Warren E, *Bankruptcy Policy,* (No.224)
[232] Korobkin, *Contractarianism and the Normative Foundations of Bankruptcy Law*, (1993) 71 Texas L Rev 541
[233] It is acknowledged that there are alternative theories put forward in addition to the three analysed, including, but not limited to, Communitarism (Gross, *Taking Community Interests into Account in Bankruptcy: An Essay* (1994) 72 Wash. U.L.Q. 1031.) and Ethicalism (P. Shuchman, *An Attempt at a 'Philosophy of Bankruptcy*' (1973) 21 UCLA L. Rev. 403.). However, although they are unique theories in their own right, they are less distinctive and representative of the range of theories put forward. Therefore, they have not been included in this chapter's analysis.

Section 1.1: Creditor Wealth Maximisation

As acknowledged by many leading commentators[234], the theory to have the greatest impact on insolvency law is perceived to have been Jackson's Creditor Wealth Maximisation[235]. At its most macro level, this theory involves the simple proposition that creditors, both secured and unsecured, should recover the greatest amount possible from the insolvency process[236]. This objective comes at the expense of other considerations[237], and requires a mandatory and collective regime. The justification for such a narrowly focused view of insolvency, according to Jackson and his co-authors, is that the insolvency process is simply a mechanism to collectivise debtor collection and then distribute all the available assets to discharge these debts[238].

The theory sprang out of the 1970s American Law and Economics movement[239], however Jackson also took his theory one step further, and incorporated Rawls' veil of ignorance[240], arguing that creditors would, if they were designing an insolvency regime without the knowledge of which position they would find themselves occupying upon the onset of liquidation, conclude that creditor wealth maximisation would be the regime they would subscribe to as being the fairest and most efficient.

A crucial feature of Creditor Wealth Maximisation is the need to recognise and respect pre-insolvency rights[241]. Thus, the interests of employees, shareholders and the wider community cannot be protected through *ex post* distributions of company assets. Instead,

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[234] Van Zwieten K, *Goode,* (No.13) at 78-79; Keay A and Walton P, *Insolvency Law,* (No.222) at 24; Finch V, *The Measures of Insolvency Law,* (1997) 17 Oxford JLS 227 at 230

[235] The theory has been adopted into the German Insolvenzordnung and into English academic thinking through the works of McCormack G, *Secured Credit under English and American Law,* (No.219) at 12 and Van Zwieten K, *Goode,* (No.13) at 78-79. See also Stubbins M, *What Kind of World,* (No.38) for the degree to which Creditor Wealth Maximisation has been adopted into the Enterprise Act 2002. This adoption of the theory gives it, and this thesis' analysis of the theory, credence within the English insolvency regime.

[236] See Finch V, *The Measures of Insolvency Law,* (No.234) at 230

[237] Mokal R, *The Authentic Consent Model,* (No.229) at 416 – there is an 'appreciation of the nature of insolvency law and its limits, and of the boundaries between insolvency and non-insolvency issues.'

[238] See Jackson T, *Bankruptcy, Non-Bankruptcy* (No.224)

[239] See the works of the founder of the Law and Economics movement; Manne H, *The Collected Works of Henry G Manne,* (US: Liberty Fund, 2009)

[240] Rawls J, *A Theory of Justice,* (Cambridge Mass., HUP, 1971)

[241] Van Zwieten K, *Goode,* (No.13) at 90-92

they can only be protected either by a surplus of company assets[242] or through non-insolvency protections, which require active and generous governmental support. This means non-creditor parties receive little to no protection from the insolvency process as governments rarely provide the necessary support. Creditor Wealth Maximisation also leans heavily on the statutory priority of distribution considered in Chapter 1, resulting in secured creditors retaining their position as the first creditors to receive company assets[243]. It can, and is repeatedly, argued[244] that Creditor Wealth Maximisation is merely a procedural mechanism that is unconcerned with policy issues and redistributive justice[245].

More prescient for unsecured creditors, however, are the alleged benefits and pitfalls Jackson proffers for adopting this theory[246], as they affect their position within the insolvency process. First in the list of proposed advantages is the guarantee that creditors will recover something from the insolvency, or at least guarantee an equal chance of recovering from the process if there are no assets left in the company[247]. Indeed, Jackson argues that by utilising a mandatory and collectivised system, slow reacting creditors[248] are protected from the free for all 'race to collect' by removing any advantage to those who move the quickest and are thereby able to recover all or a substantial percentage of their debts at the expense of all others[249]. As put by Jackson, it thereby 'stipulates a minimum set of entitlements for claimants'[250] and protects unsecured creditors by

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[242] Which is implausible given that insolvency is entered into only if the assets of the company are insufficient to cover its liabilities - s123 Insolvency Act 1986. Both tests for determining whether the company has entered insolvency, the balance sheet and cashflow tests, require there to be insufficient assets.
[243] Van Zwieten K, *Goode,* (No.13) at 90
[244] Finch V and Milman D, *Corporate Insolvency Law,* (No.6) at 29; Keay A and Walton P, *Insolvency Law,* (No.222) at 24
[245] Finch V and Milman D, *Corporate Insolvency Law,* (No.6) at 28*,* 29
[246] "…secured credit is, on the whole, socially beneficial, and that such benefits are high likely to outweigh the social costs of any transactions motivated by redistribution." - Armour J, *The Law and Economic Debate,* (No.8) at 4
[247] Mokal R, *The Authentic Consent Model,* (No.229) at 421
[248] Those who do not actively engage in monitoring the creditor or do not have access the relevant information
[249] Jackson T, *Bankruptcy, Non-Bankruptcy,* (No.224) at 861. Fletcher put this as "It is a central tenet of the collectivity principle that the debtor's assets are administered, and the creditors' claims processed, without any regard for the chronological order in which assets are acquired or debts created"; Fletcher I, *The Law of Insolvency,*(No.62) at 3; Baird DG, *The Uneasy Case for Corporate Reorganisations,* (1986) 15(1) JLS 127 at 131
[250] Ibid, at 876

ensuring that they enjoy a fair distribution of the available assets without a small minority benefiting at the expense of the general body[251]. Given that creditors cannot guarantee they will not become slow reacting creditors in any given scenario, and face high monitoring and unprofitable costs should they elect to be in a position to react quickly, this guarantee of equal access to the assets creates creditor confidence in the system, a cheaper credit market for solvent companies and a fair and protectionist procedure.

Creditor Wealth Maximisation theory is further posited to decrease the associated costs of the insolvency process, and thereby increase the potential return rates to creditors[252]. Jackson argues that by compelling all parties to participate in the same system, and participate in it equally, the procedural and legal costs are reduced by preventing multiple creditors from engaging in identical, counterproductive and costly procedural actions[253] – what are described as attempts 'to beat out' other creditors[254]. By preventing such inefficient procedural actions, and replacing them with a unified system, many procedural actions can be reduced in quantity and fewer administrative costs be incurred as a result. Jackson also acknowledges that although creditors could contract for and achieve a collectivised insolvency system, accomplishing such an outcome would be both time consuming and economically costly[255]. This is because troublesome creditors would be free to hold out from agreeing to the process[256], and could therefore demand increased shares of the asset pool and result in delayed and frantic negotiations. By compelling a mandatory process, Creditor Wealth Maximisation is able to avoid unfair distributions to creditors by preventing these holdouts from having the power to frustrate the adoption of this efficient system[257], and ensure that creditor and company assets are not inefficiently expended enforcing and defending a multiplicity of similar or identical claims.

The theory does not limit itself to minimising procedural costs, however, and also proclaims to be able to maximise the value of the insolvent's asset pool. This is

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[251] Finch V and Milman D, *Corporate Insolvency Law,* (No.6) at 1
[252] Jackson T, *Bankruptcy, Non-Bankruptcy Entitlements,* (No.224) at 862; Anderson H, *The Framework,* (No.217) at 3
[253] See Finch V and Milman D, *Corporate Insolvency Law,* (No.224) at 1; Van Zwieten K, *Goode* (No.13) at 78
[254] Jackson T, *Bankruptcy, Non-Bankruptcy Entitlements,* (No.224) at 862
[255] Ibid, at 865
[256] Ibid, at 865-866
[257] Jackson T, *Of Liquidation, Continuation, and Delay: An Analysis of Bankruptcy Policy and Nonbankruptcy Rules,* (1986) 60 Am Bankruptcy LJ 399 at 402

accomplished by allowing the liquidator to sell the company's assets as a going concern[258]. As posited, if individual creditors were free to race to enforce their debts individually, this would lead to a piecemeal break-up of the asset pool and a premature removal of the necessary operating assets[259]. Such a course of action would fail to maximise the value of the asset pool as the majority of its value is the business itself. Thus, the "substitution for individualistic remedies may be advantageous to the creditors as a group"[260] because the insolvency practitioner is placed in a position where they are able to maximise the asset pool's value and return that value to the creditors, minimising their potential losses. In calling for such an outcome, Jackson is implicitly stating that creditors, and unsecured creditors in particular as a consequence of their low return rates[261], are deserving of the assistance of insolvency law in order to increase their low return rates as the level of recovery creates an unfair situation.

What can, therefore, be extrapolated is that although it is not couched in the language of creditor protection, and Jackson does not explicitly state it is the purpose of insolvency law, unsecured creditor protection lies at the heart of the insolvency regime. By minimising the associated costs of the insolvency process through a mandatory and collective system, ensuring that all creditors receive a fair and equal share of the company's insufficient assets, and ensuring that the asset pool's inherent value is maximised, the unsecured creditor is protected from the alternative possibility of a race to enforce claims, large enforcement costs and the majority of creditors not receiving anything at the expense of the few. By doing so, a modicum of equity and fairness is achieved, even if it is not put in the explicit manner as with the provisions set out in Chapter 3.

Despite the centrality of creditor protection, and the clear fiscal advantages it has for the unsecured creditors, the theory is also problematic for such creditors. This is as a consequence of the dilution of unsecured creditor protections by Jackson's requirement that secured creditor interests not only be protected, but be given priority over all other parties to the insolvency[262]. As was graphically illustrated in Chapter 1, providing secured

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[258] Ibid, at 893
[259] Jackson T, *Bankruptcy, Non-Bankruptcy Entitlements,* (No.224) at 864
[260] Ibid, at 864
[261] McCormack G, *Proprietary Claims,* (No.188) at 1
[262] Jackson T, *Bankruptcy, Non-Bankruptcy Entitlements,* (No.224) at 868-869

creditors with such protections and priority over other creditors results in the majority of the company's asset pool being stripped away in their favour.

In supporting this proposition[263], Jackson first argues that by secured creditors deferring their enforcement rights and keeping the property in the asset pool, they are benefitting the unsecured creditors through reduced costs and by allowing the business to be sold as a going concern[264]. To reach this conclusion it is also posited that if the secured creditors were to remove their assets, the business' assets would be severely depleted and the possibility of a sale as a going concern would be severely diminished, if not extinct. Hence, it is only by including the secured assets, which the secured creditors are otherwise free and likely to remove but for a collectivised system, that the unsecured creditors are able to utilise the protections outlined above[265].

This line of reasoning for secured creditor priority is even more unsettling for the unsecured creditors, however, as it requires them to pay interest for the privilege of secured assets remaining in the asset pool. This is because secured creditors would be compelled to wait for their repayment, and so lose out on the opportunity to use the assets in an economically profitable manner[266]. In Jackson's own words, "One would expect, therefore, that the unsecured creditors would be willing to pay a secured creditor at least something to agree to join in the collective proceeding"[267]. This additional cost is of course problematic for unsecured creditors. For although it is true secured creditors would lose out on using the recovered debt in an economically advantageous manner, the nature of their security interest in guaranteeing them access to company assets enables them to minimise any losses[268]. The unsecured creditors, on the other hand, must deal with there being insufficient assets to cover the company's unsecured liabilities, must cover the high costs of the liquidation, and must deal with having their debts paid in a rigid and hierarchical order that prevents the majority from recovering anything[269]. Should

[263] Which has been supported on the grounds of freedom of contract; per Hoffmann J in *Re Brightlife* [1987] Ch 200 at 209; Nourse LJ in *Re New Bullas Trading Ltd* [1994] 1 BCLC 485
[264] Jackson T, *Bankruptcy, Non-Bankruptcy Entitlements,* (No.224) at 869; Baird DG, *The Uneasy Case for Corporate Reorganisations,* (1986) 15(1) JLS 127 at 133
[265] Ibid, at 893. See also Jackson T and Scott R, *On the Nature of Bankruptcy: An Essay on Bankruptcy Sharing and the Creditors' Bargain,* (1989) 75 (2) VLR 155 at 159
[266] Jackson T, *Bankruptcy, Non-Bankruptcy Entitlements,* (No.224) at 870
[267] Ibid, at 869
[268] See Figure 3 in Chapter 1, which shows secured creditors only recover some of debts owed.
[269] Through the statutory priority of distribution

unsecured creditors pay interest for the privilege of secured assets remaining in the asset pool, any negligible gains made by selling the assets as a going concern will be lost to the already insulated secured creditors. Consequently, notwithstanding Jackson's subsequent climbdown over the issue[270], protection of unsecured creditors is heavily qualified – whilst it gives with one hand through the going concern value, it takes with another in the form of interest payments.

Although severely qualified, the narrow focus of the theory on contractual creditors further assists the unsecured creditors' position within the liquidation process[271]. As noted above, cardinal to Creditor Wealth Maximisation is the rejection of *post ante* distributions of company property[272], preventing insolvency law from protecting non-consensual parties[273]. This is justified on the basis that if such parties were protected, they would be encouraged, owing to the limited rights they have prior to the onset of insolvency, to initiate the process[274] - improving their position at the expense of the contractual creditors, and will be incentivised to bring the company to an end prematurely and before it becomes uneconomic to sustain. In order to prevent such behaviour, contractual creditors may be held to ransom and be compelled to enter into costly and time-consuming negotiations to prevent such actions[275]. Instead, it is stated that if they should be protected, it must be done by the substantive law in other areas such as employment law or torts law[276]. Alternatively, if they occupy a special position[277], they may leverage that position to demand full repayment from the business. Irrespective of which non-insolvency mechanism is used to protect non-consensual creditors, by maintaining pre-insolvency rights, fewer parties are entitled to the asset pool, and so a larger share of the asset pool can be distributed to the contractual creditors. As a result of this, the liquidation dividend will be greater for the unsecured creditors at the expense of these non-consensual parties,

[270] Jackson T and Scott R, *On the Nature of Bankruptcy: An Essay on Bankruptcy Sharing and the Creditors' Bargain,* (1989) 75 (2) VLR 155 at 159
[271] It has also been argued that this narrow focus is supportable owing to the natural human reaction to individuals acquiring property thought of as belonging to the creditor; Parry R, *Transaction Avoidance in Insolvencies,* 3rd edn (Oxford: OUP, 2018) at 9
[272] Jackson T, *Of Liquidation,* (No.257) at 406
[273] Jackson T, *Bankruptcy, Non-Bankruptcy Entitlements,* (No.224) at 902
[274] Ibid, at 903
[275] Ibid, at 904
[276] Ibid, at 905
[277] Such as a council that must issue licences in order for the company to operate Jackson; T, *Of Liquidation,* (No.257) at 420

and the insolvency regime must create this preference in order to achieve fairness for the unsecured creditors.

Accordingly, we see that improving the unsecured creditor's position, and achieving fairness for this constituency, is central to the theory. This is achieved through ensuring that each creditor has an equal opportunity to recover something from the liquidation process and that the procedural costs are minimised. It further improves their position by prioritising their interests and excluding non-creditors from having any access to the company's property, thereby protecting the asset pool for distribution to unsecured creditors. However, as also seen above, these improvements to their position are hampered by the inevitable need to respect and give priority to secured creditor interests – also meaning that the willingness to provide them with equity is severely limited. Given that secured assets make up the bulk of a company's asset pool, and these remain unavailable to the unsecured creditors, large levels of the company's assets are siphoned off and made unavailable for distribution[278].

Though improvements to the unsecured creditor position are heavily qualified, there is nothing within the theory that prohibits wider insolvency law[279] from providing these creditors with additional protections that can improve their return rates. Although the secured assets will evidently be unavailable to fund such actions as they can only be used to cover secured creditor costs[280], it does not mean that their rights cannot be truncated to protect unsecured creditors. Indeed, Jackson himself calls for limitations to secured creditor enforcement of their rights if selling the company as a going concern will return greater amounts than a piecemeal carve up of the business – which is itself an oblique form of unsecured creditor protection as outlined above. Therefore, although not explicit, the protection provisions set out in Chapter 3 fall within Creditor Wealth Maximisation as, just like the theory, they improve the unsecured creditors' financial position. Hence, it is submitted that so long as pre-insolvency rights are respected, and the secured assets are left intact, there is nothing within the theory to prevent attempts to expand unsecured

[278] This principle of protecting secured creditor rights is deeply inscribed into English insolvency law: see Van Zwieten K, *Goode,* (No.13) at 115-116
[279] Those areas of insolvency law not directly affected by the theory
[280] Recognised in English law by *Re Leyland DAF* [2004] UKHL 9, where it was held by the House of Lords that there are two 'funds' (secured and unsecured) that must cover their own costs. See Chapter 5 for detailed analysis.

creditor protections. Finally, given the prominence secured creditors interests are given, the theory also implicitly justifies not only attempts to maintain the size of the asset pool, but also increase return rates. This is discerned from Jackson's justifications for the theory resting primarily on the fiscal advantages for the unsecured creditors in acquiring a greater and more equitable share of the company's assets. The protectionist nature Creditor Wealth Maximisation cannot, therefore, be doubted.

Section 1.2: Criticisms and Alternative Theories

Notwithstanding Creditor Wealth Maximisation's popularity and appealing theoretical simplicity, the theory was been heavily criticised by many, including Carlson, who forcefully concluded in his review that "Thomas Jackson has written an unremittingly dreadful book"[281]. Whilst there are many existing criticisms of the theory, owing to the narrow focus of this chapter to unsecured creditor protection, and the criticisms only having a passing relationship with this issue, they will only be briefly outlined.

The disparagement of Creditor Wealth Maximisation has focused on two principal objections. The first is that the theory relies too heavily on assumptions of behaviour. As noted above, Jackson's bases his theory on Rawls' veil of ignorance, which makes presumptions about the behaviour of the uninformed party/creditor should they partake in the insolvency process, and asserts that they would agree that maximising creditor returns is the fairest outcome. Despite this having some compelling features, it has been observed that these assumptions are open to serious questioning[282]. It is posited that human behaviour is not so predictable, and many will act in a manner contrary to that concluded by Jackson. Indeed, each creditor in the real world, as well as in the theoretical model where general personalities are retained, has their own knowledge, experience and prejudices that impact on the decisions they make when faced with the prospect insolvency. Not every creditor, particularly those with greater resources, would therefore conclude that such an insolvency system would be beneficial for them, and would find alternative non-collective models compelling. Additionally, Jackson's work focuses solely on the contractual creditors at the expense of non-contractual creditors, who again

[281] Carlson D, *Philosophy in Bankruptcy (Book Review),* (1987) 85 Mich LR 1341
[282] Keay A and Walton P, *Insolvency Law,* (No.222) at 26

have very different priorities among this constituency. Accordingly, Creditor Wealth Maximisation has been criticised for being prefaced on unstable assumptions.

The second primary objection builds upon the exclusion of non-contractual creditors from the insolvency regime. As concluded above, the narrow focus of Creditor Wealth Maximisation reduces the number of parties who have a right to a share of the company's assets. However, for those excluded, the consequences can be disastrous, with no protection being provided at all from the insolvency process[283]. As non-contractual creditors include tort victims and employees[284], who are not in a strong enough position to protect themselves through alternative measures, these creditors must bear the brunt of the insolvency[285]. This is illustrated by Finch, who notes that employees and similar creditors are unable to recover their 'displacement costs'[286] nor receive any form of priority[287] despite them possibly considering that their claims have moral superiority over those of contractual creditors[288]. Consequently, the theory has been categorised as occupying an unfair position. Despite these criticisms though, there is nothing in either of them that argues that Creditor Wealth Maximisation should not provide unsecured creditors protection within the insolvency system. In fact, the argument that those in distress should be afforded greater protections implicitly calls for an increase to unsecured creditor protections as a result of their precarious position, as does the criticism of the assumptions drawn, as the broader the constituency the more protections that are likely to be demanded.

In light of these retorts, and seeking to build upon them, a number of alternative theories have been proffered, the most extreme of which has been Elizabeth Warren's Multiple Values Approach[289]. Although Warren's theory is the most prominent alternative theory

[283] Gross K, *Taking Community Interests into Account in Bankruptcy: An Essay,* (1994) 72 Wash LR 75
[284] Beyond their unsecured claims to unpaid but contractually agreed remuneration
[285] Van Wezel Stone K, *Policing Employment Contracts Within the Nexus-of-Contracts Firm,* (1993) 43 U Toronto LJ 353
[286] Such as finding new employment, lost wages during this process and any retraining they must undertake in order to acquire new employment
[287] Apart from priority over shareholders – s107 Insolvency Act 1986
[288] Finch V and Milman D, *Corporate Insolvency Law,* (No.6) at 32; Carlson D, *Philosophy in Bankruptcy (Book Review),* (1987) 85 Mich LR 1341 at 1353
[289] Warren E, *Bankruptcy Policy,* (No.224)

on this issue, and so is the one analysed in this chapter, many others including Gross[290], the British Government‘s Department of Trade and Industry[291], Fletcher[292] and the United Nations Commission on International Trade Law[293] have all proposed similar ideas. Owing to their similarly to Warren’s theory, however, they will not be analysed.

The Multiple Values Approach, in stark contrast to Creditor Wealth Maximisation, does not possess a simple and single purpose with a narrow set of constituents. Instead, it is concerned with a varying and ever-changing roster of parties that have complex and competing interests that prevent the creation of neat and easy to apply priorities. It is therefore proffered that instead of the structured distribution of the company’s assets to contractual creditors, insolvency law should be fluid and distribute losses according to those who can withstand them the most[294]. This is because whilst some creditors may lose out as a result of their own actions, they may also lose out as a result of “unforeseeable” circumstances out of their control[295]. Central to achieving this outcome, the theory requires the judiciary to be given large levels of discretion to determine how the assets should be distributed and to whom they should be received. Again, in contrast to Jackson’s protestations, the theory also calls for the opportunity to restructure a company, especially if it will safeguard individuals in employment or suppliers with valuable contracts[296]. Definitive conclusions are thereby prevented from being drawn, with each insolvency taking on a unique character with potentially widely different outcomes.

Given these objectives, it is evident that the Multiple Values Approach is concerned with protecting vulnerable parties involved in insolvency proceedings. It also evident that in order to achieve this, there must be a disturbance of pre-insolvency interests and a potential reduction in the assets protected by secured interests. In determining how asset

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[290] Gross K, *Taking Community Interests into Account in Bankruptcy: An Essay,* (1994) 72 Wash LR 75

[291] Department of Trade and Industry, *Insolvency - A Second Chance,* (White paper, Cm 5234, July 2001) at para 2.5

[292] Fletcher I, *The Law of Insolvency,* (No.62)

[293] UNCITRAL *Legislative Guide on Insolvency Law* (UN 2005)

[294] McCormack G, *Secured Credit under English and American Law,* (No.219) at 6; Finch V and Milman D, *Corporate Insolvency Law,* (No.6) at 39; Warren E, *Bankruptcy Policy,* (No.224) at 777

[295] Warren E, *Bankruptcy Policy,* (No.224) 775 at 778.

[296] Ibid, at 778, 788

distributions should be made, four main factors are provided[297]: 1) the relative ability for parties to bear the costs of a default[298]; 2) whether or not the parties have been incentivised into providing the necessary credit to keep the company functioning and avoid insolvency; 3) whether creditors who share similar characteristics such as unsecured creditors can, and should, be treated in an identical manner; and 4) whether or not a contract or transaction entered into with the now insolvency company is of benefit to the estate.

The use of these ill-defined factors fails to provide a measure of predictability among insolvency cases. For example, using the factor of the ability to bear the costs of a default, it is impossible to predict who will be able to best bear the loss. In many instances, as outlined in Chapter 1, institutional lenders will be able to absorb the losses that arise from the creditor entering into insolvency due to their ample financial resources. Meanwhile, the employees will be unable to do so owing to their relative limited financial resources. However, should the institutional lender overextend themselves and lend too much to the creditor or be in severe need for the loan repayments to cover other debts that they owe, or the employees be sufficiently well remunerated so as to be in a position to easily withstand the loss of employment and find new employment, the traditional manifestation of the balance of tolerance within the insolvency process will be turned upon its head. Despite the above only covering a limited number of examples, the potential agglomeration of parties and their financial resilience are myriad and impossible to foresee.

Equally with the utility of contracts or transactions, the same worker will be treated very differently depending on factors out of their control. Taking a mechanical engineer as an example, they may possess the skills few have to keep a machine running. Therefore, they will be valuable to an insolvent company in seeking to restructure the business or a purchaser who wishes to purchase the insolvent asset for their own use. This will result in the employment contract being respected and the job maintained. However, the same engineer with the same skills may not be so valuable should the company not be seeking

[297] Ibid, at 790-793

[298] For example, employees are unable to bear the cost of not being paid or being out of work, whereas institutional secured creditors with large levels of resources can withstand the financial hit

to restructure[299] or should the purchaser of the asset already have employees with the necessary skills. This will result in a termination of the contract and the loss of the job despite possessing identical qualities. All workers, irrespective of their qualification and experience, will face high levels of unpredictability over their eventual treatment within this flexible insolvency regime, whereas under Creditor Wealth Maximisation their position is already known.

Warren herself recognises this feature of unpredictability within her theory, calling it a "dirty, complex, elastic, inter-connected view"[300]. Undeterred, she also claims that her plans to provide the judiciary with wide scale discretion do not "amount to fuzzy "do equity" preachments of the hopelessly confused, who leave good results to good people and assume that ideas and analysis have no content."[301] Despite Warren's protestations to the contrary, there appears to be nothing in her theory, or the guidelines she provides to enable to the judiciary to implement her view of insolvency law, that would give credence to the assertion that it would not amount to the judiciary merely achieving 'fuzzy equity'[302]. This is because nothing is provided that would create a reasonably predictable insolvency framework. Similar conclusions have been reached by Schermer[303], who concludes that a fundamental issue with the theory is that "there are an infinite number of community interests…and their boundaries are limitless" – meaning that foreseeability of the end result goes out the window.

The Multiple Values Approach therefore has two potential outcomes for a company's unsecured creditors. Under the first, given that many creditors are left in a perilous position by the onset of insolvency through the prospect of recovering little, and Warren actively wishing to protect such constituents from their vulnerabilities, it is clear they are deserving of high levels of protection. As such, the judiciary would accordingly have the discretion to grant them increased access to the company's asset pool or affirm a contract at the expense of the secured creditors, and thereby reduce their potential losses. By doing

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[299] This may occur due to the futility of trying to turn around the business, especially in dying or troubled industries

[300] Warren E, *Bankruptcy Policy,* (No.224) 775 at 811

[301] Ibid, at 798

[302] See the above analysis

[303] Schermer, *Response to Professor Gross: Taking the Interests of the Community into Account in Bankruptcy,* (1994) 72 Wash ULQ 1049 at 1051

so, this outcome of the theory would be beneficial to the unsecured creditors and ensure greater levels of fairness through increased protections.

However, it is also foreseeable that in many instances it may be detrimental and lead to catastrophic outcomes for the unsecured creditors. This a real possibility as although the unsecured creditors regularly occupy a precarious financial position, the position of tort creditors and employees is often much worse. Given the possibility of there being numerous such parties, particularly if the company was engaged in dangerous industrial ventures, the judiciary may be inclined to use their discretion to favour such parties over the unsecured creditors by granting victims limited access to the asset pool or preventing the unsecured creditors from recovering anything at all. As such, the meagre unsecured creditor returns currently received could potential be wiped out in such a discretionary system. Similarly to Creditor Wealth Maximisation, Warren's theory purports to give with one hand, it takes with another.

Notwithstanding the lack of predictability, it is apparent that the theory does call for protections to be provided for these creditors. It acknowledges that where the unsecured creditors are the worst affected constituents, they should be afforded a greater share of the company's assets to ensure a more equitable outcome. In order to achieve this, although not expressly considered by Warren, the protection mechanisms set out in Chapter 3 are indispensable so as to ensure the asset pool remains intact and can then be used in a discretionary manner. Similar conclusions to that with Creditor Wealth Maximisation can be drawn, that although the extent of the protections afforded unsecured creditors is qualified, it is unquestionable that the Multiple Values Approach calls for some form of creditor protection owing to the unfair position unsecured creditors occupy.

Lying in between the extreme positions of Warren and Jackson's theories rests Korobkin's Broad Based Contractarianism[304], which seeks to propose a reasoned middle ground for insolvency's theoretical foundations. In contrast to Creditor Wealth Maximisation's use of the veil of ignorance, Contractarianism includes other constituents affected by the onset of insolvency, such as employees, managers, tort victims and the

[304] Korobkin D, *Contractarianism,* (No.232)

wider community. By including these additional constituents, it is contended that a broader and more representative section of society are enabled to set insolvency policy[305], and are able to create a fairer system that foresees widespread damage from the collapse of the company and the need to spread the risk[306].

In expanding the constituency of those who set insolvency interests, Korobkin argues that two principles would be adopted by those behind the veil. The first is the principle of 'inclusion'. This mandates that all parties affected by the insolvency are entitled to make submissions that they are entitled to a share of the asset pool. Thus, parties other than contractual creditors would be able to petition for a favourable outcome to insolvency proceedings. The second principle, 'rational planning', appraises these requests for access to the asset pool and determines the extent to which they would be able to enforce their submissions. This second principle would seek to give effect to the most important aims and achieve what was best in the long-term interests of the company[307]. This is to be done even if it ignores and violates pre-insolvency rights, again meaning secured creditors' interests are placed at risk[308]. It thus mandates that those in the most precarious positions should be afforded priority over those who can better withstand non-repayment, and does in effect call for the creation for a form of preferential creditors.

Even though Contractarianism *prima facie* shares more similarities with the Multiple Values Approach than Creditor Wealth Maximisation due to its desire to protect vulnerable constituents, it diverges on the basis that instead of granting the judiciary free rein to exercise discretion in each individual case, a uniform and structured insolvency system is called for. Indeed, in rejecting the adoption of 'pure equity', Korobkin posits that the judiciary must be given strict limitations on what they can and cannot order so as to provide some sense of predictability. This necessitates a system similar to that already adopted in many jurisdictions. Unlike under the Multiple Values Approach, where it is impossible to predict what position the unsecured creditors will inhabit, their position is

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[305] Finch V and Milman D, *Corporate Insolvency Law,* (No.6) at 34

[306] Other alternative theories include Communitariansim (Gross K, *Taking Community Interests into Account in Bankruptcy: An Essay*, (1994) 72 Wash. U.L.Q. 1031) and Ethicalism (Shuchman P, *An Attempt at a 'Philosophy of Bankruptcy*', (1973) 21 UCLA L. Rev. 403), however neither theory clearly demarcates its boundaries.

[307] Finch V and Milman D, *Corporate Insolvency Law,* (No.6) at 34

[308] Korobkin D, *Contractarianism,* (No.232) at 550; Mokal R, *The Authentic Consent Model,* (No.229) at 404

governed by substantive and known rules, in a similar manner to Creditor Wealth Maximisation.

Additionally, although a middle ground between the extreme theories outlined above, three things become evident. The first is that Contractarianism suffers from the same issues surrounding the use of a veil of ignorance[309]. This is because even though Korobkin may improve upon Jackson's use of the veil by including a wider range of constituents, it also fails to account for the different reactions individuals have to their position, and that they regularly fail to act in a rational manner. Thus, the theory fails to accommodate both those who are risk adverse or risk takers, both of whom would have very different conclusions, in the same uniform system.

Secondly, the theory has been attacked on the grounds that it does not go far enough. In his appraisal, Mokal[310] put forward that as Korobkin limits his approach to insolvency law, and does not wish to reform any other areas, an unfairness is created to those who are reliant on companies that do not technically enter into insolvency[311]. This is because they are unable to take advantage of the benefits Korobkin puts forward due to them being limited to the use of insolvency regimes[312]. This accordingly 'creates a discrepancy in the treatment of people who are going through exactly the same problems'[313], and causes inequitable treatment of unsecured creditors.

Finally, it becomes evident that unsecured creditor protection has an important role to play within the theory. Even though not as potentially beneficial as Warren's approach may be, by using the 'rational planning' principle in allocating company assets to those who require them the most, unsecured creditors may be in line to receive an increased allocation compared to Creditor Wealth Maximisation due to their high losses. However, as with Multiple Values, the unsecured creditor may also not be deemed 'worthy' enough of receiving an increased share of company assets, or any assets at all, and instead find

[309] Loughlin M, *Public Law and Political Theory,* (London: Clarendon Press, 1992) at 96; Finch V and Milman D, *Corporate Insolvency Law,* (No.6) at 34
[310] Mokal R, *The Authentic Consent Model,* (No.229)
[311] Ibid, at 419. This includes companies that are able to survive through severe redundancy plans or creditor voluntary agreements
[312] Ibid, at 418
[313] Ibid, at 419

them allocated to tort victims or employees as preferential creditors. The further difference between Korobkin and Warren is that in spite of the fact that Warren's theory means these worries are limited to individual insolvencies and members of the judiciary, Korobkin's calls for structured rules, which means the insolvency system must either be generous in all circumstances to unsecured creditors or be detrimental in all circumstances.

Section 1.3: Conclusions on the Position of Creditor Protections

To conclude on all three theories, it is clear that they all promote or condone the existence and use of creditor protections. All the theories analysed above place the unsecured creditor towards the centre, if not the actual centre, of their theoretical model. The basis for this protection, which is uniform amongst all of the theories, is the unfair position of the unsecured creditor. All conclude that as they receive very little from the insolvency process, and others receive substantially more, action must be taken to maximise their liquidation dividend. It is also concluded in the Creditor Wealth Maximisation and Contractarian theories that these features of insolvency law can be supported on the basis that the majority of parties, when placed behind the veil of ignorance, would call for such protections.

The extent to how far insolvency regimes should go to protect these creditors is vociferously contested, however, with very little agreement existing. At the very minimum, as all the theories require an intact asset pool, they condone the existence of mechanisms to maintain its integrity and prevent improper distributions. Beyond this, agreement is lacking on what insolvency law should seek to achieve. The least ambitious, Creditor Wealth Maximisation, seeks to merely distribute non-secured assets in accordance with the statutory priority of distribution on a *pro-rata* basis, with changes to this strictly forbidden and the benefits stemming from predictability and reduced procedural costs. The alternative theories, which seek to achieve a more equitable distribution of company assets, go beyond this and attempt to assist those in most need by a non-proportionate distribution of assets. Notwithstanding this fundamental disagreement of how the assets should be distributed, all of the theories at a minimum permit creditor protections so long as they do not negatively impact upon other classes of creditor (particularly secured creditors), meaning that so long as the secured creditor

interests are respected, there is scope for extending creditor protection. Hence, all three theories justify the use and expansion of unsecured creditor protections.

Section 2: Purposes of English Insolvency Law

In sharp contrast to American attempts, English insolvency law has elected to adopt a more pragmatic approach and limited its concerns to identifying its practical purposes[314]. Accordingly, as this thesis is focused upon the English insolvency regime, it is imperative that this practical approach is analysed to determine whether or not the unsecured creditor protections advocated in the theoretical models have been adopted into the real world.

The practical foundations of English theory have been set out in two landmark texts, both of which demonstrate the extent to which the American theories outlined above have been adopted into English law. The first of these texts, the Cork Report[315], provides a Government sanctioned review of English insolvency law, its principles and purpose. The second text, originally by Prof Goode[316], provides an academic analysis and perspective. Although both texts have some diverging opinions on insolvency law and its ideal form, the prime positions they both afford to unsecured creditors and their respective protections is unquestionable. It is necessary to analyse these two texts, rather than governmental policy documents, as those documents fail to properly set out the purpose of insolvency law, and instead solely focus on setting out substantive policy changes[317]. This is particularly true of the Cork Report as it would form the underpinnings of the Insolvency Act 1986.

[314] Keay A and Walton P, *Insolvency Law,* (No.222) at 25; Van Zwieten K, *Goode,* (No.13) at 75-77; Finch V and Milman D, *Corporate Insolvency Law,* (No.6) at 28
[315] Cork K, *Report,* (No.2)
[316] Van Zwieten K, *Goode,* (No.13)
[317] See Department of Trade and Industry, *A Revised Framework for Insolvency Law,* (White Paper, Cm 9175, Feb 1984); Department for Business, Energy and Industrial Strategy, *Insolvency and Corporate Governance: Government Response,* (26th August 2018) for a contemporary example; Stubbins M, *What Kind of World,* (No.38)

Within his report[318], Sir Kenneth places the unsecured creditor at the centre of the insolvency regime, raising them to the position of the primary constituent insolvency law is concerned with[319]. As observed in the Report:

> "Insolvency proceedings are inherently of a collective nature; their prime beneficiary is the general body of the insolvent's creditors, each of whom is affected, though clearly by no means necessarily to the same extent, by the common disaster. If each such creditor is denied by law the right to pursue separate remedies against the insolvent and is obliged to rely on the outcome of collective proceedings, then his interest is those proceedings ought to be, so far as is consistent with the claims of his fellow creditors, as fair and reasonable as circumstances will permit, to compensate him for the loss of his individual rights."[320]

From this approach several facets of insolvency law's purposes can be extrapolated. The first is that the party who should benefit most from the insolvency process is the unsecured creditors. This reflects the Creditor Wealth Maximisation theory, that although secured creditors should be protected in the insolvency process, it is the unsecured creditors who should benefit most from administrative efficiencies. In contrast to Jackson, however, Cork concludes that this should occur because of how poorly they are treated by the insolvency process rather than any benefits they might acquire. It is instead posited that as creditors are required to concede their rights to sue individually[321], and so lose the ability to rush and recover all of the debts owed to them, the insolvency procedure must be equitable and reasonable to them. To ensure this takes place, they must be entitled to a *pro rata* share of the company's assets. As outlined below, in order for these objectives to become effective, it is requisite that there be creditor protections that prevent the dissipation of, and provide for the opportunity to enlarge, the company asset pool. If such protections are unavailable, and parties are free to chip away at the

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[318] See the Insolvency Act 1986, the current legislative framework for English law

[319] Cork K, *Report,* (No.2) at para 17: "The laws of bankruptcy and company winding up are concerned exclusively with the realisation of the debtor's uncharged assets and the distribution of the proceeds among unsecured creditors."

[320] Ibid, at 232

[321] A concession Jackson argues to be beneficial for all unsecured creditors affected by the insolvency

asset pool[322], a fair and equitable distribution of assets becomes impossible, with only the most quick-witted recovering, and an unjust system is created.

Further justifications for prioritising the protection of unsecured creditors include that economic realities require robust safeguarding mechanisms[323]. It is argued that by allowing the existence of the banking system, and the credit it provides to companies, risks of insolvency and losses to those who extend credit are multiplied and made much more foreseeable[324]. In addition, given the prevalence of credit[325], and that the majority of creditors acquire unsecured status, should confidence be lost, companies would become unable to acquire the credit they require, and economic activity would grind to a halt[326]. To ensure that creditors have the confidence to lend[327], have the confidence that commercial morality will be maintained, and that they will not be subject to mistreatment[328], it is necessary that all creditors are offered adequate protection to ensure the continued supply of credit. Hence, in Cork's view insolvency law must protect the unsecured creditor for fear of the fatal economic consequences that would follow should confidence in the system be lost.

The conclusions reached by the Report were put into practical form by a number of recommendations made for how unsecured creditors might be protected. The first of these recommendations was the abolition of the majority of preferential debts, as these frustrated the possibility for true *pari passu* distribution between the general body of creditors[329]. These creditors, who are given priority over the general body, had, according to Cork, become so numerous[330] and so unpopular with the judiciary[331] that

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[322] As happens in an un-collectivised system. The result of allowing parties free rein to collect their debts is illustrated in the receivership mechanism; Anderson H, *The Framework,* (No.217) at 44-47

[323] Cork K, *Report,* (No.2) at para 23: "We consider that it is incumbent upon society to provide machinery which, in the event of insolvency, is adequate to ensure a fair distribution of the insolvent's assets among his creditors." Others to conclude similarly include: Anderson H, *The Framework,* (No.217) at 3,6; and Keay A and Walton P, *Insolvency Law,* (222) at 1

[324] Ibid, at para 20 and 23

[325] See Finch V and Milman D, *Corporate Insolvency Law,* (No.6) at Chapter 3

[326] Fletcher I, *The Law of Insolvency,* (No.62) at 2

[327] Cork K, *Report,* (No.2) at para 25

[328] Ibid, at para 191

[329] Ibid, at para 1396

[330] See the Preferential Payments in Bankruptcy Act 1897

[331] See *Re Rudd & Sons* [1984] Ch. 237 per Nourse J for an example of judicial

they threatened the fundamental effectiveness and viability of the floating charge[332]. In undermining the attractiveness of the floating charge – the go to security interest until the Enterprise Act 2002 reforms – a pillar of the necessary confidence for creditors to lend was eroded. Abolishing the majority of preferential creditors[333] would immunise unsecured creditors from the harshest elements of the insolvency process by ensuing that the meagre general creditor assets pool could be fairly distributed, and creditors being confident of equal treatment[334]. Thus, creditor protections, on a practical level, not only ensure a just solution to the onset of insolvency, but also help instil stability into the wider corporate and finance worlds. Insolvency law is therefore pertinent not only to corporate failure but also the general commercial activity.

Secondly, it was recommended that the fraudulent trading provisions be retained and new provisions for wrongful trading be created in order to protect the asset pool[335]. Though these provisions are analysed fully in Chapter 3, it can be briefly stated that they impose personal liability on those who partake in the running of a company against the interests of the general body of creditors in the period before it enters liquidation. Even though the effectiveness of these provisions has been vehemently questioned[336], the inclusion in the Report of provisions that would return assets to the company from third parties means that it is possible to deduce that it was aspired to clamp down on unethical dispositions of company assets and improve the position of the unsecured creditors through providing assets to the company to make up for losses that should not have been sustained. In doing so, it is again evidenced that unsecured creditors should form the centre of the insolvency system.

Finally, broader recommendations were also made to try and enlarge the distributable assets for unsecured creditors through non-personal liability means, with attempts made

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[332] Milman D and Durrant C, *Corporate Insolvency: Law and Practice,* 3rd edn (London: Sweet and Maxwell, 1999) at 143. The floating charge was, and remains, one of the primary security devices available to secured creditors.
[333] The only ones to survive were those that could be 'justified by reference to principles of fairness and equity which would be likely to command general public acceptance' - Cork K, *Report,* (No.2) at 1398
[334] Ibid, at 198 and 1396
[335] Ibid, at Chapter 44
[336] See Chapter 5 for full analysis, where it is concluded that the provisions fail to adequately protect unsecured creditors.

"to increase the amount available in an insolvent's estate for the ordinary creditors"[337]. This included the gradual replacement of the individualistic receivership with a new collective process[338]. Despite Cork never expressly calling for the abolition of receivership, it was recommended that the alternative administrative receivership be created[339]. By proposing an insolvency mechanism through which the company could be turned around and rescued, unsecured creditors were being given the opportunity to be insulated from the prospect of receivership, with secured creditors being prevented from dismantling the company solely for their own purposes. Should the secured creditors undertake action solely in their own interests, there would be no prospect of any business turnaround occurring or sell-on value being accumulated. In preventing these outcomes, the insolvency process is able maximise the assets received by the general body of creditors – adopting the conclusions of Jackson. Cork's recommendation was subsequently given effect through the abolition of receivership by the Enterprise Act 2002[340], which has seen successful examples of this intention including the rescue of House of Fraser.

It was further recommended that a 10% fund, already analysed in Chapter 1, be created. Notwithstanding that its eventual implementation through the 'prescribed part'[341] would be largely ineffective[342], the intention and aims behind the recommendation were clearly to improve the unsecured creditors' financial position at the expense of the floating charge holders and centralise the position of the unsecured creditor within the English insolvency regime[343].

Building upon the Cork Report, and evidencing the general reception to both it and the American insolvency theories in the wider academic community, is the work of Prof Goode[344].

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[337] Cork K, *Report,* (No.2) at para 1980
[338] Anderson H, *The Framework,* (No.217) at 44
[339] Cork K, *Report,* (No.2) at Chapter 9
[340] S250 Enterprise Act 2002 inserting s72A Insolvency Act 1986
[341] S252 Enterprise Act 2002 inserting s176A Insolvency Act 1986
[342] See Chapter 1 for full analysis
[343] Anderson H, *The Framework*, (No.217) at 6; and Keay A and Walton P, *Insolvency Law,* (No.222) at 44-47; Finch V and Milman D, *Corporate Insolvency Law,* (No.6) at 14
[344] McCormack G, *The Priority of Secured Credit: an Anglo-American Perspective,* (No.8) 405

In setting out his conclusions on English insolvency law – conclusions that broadly follow the standard discourse set out above – it is stated that the objectives of English insolvency law are "…to maximise the return to creditors; to establish a fair and equitable system for the ranking of claims and the distribution of assets among creditors, involving a limited redistribution of rights…"[345] Goode is therefore a disciple of Jackson and the Creditor Wealth Maximisation theory, and views the primary objective of insolvency as being to ensure only the legitimate creditors are able to enforce their claims. Should they be successful in doing so, they should also able to recover the greatest amount possible – a protectionist stand in favour of creditors.

In adopting the Creditor Wealth Maximisation theory, which has not been unquestioningly accepted by contemporaries[346], it is also elaborated on how this is to be achieved in practical terms. The first means of achieving the objectives is for the retention of company assets until they can be distributed by the liquidator for the benefit of the unsecured creditors[347] - referred to as the 'anti-deprivation rule'[348]. The result of this rule is that the unsecured creditors are protected by keeping the asset pool intact and out of the hands of those parties who have no right to the property. To identify those who have a legitimate interest in the assets, the second mechanism is the subjugation of individuals' rights[349]. Echoing Jackson, it is argued that if creditors were free to enforce their claims on a first come basis, the insufficient company assets would go to those who can react the quickest and it would be impossible to acquire the maximum value of the assets. Consequently, limiting creditors' individual rights is essential for achieving fairness. The final aspect is providing creditors, be they secured or unsecured, priority over other parties with an interest in the insolvency[350]. Again echoing Jackson, it is argued unfair to change pre-insolvency rights, as those who have entered into these agreements are entitled to expect them to be honoured[351].

[345] Van Zwieten K, *Goode,* (No.13) at 73-75
[346] See Finch V and Milman, *Corporate Insolvency Law,* (No.6) at 28-33; Keay A and Walton P, *Insolvency Law,* (No.222) at 26-30; and Fletcher I, *The Law of Insolvency* (No.62) at 2. These authors, whilst acknowledging there is a place for Creditor Wealth Maximisation, identify other constituents and priorities for the insolvency process. These authors thus adopt elements of Contractarianism and the Multiple Values Approach into their writings.
[347] Van Zwieten K, *Goode* (No.13) at 78-79
[348] See Chapter 5 for full consideration of the principle
[349] Van Zwieten K, *Goode,* (No.13) at 78-79
[350] Ibid, at 83-85
[351] Jackson T, *Bankruptcy, Non-Bankruptcy,* (No.224) at 902

To reinforce the anti-deprivation rule, and make it effective, it is acknowledged that there must be active and effective creditor protection mechanisms, including provisions on preferences, transactions at an undervalue, fraudulent trading and wrongful trading[352]. Indeed, Goode is so supportive of their existence that he refers to them as "…major instrument[s] of corporate insolvency law…"[353] to ensure unscrupulous parties are not allowed to profit from the asset pool unfairly, meaning the provisions protections lie at the heart the insolvency system[354].

Even though the majority of Creditor Wealth Maximisation is accepted and then adopted, certain aspects are also rejected[355]. In opposition, it is stated that whereas the theory is only concerned with contractual creditors, English insolvency law must have a broader perspective and be concerned with a greater number of interested parties[356].

Therefore, some *ex post* creditors, such as tort victims, should be entitled to sue as preventing them from doing so would be 'grossly unfair'[357] and cause hardship[358]. Consequently, "no distinction is made between voluntary (consensual) and involuntary (non-consensual) claimants"[359]. The same is true for unmatured claims[360], such a long term debt claims, as in a recall of Cork, not allowing them to enforce their debts would "discourage long term loan capital and be likely to precipitate contractual debt acceleration in the event of default."[361] Hence, Jackson's argument is "neat, but ultimately unpersuasive…"[362] and "It is also clear that insolvency law has at least some

[352] See Chapter 5 for full analysing of the provisions.
[353] Van Zwieten K, *Goode,* (No.13) at 85-86
[354] Others to adopt the same deduction include Parry R, *Transaction Avoidance,* (No.271) at 15
[355] Van Zwieten K, *Goode,* (No.13) at 90-93
[356] Ibid, at 93-94
[357] Ibid, at 108-110. Others that have reached the same conclusion include Parry R, *Transaction Avoidance,* (No.271) at 12
[358] This is as a consequence of their poor bargaining position inability to effectively monitor the debtor; McCormack G, *Secured Credit under English and American Law,* (No.219) at 6
[359] Van Zwieten K, *Goode,* (No.13) at 108
[360] Claims that were not enforceable before the onset of insolvency
[361] Van Zwieten K, *Goode,* (No.13) at 108. Similar views have been expressed by Gulliffer in Goode R and Gulliffer L, *Goode On Legal Problems of Credit and Security,* 6th edn (London: Sweet & Maxwell, 2017) 1
[362] Goode R, *Principles of Corporate Insolvency Law,* 3rd edn (London, Sweet & Maxwell, 2011) at 73

redistribution role to play…"[363] A more paternalistic view of insolvency law is therefore offered by Goode that includes a greater willingness for English law to offer greater protections to unsecured creditors.

Notwithstanding this call for greater protection, beyond allowing *ex post* creditors to claim as unsecured creditors, Goode, as with Cork, refuses to offer them the greater and more effective position of preferential creditors, on account of not wishing to disturb pre-insolvency entitlements and ensure equitable distributions among the general body of creditors[364]. Neither are there demands for any additional mechanisms that would assist in reducing unsecured creditor losses. Consequently, even though there is a call for protections, a clear limit exists on what form they may take – including not disturbing pre-existing rights[365] - and resulting, as a consequence of recognising some *ex post* creditors, in a greater number of unsecured creditors with no major increase in the size of the asset pool.

Having analysed the foundational commentators on contemporary English insolvency law, it is apparent that both are broadly in alignment over the issue of unsecured creditors. Both texts, in adopting a practical perspective on insolvency law, categorically set out that creditors are entitled to protection from the law. The mechanisms they call for in order to achieve this protection are several, and include limitations to the classes of preferential debt, personal liability provisions, abolition of receivership, and creation of a 10% fund. Notwithstanding these practical and (theoretically at least) effective mechanisms, both also recognise that limitations must be placed upon them, particularly respecting the pre-insolvency entitlements of secured creditors.

Section 3: Conclusion

Of the two aspects analysed in this chapter, insolvency theory and insolvency practice, it can be concluded that both demand and propose some form of unsecured creditor safeguard. As both aspects include creditor protections, this demonstrates clear, if not unqualified, acceptance of the principle into English insolvency law.

[363] Ibid, at 76
[364] Van Zwieten K, *Goode,* (No.13) at 75-76, 112-113
[365] Thereby the protecting the interests of the secured creditors

Within the theoretical models, although none can agree on what form insolvency law or unsecured creditor protection should take, and some may actively place the unsecured creditor in a poorer position should other constituents be more vulnerable, all acknowledge that something should be done to maintain or increase liquidation dividends. Given that Creditor Wealth Maximisation is widely perceived as being the dominant and most accepted theory, this means the primary methods of offering protection are through the minimising of insolvency costs, the guarantee of equal treatment and the continued integrity of the asset pool. The majority of the theories also call for clear, uniform substantive rules to ensure this equal treatment.

English insolvency, through its piecemeal evolution, has likewise acknowledged that some form of creditor protection is necessary. Building upon the three main theories, it has been concluded that insolvency law must act to make certain there is a fair and equitable system which ensures creditors, particularly those who acquire unsecured status, will be treated fairly and equally. In making these postulations, a number of practical protection methods are put forward including limitations to the classes of preferential debt, personal liability provisions, abolition of receivership, and creation of a 10% fund. All of these are intended to either maintain or enlarge the asset pool by preventing improper divestments of company property.

Although theoretically sound, there is a strict limit placed on how far the protections can go. Notwithstanding the Multiple Values and Contractarian theories permitting the disturbance of pre-insolvency rights, particularly those of the unsecured creditor, the majority of insolvency theory and practice does not permit such disturbances. Given that English law has categorically accepted this restriction, any protection mechanisms must respect secured creditor interests. Otherwise, there is little to restrain evolution in protection mechanisms beyond ensure there are clear and uniform rules, and indeed the majority of commentators call for more to be done. Consequently, any conclusions drawn by this thesis that the resulting trust is an effective mechanism will be based upon justifiable grounds. The effectiveness of the current English creditor protections is analysed in the next chapter to determine whether alternatives need be explored.

Chapter 3: The Limitations of the Liquidation Process for Unsecured Creditors[366]

In tandem with the security interests and the statutory priority of distribution analysed in Chapter 1, unsecured creditors partaking in the liquidation of an insolvent creditor are affected by improper divestments of company property in the lead up to the company entering insolvency[367]. These divestments include the company transferring property to creditors in preference to the general body of creditors[368], entering into uncommercial contracts below market value[369], and continuing to trade both fraudulently[370] and wrongfully[371]. The effect of these improper divestments by the company is to reduce the available assets that can be distributed to unsecured creditors through the liquidation dividend, and place them in the hands of creditors or other parties who are now in a better position than had they participated in the insolvency process. Such provisions are vital for unsecured creditors owing to impact of security interests – given their priority, it is necessary to protect the remaining meagre asset pool to enable a distribution to unsecured creditors.

Given the potential adverse consequences of improper company divestments on unsecured creditors, English law has long sought to protect such unsecured creditors

[366] This analysis of the anti-deprivation and personal liability provisions is confined to the context of liquidation, even though s177 Small Business, Enterprise and Employment Act 2015, inserting s246ZA Insolvency Act 1986, grants administrators the power to bring claims for fraudulent and wrongful trading. This is because despite the 2015 reforms increasing the pool of potential applicants, administrators are term limited to 1 year (Sch B para 76 Insolvency Act 1986) unless extended with the consent of the creditors or court (Sch B paras 76(2) and 77 Insolvency Act 1986), and thus investigating and commencing litigation within the short-term limit is troublesome. Equally, as the administrator's first priority is to rescue the company as a going concern (Sch B para 3 Insolvency Act 1986), this will require them to focus their time and resources on selling off and restructuring the business, rather than engaging in speculative and drawn about litigation. See Williams R, *We Can We Expect to Gain from Reforming the Insolvent Trading Remedy?,* [2015] 78 MLR 55, who concludes the 2015 reforms will have little impact. For these reasons, it is unforeseeable that many administrators will engage in such litigation, and so will not impact upon the body of unsecured creditors.

[367] Keay A, *Transactions Defrauding Creditors: The Problem of Purpose Under Section 423 Of the Insolvency Act,* [2003] CPL 272

[368] S239 Insolvency Act 1986

[369] ss238 and 423 Insolvency Act 1986

[370] s213 Insolvency Act 1986

[371] s214 Insolvency Act 1986

through the 'anti-deprivation' rule[372], which is intended to protect the insolvent estate and maximise the available assets for distribution[373]. This rule is central to the English law of insolvency, and its manifestations can be seen in the historical abolition of the divestment of ownership in liquidation clauses. Unlike legitimate *Romalpa* clauses[374], which prevent title from passing to the creditor, these contractual clauses transfer title to the company on the understanding that the property will be retransferred to the creditor should the borrower become insolvent. Such clauses are thus repugnant to the outright transfer of property[375], and so are unavailable under English law[376]. Similarly, English law also annuls contractual terms that increase a company's contractual obligations upon the company entering liquidation – for example increasing the amount due to redeem a mortgage[377] or allowing the whole of the royalties due to the company to be retained instead of the half before liquidation[378].

Given the protective nature of the anti-deprivation rule, and the conclusion reached in the previous chapter that unsecured creditor protections are justified, this chapter will therefore analyse the modern proprietary anti-deprivation provisions, their associated personal liability provisions, and conclude whether they are effective in protecting unsecured creditors within the liquidation process by safeguarding the integrity of asset pool. This protection is necessary owing to the precarious position outlined in Chapter 1 of the unsecured creditor within the liquidation regime. This chapter's analysis will thereby inform whether the existing insolvency regime is effective in protecting unsecured creditors compelled to partake in the liquidation process, and whether it is a further cause their unsatisfactory position. It will also inform whether further efforts are necessary to protect such creditors.

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[372] Van Zwieten K, *Goode,* (No.13) at 255-261; Anderson H, *The Framework,* (No.217) at 174

[373] Milman D*, Transactional Avoidance in Insolvency: an Update on Recent Developments,* [2013] Insolvency Intelligence 81 at 81

[374] See Chapter 1 for detailed analysis

[375] Van Zwieten K, *Goode,* (No.13) at 255-256; *Belmont Park Investments Pty Ltd v BNY Corporate Trustee Services Ltd* [2012] 1 A.C. 383

[376] See *Metcalfe v Metcalfe* (1889) 43 Ch D 633. See also *Holroyd v Gwynn* (1809) 2 Taunt 176; the terms also offend against the principle that property cannot be transferred to a person on terms that are unavailable to his creditors - *Ex p Mackay* (1873) LR 8 Ch App 643.

[377] *Re Johns* [1928] Ch 737

[378] *Re Jeavons, ex p Mackay* (1873) 8 Ch App 643

This chapter concludes that the existing legislative provisions are insufficient to protect the asset pool and the general body of creditors. It is therefore submitted that owing to alternative government priorities, an alternative mechanism of protection, outside the law of insolvency, is required to protect and improve the position of unsecured creditors by increasing their returns from the liquidation process. This alternative mechanism, the resulting trust, is set out and analysed in Chapters 5 and 6. Although Chapter 5 and 6 conclude that the resulting trust is not able to directly address the limitations of the Insolvency Act, they do conclude it is able to address the overarching issue – limited revest of property – and the analysis of Chapters 3 and 4 will also assist in identifying the limitations of utilising the resulting trust and the compact role it can have .

This chapter is therefore split in three separate sections. Section 1 addresses the anti-deprivation provisions set out in the Insolvency Act 1986, and the law of preferences, transactions at an undervalue and transactions defrauding creditors in particular. It concludes that the provisions are ineffective in preventing disbursement of a company's asset pool in the period leading up to the onset of insolvency. Section 2 will address the personal liability of directors in the context of wrongful and fraudulent trading. It similarly concludes the provisions are ineffective in maintaining or protecting the company's asset pool. Finally, Section 3 analyses the availability of funding for liquidators to initiate litigation. It concludes that the substantive rules and economic conditions result in insufficient funding available being available to liquidators, preventing them from initiating litigation.

Section 1: Anti-Deprivation Provisions

Section 1.1: Justifications and Rationale

The modern anti-deprivation provisions contained within the Insolvency Act 1986 are intended to prevent the improper divestment of a company's assets in the period before the commencement of liquidation[379]. These provisions, also known as the avoidance of transactions provisions, grant the liquidator the powers to 'avoid', or set aside, transactions that were at a gross undervalue or were an unauthorised reduction of

[379] Van Zwieten K, *Goode,* (No.13) at 255-256

capital[380]. All are intended to the help protect the general body of creditors against reductions of company assets that also confer an unfair or improper advantage to a third party[381].

Before considering the provisions in detail, it is necessary to state the theoretical justifications these anti-deprivation provisions are based on so as to 'discern the parameters of the provisions'[382]. Prof Goode, with whom the Court of Appeal and Supreme Court agreed with in the *Rubin v Eurofinance* appeals[383], begins his authoritative analysis of the anti-deprivation rules by arguing that they are unjust enrichment procedures, with unjust enrichment affecting creditors in one of two ways[384]. The first is that it may reduce the company's net asset value if it involves a transfer of company property to another party at an inadequate price, or if it involves the purchase of property by the company at an inflated price. Secondly, it may, without disturbing the company's net asset value, involve the payment or satisfaction of debt, thereby giving the creditor a preference over other creditors at the disregard of the statutory priority of distribution[385] and *pari passu* principle[386]. These provisions, according to Goode, are necessary to ensure the preservation of the company's net asset value and ensure the equality of distribution within the statutory priority of distribution. Goode consequently uses the term unjust enrichment in a very narrow sense, being solely in relation to the conferment of an improper advantage at the expense of the company's existing creditors. It does not relate to the members of the company as they possess alternative mechanisms through which to protect and deal with their interests[387]. Neither does it relate to the different treatment of

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[380] *Trevor v Whitworth* (1887) 12 App Cas 409; see also Armour J, *Avoidance of Transactions as a 'Fraud on Creditors' at Common Law,* in Armour and Bennett's *Vulnerable Transactions in Corporate Insolvency* (Oxford: Hart, 2002)

[381] Van Zwieten K, *Goode,* (No.13) at 614-615; Keay A, *In Pursuit of the Rationale Behind the Avoidance of Pre-Liquidation Transactions,* (1996) 18 Sydney LR 55 at 60; Calnan R, *Proprietary Rights,* (No.71) at 33; *Belmont Park Investments Pty Ltd v BNY Corporate Trustee Services Ltd* [2012] 1 A.C. 383 per Lord Collins

[382] Keay A, *In Pursuit,* (No.381) at 56

[383] *Rubin v Eurofinance* [2010] EWCA 895, at para 55; *Rubin v Eurofinance* [2012] UKSC 46, at para 95

[384] Van Zwieten K, *Goode,* (No.13) at 616-617

[385] See Chapter 1

[386] See Chapter 1

[387] Goode R, *Principles,* (No.392) at 523

creditor classes, as it strikes a balance between the interests of parties to the transaction and the insolvent estate as a *whole*[388].

Building on Goode's analysis, Parry has put forward a third justification for the anti-deprivation provisions[389], and argues that they also have the potential to act as a discouragement against attempts to impugn the integrity of the asset pool. Owing to the possibility that property will be recovered, Parry posits that these provisions discourage directors in troubled companies from taking actions that prejudice the interests of the legitimate creditors by forewarning them that they will be unable to retain their ill-gotten gains. Goode, though, challenges the validity of this submission, arguing that the limitations that exist regarding the use of these provisions[390], and the widely acknowledged probability the liquidator will be unable to undertake the necessary litigation[391], severely limit the discouragement the provisions may achieve[392]. Milman, though, has argued that they are "essential in ensuring that ethical standards of stewardship…"[393]. Despite Goode's objections to the inclusion of the discouragement argument, the mere existence of the provisions, and the diffusion of their existence by accountants, auditors and business advisers, must discourage at least some (if not all) informed directors from engaging in improper divestment of company assets, especially as not all parties will be aware of the limitations associated with the provisions[394].

Despite the academic community piecing together well articulated justifications, such assistance from the judiciary and legislature have not been forthcoming. Indeed, Keay comments that "there is little evidence of the courts seeking to ascertain the rationale for the existence of these provisions…"[395]

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[388] Anderson H, *The Framework,* (No.217) at 179
[389] Parry R, *Funding Litigation in Insolvency,* [1998] CfiLR 121; see also *Alderson v Temple* (1768) 98 ER 1277 at 1279, per Lord Mansfield – the provisions are useful in "preserving commercial morality and the prevention of fraud."
[390] See Sections 1 and 2 of this chapter
[391] See Section 3 of this chapter
[392] Goode R, *Principles,* (No.392) at 523*;* see also Keay A, *In Pursuit,* (No.381) at 77
[393] Milman D, *Facilitating Recovery and Avoidance Claims by Insolvency Office-Holders,* [2015] CLN 1 at 1
[394] Katz and Mumford, *Making Creditor Protection Effective,* Centre for Business Performance, ICAEW, 2010) at 63; Anderson H, *The Framework,* (No.217) at 180
[395] Keay A, *In Pursuit,* (No.381) at 55

Milman has also welcomed the existence of the anti-deprivation provisions, even if there are no cogent justifications from the judiciary or legislature, arguing that they are a 'win-win':

> "Anything that can facilitate the restoration of "lost assets" is therefore a welcome step in the process of maximising potential distributions to creditors…Recovery thus represents a "win-win" outcome for any just and effective system of corporate law."[396]

Thus, it can be ratiocinated that the anti-derivation provisions are supportable as mechanisms to restore misappropriated assets to the insolvent company, thus maximising the returns to creditors through the statutory priority of distribution. It can also be stated that the provisions are also necessary to ensure the ethical standards of directors by discouraging the dissipation of assets through the knowledge that those assets can be 'clawed back' by the liquidator at a later date. Hence, this chapter's analysis of the anti-deprivation provisions is framed by whether these provisions effectively and efficiently give effect to these academically articulated policy justifications.

Section 1.2: The Qualifying Requirements of the Anti-Deprivation Provisions

Although the anti-deprivation provisions all have their own substantive legal requirements, they also have four qualifying requirements that must be met before these provisions become operational and the transaction be upset. Therefore, these four requirements will be considered in insolation and before the substantive individual anti-deprivation provisions. These four requirements will be analysed to determine whether or not they assist or hinder creditor protections.

The first prerequisite for the provisions to be made available to the liquidator is the need for the company to have entered insolvency. Thus, these provisions are not available to members of a solvent company who are dissatisfied with transactions entered into by its directors; they must seek redress through the provisions of the Companies Act 2006.

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[396] Milman D, *Facilitating Recovery,* (No.393) at 1

Support for this requirement is put forward most authoritatively by Goode, who argues that so long as a company is solvent, and the company is acting in a lawful manner, the law has no justification for unsecured creditors to attack the transaction or interfere in the company's affairs[397]. As the company is able to repay the unsecured creditors, they have no interest in the company's assets nor any right to question how the company conducts its affairs – especially as the company's business is sufficiently efficient to maintain the necessary turnover to make the necessary repayments. Goode further justifies his support for the onset of liquidation as prior to this occurring, particularly under the inability to pay debts test[398], the creditors have a more direct methods of obtaining payment by instituting proceedings against the debtor company within the law of contract for breach of contract, obtaining judgment for damages and enforcing that judgment. Thus, the laws of contract and debt offer detailed and efficient mechanisms to protect creditors of solvent companies – particularly the rights to seize and sell assets[399] - and so the law of insolvency is not required to offer any further assistance in these instances.

Finally, both Goode[400] and Keay[401] have posited that the need for liquidation is necessary to ensure 'collectivism' – that creditors are required to act together in enforcing these provisions[402]. Both argue that no single creditor should be allowed to place himself in a better position at the expense of other creditors, especially as the right to set aside belongs to the general body of creditors collectively. Keay[403] takes this position one step further by arguing that liquidation protects smaller, less powerful creditors by nullifying the oversized 'clout' of the larger creditors. Additionally, Keay submits that the liquidation process protects recent creditors of the insolvent company, and means they are not punished for their lack of due diligence in determining whether the debtor company is able to the repay their debts. Hence the liquidation process, which demands a collective approach[404], is the ideal mechanism to give effect to these policy factors and protect the competing interests of unsecured creditors. This prerequisite does not, therefore, preclude

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[397] Goode R, *Principles,* (No.392) at 525
[398] S123 Insolvency Act 1986
[399] For detailed analysis see Chapter 1
[400] Goode R, *Principles,* (No.392) at 526
[401] Keay A, *In Pursuit,* (No.381) at 61
[402] See Chapter 2 for consideration of the advantages and role of collectivism
[403] Keay A, *In Pursuit,* (No.381) at 64
[404] See Chapter 1

or hinder creditor protection, and in fact strengthens the protections provided to smaller creditors.

Secondly, there must be a diminution of the assets that can be made available to the general body of creditors. Such a reduction can occur in two ways: by a reduction in the net asset value of the company, or by granting an individual creditor a preference at the expense of the other creditors. However, where the company has received full value for assets, creditors have no need for recourse as the company has not suffered a diminution in value – and have thus not suffered a decrease in the level of assets that can or will be made available to them in the liquidation dividend[405]. Equally where the company purchases property at its true market value, no diminution to the company's assets occurs - it has merely been converted from one from to another. Thereby, there is no need for the law of insolvency to disturb such transactions as there has been no diminution which reduces the assets that can distributed to unsecured creditors.

The anti-deprivation provisions also require the company to be insolvent at the time of the transaction or to have entered into insolvency as a consequence of the transaction. Determining whether this has occurred has been assisted by *BNY Corporate Services v Eurosail*[406]*,* where it was held that rather than the company needing to reach the 'point of no return'[407], the company merely has to reach the position that upon a comparison of its present and future liabilities it is established it can no longer meet its obligations[408]. Thus, following this relaxation of the insolvency test there are now more opportunities for the liquidator to successfully argue the company was insolvent.

The need for the company to have entered liquidation was again put forward authoritatively by Goode[409], who argues that if the company was solvent at the time of the transaction, and the transaction does not cause the company to become insolvent, there is no prejudice to the creditors by the diminution in value to the company. Instead, it is only the members of the company, who should the company be dissolved at that point lose out, who have the right and standing to challenge such transactions. Thereby, it limits

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[405] Goode R, *Principles,* (No.392) at 526-7
[406] [2013] UKSC 28
[407] Ibid, at 42
[408] Ibid, at 38
[409] Goode R, *Principles,* (No.392) at 527

standing to those directly affected by the transaction, and prevents the courts being deluged by desperate creditors looking for any means to recover their debts.

Finally, the company must enter liquidation within the 'relevant time' after the transaction was entered into. Two 'relevant' periods are operational: 6 months for unconnected parties[410] and 2 years for a connected party[411]. As noted above, the reform to the insolvency tests has assisted liquidators in establishing the onset of insolvency by relaxing the strictness of the test from the 'point of no return', and there is therefore greater flexibility in determining when the company became insolvent.

However, the 6-month relevant time period for unconnected parties is restrictive, and although it has supporters, it also has the potential to seriously hamstring attempts at bringing proceedings. Those in favour of the strict time limit argue that the transaction becomes 'cleansed' with time, as it is unfair for contracting parties to be exposed to indefinite liability to restore the property to the company[412]. Notwithstanding the merit of this submission, and honest parties to commercial transactions do undoubtably require protection, the argument is taken further and stated that creditors should take steps to place the company in liquidation within the relevant period[413]. This does not, however, stand up to scrutiny. Firstly, it is difficult to sustain the argument that creditors should be aware of the improper transaction[414]. As seen in the case law on preferences, it is troublesome enough establishing whether a company was insolvent with the aid of hindsight[415]. Expecting unsecured creditors, who have little knowledge of the company's inner dealings[416], to be aware of such transactions is impossible. Secondly, expecting unsecured creditors to find out the relevant information, process it, apply for a winding up order and cover the costs of this process within the six-month time limit is also asking too much of such under resourced parties.

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[410] S240(1)(b) Insolvency Act 1986
[411] S240(1)(a) Insolvency Act 1986
[412] Goode R, *Principles,* (No.392) at 528
[413] Ibid, 529
[414] Williams R, *What Can We Expect to Gain from Reforming the Insolvent Trading Remedy?,* [2015] 78 MLR 55 at 58
[415] Especially where the valuation of the company is unclear: Anderson H, *The Framework,* (No.217) at 30-32
[416] See Finch V and Milman D, *Corporate Insolvency Law,* (No.6) at Chapter 3

Those against the six-month time limit reference the challenges this poses for liquidators. Calnan notes that the restrictive timeframe creates a new, and usually insurmountable, obstacle to liquidators being able to bring anti-deprivation claims[417]. Despite not being referenced by Calnan, this is particularly the case where the transaction does not immediately cause the company to enter liquidation and instead limp along terminally weakened. As the directors and contracting parties may be able to structure the transaction so that enough is left in the business to keep it ticking over for the relevant period, creative directors may be able to unjustly enrichment themselves whilst staying outside of the law's clutches. This has led some commentators to question whether or not the relevant period should be extended[418], however moves to amend the length have been unforthcoming, and so the majority of transactions are unassailable.

In contrast, where the parties are connected[419], the two-year time-limit is not so problematic. A connected person is defined as including relatives, business partners or employees. This extension makes it more realistic that a company will enter liquidation following the transaction and so be attackable[420], however the restriction to 'associates' severely limits the practical application of the anti-deprivation provisions in the majority of insolvencies by excluding merely unfavourable commercial transactions – transactions that is easy for the company to enter into.

Section 1.3: The Substantive Provisions

a) The Law of Preferences

The law of preferences is well-established and stretches back to 1768[421] and its codification in 1914[422]. Now set out in s239 Insolvency Act 1986, the court may, on the application of the liquidator, make an order restoring property to the company if a preference has been given to a creditor. A preference is where a company does anything

[417] Calnan R, *Proprietary Rights,* (No.71) at 33-34
[418] Wong C, *Are the Avoidance Provisions of the Insolvency Act 1986 in Need of Reform?,* [2017] CL 353
[419] s249 Insolvency Act 1986. See s435 Insolvency Act 1986 for the definition of an associate
[420] See Chapter 4 and the case study of BHS
[421] *Alderson v Temple* (1768) 4 Burr 2235
[422] S44 Bankruptcy Act 1914

or suffers anything to be done which has the effect of putting a creditor in a position which, in the event of the company's liquidation, will be in a better position than had that thing not been done[423]. Put simply, a preference is the improvement of one creditor at the expense of the other creditors without legal justification – "Peter has been robbed to pay Paul"[424]. The allure of preference claims for liquidators can be seen in the extensive and potentially profitable powers awarded to the court to remedy a preference, which include the revestment of property to the company, the discharge of a security given by the company, or the requirement to make a payment to the liquidator by an individual of any benefits received from the company[425].

Substantively, central to the English law of preferences is the need for intention[426]. Whilst the previous law demanded that the intention to prefer was the dominant intention[427], the Insolvency Act 1986 reformulated the criteria to require a 'desire' to place the creditor in a better position than if the payment had not been made[428]. The differences between the two requirements was considered by Millet J (as he was then) in *Re MC Bacon*[429] and recently affirmed in *Re Oxford Pharmaceuticals*[430].

Millet J began his analysis by "emphatically protest[ing]" against the applicability of the old law, arguing that the two provisions were now "completely and deliberately"[431] different. In defining the present requirements for a preference to have occurred, Millett J then rejected the need for the intention to prefer to be the dominant intention (it need only be an influencing factor) or for there to be direct evidence of the desire[432], and instead held that there must be a "desire to produce the effect"[433]. Although this conclusion may appear *prima facie* to benefit liquidators by only requiring the desire to be present, and

[423] The role of preference law was set out by Professor Weisberg in *Commercial Morality, the Merchant Character, and the History of Voidable Preference,* (1986) 39 Stanford LR 3
[424] Farrar, *The Bankruptcy Law of Fraudulent Preference,* [1983] JBL 390
[425] S241 Insolvency Act 1986
[426] S239 Insolvency Act 1986
[427] S44 Bankruptcy Act 1914
[428] S238(5) Insolvency Act 1986
[429] *Re MC Bacon* [1990] BCC 78
[430] [2010] BCC 834
[431] *Re MC Bacon,* (No.429) at 86
[432] Ibid, at 86
[433] Ibid, at 78

avoid the insurmountable evidential issues[434] associated with showing that the wish was the dominant reason for transaction, Millet J's definition undermines this benefit[435]. Indeed, desire was defined as being subjective and open to interpretation[436] - "Intention is objective, desire is subjective. A man can choose the lesser of two evils without desiring either."[437] Thus, the liquidator must now also show that the company itself *subjectively desired* to improve the position of the creditor, rather than was pressured into making the transaction – a task that is troublesome for the liquidator to effectively complete given the numerous natural persons who control the company's 'mind'[438].

The consequences of *Re MC Bacon* are well documented in the academic literature[439], and mean that should a creditor be forceful in their demands to be repaid, and the company pays in the belief it will keep the company operating, there is no 'desire' on the part of the company.[440] Equally, as s239 focuses solely on the debtor company, and not the creditor, the latter is incentivised to strong arm debtor companies into entering into transactions that place them in a better position[441]. The limitations of the need to show a 'desire' are seen in *Re MC Bacon* itself, where it was held that the granting of the creditor bank a debenture in the final days of the company was not a preference owing to mistaken belief that by granting the debenture, the bank would have to provide support to the company. Consequently, even if the directors are incompetent and mistakenly interpret the situation, or are even just indifferent[442], it will be found that there is no preference.

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[434] Including how a company may form a desire, and which human agent can be responsible - Van Zwieten K, *Goode,* (No.13) at 681; Bowen LJ in *Ex parte Hill* (1883) 23 Ch D 695; Cork K, *Report,* (No.2) at para 125

[435] *Ischac v David Securities Pty Ltd (No 6)* (1992) 10 Australian Company Law Cases 652, per Young J at 653 who recognises that ascertaining the intention of a company is "a very tricky business".

[436] Keay A, *Preferences in Liquidation Law: A Time for a Change,* [1998] 2 CFILR 198 at 205

[437] *Re MC Bacon,* (No.429) at 86

[438] *Leonard's Carrying Co Ltd v Asiatic Petroleum Co Ltd* [1915] AC 707; *El Ajou v Dollar Land Holdings* [1994] BCC 143*; Belmont Park Investments Pty Ltd v BNY Corporate Trustee Services Ltd* [2012] 1 A.C. 383 per Lord Collins at [75]

[439] McCormack G, *Swelling Corporate Assets: Changing What is on the Menu,* (2006) 6 J Cor L Studies 39 at 41-43

[440] Ibid, at 46

[441] Ibid, at 46

[442] Ibid, at 46

The problematic nature of the 'desire to prefer' was more recently illustrated in *Re Hawkes Hill*[443], which concerned the sale of a failing magazine business and the granting of a debenture[444]. Two publications were created, and a small business loan was granted to the company in return for a debenture over the whole of the company's assets and a personal guarantee from the directors. Upon attempts to sell the business, the bank demanded the sale proceeds be used to discharge the debenture – which duly occurred upon the sale. It was this payment, and the linked discharge of the guarantee, that the liquidator submitted formed the necessary desire to prefer. It was held that if the transaction had not occurred, the bank would have initiated the sale themselves, recovered the £20,000 and discharged the debenture, and consequently the personal guarantee. It can therefore again be seen that where there is sufficient commercial pressure from a creditor, no preference will exist even if the directors personally benefit at the expense of unsecured creditors.

Finally, in relation to desire and unconnected persons, the evidential limitations are exacerbated should companies be run in a disorganised manner[445]. It is argued that where the company is run in such a manner, the confusion makes it extremely difficult for the liquidator to piece the evidence together to establish the requisite desire – which is made even harder by the courts' reticence to make inferences of the mind of the company that the desire to prefer was present[446], and they instead require clear evidence of the relevant desire. Although a rebuttable presumption in favour of the desire being present when the transaction involves connected parties[447], this too can be easily rebutted should the evidential hurdles mentioned above arise and doubt seep into the liquidator's case[448].

Given the substantial limitations of the requirement to desire, many have questioned its use, with Keay asserting the subjective nature of the test is "unrealistic and unreasonable"[449], and Finch concluding "The present subjective test and its weak

[443] *Re Hawkes Hill Publishing* [2007] BCC 937
[444] See also *Re Fairway Magazine Ltd* [1992] BCC 924
[445] Wong C, *Are the Avoidance Provisions,* (No.418); Finch V and Milman D, Corporate *Insolvency Law,* (No.6) at 489
[446] Fletcher I, *Voidable Transactions in Bankruptcy Law* in J. Ziegel (ed.), *Current Developments in International and Comparative Corporate Insolvency Law* (Oxford: Clarendon Press, 1994); *Re Beacon Leisure* [1991] BCC 213; *Re Fairway Magazines* [1992] BCC 924
[447] S239(6) Insolvency Act 1986
[448] Keay A, *Preferences in Liquidation,* (No.436) at 201
[449] Ibid

protection of *pari passu* has the effect of adding further to the unfair burden that unsecured creditors bear: they, after all, are parties that depend on strong application of the *pari passu* principle."[450] Many have therefore called for the adoption of an objective test[451], with Cork examining the case for it. He did, however, reject such a move on the basis that the law should not interfere with the lawful discharging of debts and that creditors should not be discouraged from attempting to recover their lawful debts[452]. Though this conclusion has been strongly criticised on the basis that it helps subvert the *pari passu* principle[453] and encourages creditors to enter the 'race to collect'[454], there appears little Parliamentary appetite to reform the law of preferences[455], and so unsecured creditors in the majority of cases are unable to benefit from liquidator brought litigation to recover assets from 'preferred' creditors[456] despite the extensive powers granted to the courts.

b) Transactions at an Undervalue

In tandem with the preference provisions, the English insolvency regime seeks to protect unsecured creditors by preventing directors and creditors from disgorging company assets at an undervalue shortly before the onset of liquidation. The introduction of s238, which had no predecessor[457], was championed by Cork as a mechanism for achieving greater unsecured creditor equality. In order for a transaction to be considered to have been at an undervalue, it must have been entered into at the relevant time[458] and the transaction must have been a gift or at a level of consideration whose value in money or money's worth is significantly lower than its true value[459]. Furthermore, the transaction must occur when

[450] Finch V and Milman D, *Corporate Insolvency Law,* (No.6) at 490
[451] Wong C, *Are the Avoidance Provisions,* (No.418); Keay A, *Preferences in Liquidation,* (No.436) at 198
[452] Cork K, *Report,* (No.2) at para 1256
[453] Keay A, *Preferences in Liquidation,* (No.436) at 212
[454] Finch V and Milman D, *Corporate Insolvency Law,* (No.6) at 489; see also Cork K, *Report,* (No.2) at 1257
[455] Keay's repeated attacks on the adequacy of s239, and calls for reform over a 25-year period evidence the lack of desire to reform. Also, the Small Business Enterprise and Employment Act 2015's non-inclusion of reform to the substantive preference provisions indicate a lack of current Parliamentary interest in effecting such a change.
[456] Wong C, *Are the Avoidance Provisions,* (No.418) at 533
[457] Parry R, *Transaction Avoidance,* (No.271) at 78.
[458] Six months for unconnected persons and 2 years for connected persons
[459] S238 Insolvency Act 1986

the company is insolvent or cause the company to become insolvent as a consequence of the transaction[460]. This usually involves the company entering into transactions in which it receives little or no consideration[461], and sees the sale of assets, the acceptance of low value assets in lieu of payment, the creation of trusts in favour of creditors, the creation of leases and outright gifts.

Problematically, to fall within the remit of s238, the debtor must have taken some step to participate in the transaction. However, to assist liquidators in bringing claims, it has been concluded that the company's passive acceptance of other parties' actions – such as instructing or allowing other parties to transfer assets or payments due to the company at the company's expense – ensuring that backhanded and off the book transactions between the company and its creditors are vulnerable to attack by liquidators[462] and do not form a lacuna within the anti-deprivation provisions.

This revestment of company property is achieved through the wide powers granted to the court[463]. Under s238, the court is granted the powers to 'make such order as it thinks fit for restoring the position' of the company prior to the transaction, and s241 grants the court the specific powers to order the vesting of property transferred as part of a transaction involving the company[464], require property to be vested in the company if it represents the proceeds of the sale of property involved in the transaction[465] and releasing or discharging any security given by the company[466]. Therefore, in the same manner as the powers granted to the courts by s239, a successful transaction at an undervalue claim is potentially lucrative for the liquidator to pursue in their quest to return assets to the unsecured creditors.

Although the purpose of s238 is clear, the effectiveness of the provision is debatable, as although *prima facie* the requirements appear simple to meet, their interpretation has proved problematic. This uncertainty begins with the need for a transaction "whose value

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[460] S238(5) Insolvency Act 1986; See above for details
[461] S238(4) Insolvency Act 1986
[462] *Hunt (Liquidator of Ovenden Colbert Printers Ltd) v Hosking* [2013] EWCA Civ 1408.
[463] Ss 238 and 241 Insolvency Act 1986
[464] Ibid, at S241(1)(a)
[465] Ibid, at S241(1)(b)
[466] Ibid, at S241(1)(c)

in money or money's worth is significantly lower than the value of consideration provided by the company"[467]. For although it is usually possible to identify the relevant transaction[468], identifying the relevant consideration, and whether it is a significantly lower value, has proved controversial[469].

In seeking to assist identifying the relevant consideration, and whether this consideration was significantly below market value, *Brewin Dolphin*[470] clarified the meaning of 'significantly below market value', with Lord Scott suggesting that market value is "the amount that a reasonably well informed purchaser is prepared, in arm's length negotiations, pay for it."[471] This has subsequently been held to be the market value where there is a market[472] or expert evidence where no market exists[473]. Although the adoption of objective means of identifying the true market value of the asset disposed of by the company, and so the disparity between it and the consideration provided in the transaction, assists both the courts and the liquidator in determining whether the transaction was at an undervalue by providing a reliable baseline from which to operate, this process is undermined by the retention of a subjective element. This is because, although the asset's value is determined by its objective value[474], this value is only the value ascribed by the company, not the wider world or market[475]. Thus, should it be shown that whilst the asset has inherent market value, but little value to the company[476] or the company's position is such that it cannot acquire the true market value (such as it has no expertise in dealing with the asset or its poor financial position makes its negotiating position perilous), there will be no transaction at an undervalue, and so no protection for the unsecured creditors.

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[467] *Philips v Brewin Dolphin* [2001] 1 WLR 143
[468] Even if the transaction occurs between third parties and not directly with the company, due to the movement of assets
[469] Parry R, *Transaction Avoidance,* (No.271) at 81
[470] *Philips v Brewin Dolphin,* (No.467)
[471] Ibid, at 154; See also Milman D, *Facilitating Recovery,* (No.437) at 3
[472] *Re Brabon, Treharne v Brabon* [2001] BCLC 11
[473] *Re Hollier, Carman v Letchford* [2010] EWHC 3155 (ch)
[474] With the assistance of hindsight: see *Green v El Tai* [2015] B.P.I.R. 24 at 82
[475] *Re Thoars (No2), Reid v Ramlort Ltd* [2004] EWCA Civ 800
[476] Because the company cannot make use of it – such a mining company owning the intellectual property to a hybrid car engine

Equally problematic is identifying the existence of consideration in the context of s238[477]. *Brewin Dolphin* confirmed that the relevant consideration is not strictly limited to the transaction itself, but also included collateral agreements that were entered into by the company and relevant parties, and that the relevant consideration is a combination of the relevant collateral transactions[478]. Owing to the prevalence of collateral contracts[479] as a means of reducing tax liabilities[480] and corporate group priorities, these collateral contracts can be "indissolubly bound up as part of the same overall transaction".[481] In *Delaney v Chen* for example, the relevant transaction involved the sale and lease back of land. The land was sold for £210,000 with a lease back from 21 years at a fixed rent of £500 a month that was unassignable. The liquidator argued the true value was £275,000, meaning an undervalue of £65,000. However, as the court valued the lease at £80,000[482], and as £210,000 had already been received, the transaction was £25,000 above the market value and so not at an undervalue.

However, the adoption of collateral contracts as a mechanism for determining the level of consideration can benefit claims brought by liquidators, rather than hinder them, as is seen in *Agricultural Mortgage v Woodward*[483]. The first defendant borrowed money from the claimant who was granted a mortgage over the defendant's farm. Shortly before the deadline to repay the mortgage arrears, the defendant granted the second defendant an agricultural tenancy at market value. In granting such a tenancy, the value of the first defendant's farm fell from £1 million to £500,000, and granted the second defendant the position of extorting the claimant by demanding a release fee to enable the sale of the farm. Taking both contracts into consideration, despite the tenancy being at full market value, the court concluded that the agricultural tenancy depreciating the value of the farm by half meant that the transaction was at an undervalue. Whilst *Delaney* illustrates the potential pitfalls liquidators face in establishing the transaction was at an undervalue, such as unknown collateral contracts that are of value to the company, *Woodward* illustrates

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[477] Wong C, *Are the Avoidance Provisions,* (No.418) at 354
[478] *Philips v Brewin Dolphin* [2001], (No.467) at 150
[479] Parry R, *Transaction Avoidance,* (No.271) at 81
[480] See *Brewin Dolphin* itself, where the transaction involved the sale of the business for nominal consideration in return to a valuable lease agreement to reduce the purchaser's tax liabilities.
[481] *Delaney v Chen* [2010] EWHC 6 (ch) at para 10, and later affirmed by the CA at [2010] EWCA 1455; see also *NatWest v Jones* [2002] 1 BCLC 55
[482] Owing to the below market rent and presumed surrender value that could be demanded by the company
[483] [1994] BCC 688

that the court will not be bound by the market value of a transaction, and will acknowledge any peripheral consequences of the transaction has on the diminution of the asset value of the company. Thus, the courts' embrace of 'reality' over strict contractual formality both assists and hinders transaction at an undervalue claims. This balance between the interests of the company and the creditors has also been praised by Parry, who acknowledges that it "provides a commercially realistic approach" that reduces the concerns of the parties[484] .

Another potential hurdle to s238 claims is the courts' attitude to security interests, which in the last two decades has shifted into uncertainty. Initially, *Re M.C Bacon*[485] concluded that arguing a security interest could be classified within the undervalue provision was 'misconceived', as the granting of a security interest does not deplete the company's assets nor does it diminish their value. Additionally, Millett J also concluded that as a company retains the right discharge the security interest and sell or remortgage the assets, the company loses the capability to use the proceeds of sale at its free will – something that cannot be determined by a monetary value.

Despite the soundness of this conclusion on the ground that the company's asset value is not diminished but merely reattributed for the life of the security interest, as recognised by Stubbs[486], this has been questioned by recent case law. Stubbs cites *Re Leyland Daf*[487]*,* as undermining *Re M.C. Bacon* due to their Lordships' conclusions that assets subject to a security interest belong to the creditors, with the company only retaining "an equity of redemption"[488], and thus only retaining legal title to the asset. Arden LJ[489] has also questioned the correctness of *Re M.C. Bacon* as assets subject to security interests are no longer the property of the company. Although Arden LJ's comments were *obiter*, and there has been some academic objection[490], Stubbs does conclude that a shift has occurred in the treatment of security interests under s238. It is concluded that although *Re M.C Bacon* must be treated as good law, in some circumstances the granting of a security

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[484] Parry R, *Transaction Avoidance,* (No.271) at 82
[485] [1990] BCC 78 at 91-2
[486] Stubbs R, *S423 of the Insolvency Act in Practice,* [2008] Insolvency Intelligence 17
[487] *Re Layland Daf, Buchler v Talbot* [2004] UKHL 9
[488] Ibid, at 29, per Lord Hoffmann
[489] *Hill v Spread Trustee* [2007] 1 WLR 2404
[490] Van Zwieten K, *Goode,* (No.13) at 644-645

interest may constitute an under value should the correct factual matrix occur[491] - although that correct factual matrix remains elusive. Hence, any liquidator posed with a transaction at an undervalue involving security interests is unlikely to pursue the claim and risk the integrity of the asset pool on a gamble of possessing the illusive factual matrix – leaving unsecured creditors exposed.

Despite many hurdles existing, liquidators are somewhat assisted by its objective nature when compared to the preference provisions. Under s238, the company is not required to subjectively intend any outcome – liability is a results-based test on whether true market value was acquired by the company[492]. As a result of not being required to analyse the company's intentions, the issues associated with evaluating 'desire' outlined above are avoided[493], and a more reliable mathematical calculation can be made.

Although partially aided by its objective nature, s238 is further hamstrung by the 'in good faith and for the purpose of carrying on business' defence made available under s238(5)(a)[494] that the transaction was entered into in good faith and that at the time of the transaction, there were reasonable grounds for believing the transaction would benefit the company. Although there is a need for reasonable grounds, this does not require honesty – the company is able to sell goods at an unsatisfactory quality[495] and is able to purchase property on credit that it knows it cannot repay, so long as it promotes the company's interests[496]. Instead, all that is required is the existence of reasonable, objective grounds for believing the transaction was beneficial to the company to avoid liability. Thus, although not as problematic as the subjectivity of 'desire', the existence of this defence could potentially scupper any potential claim, and deter any liquidator from pursuing as claim – irrespective of how attractive the available remedies are.

c) *Transactions Defrauding Creditors*

[491] Stubbs R, *S423 of the Insolvency Act in Practice,* [2008] Insolvency Intelligence 17 at 21
[492] Milman D*, Transactional Avoidance,* (No.373) at 83
[493] Wong C, *Are the Avoidance,* (No.418); Finch V and Milman D, *Corporate Insolvency Law*, (No.6) at 492
[494] Finch V and Milman D, *Corporate Insolvency Law,* (No.6) at 492
[495] Parry R, *Transaction Avoidance,* (No.271) at 124
[496] Van Zwieten K, *Goode,* (No.13) at 648-649; Also includes the closing down of the business - *Re Scarflax* [1979] Ch 592; *Wallach v SS for Trade and Industry* [2006] EWHC 989 (Ch)

An alternative mechanism open to liquidators to revest property in an insolvent company is s423 Insolvency Act 1986, which prohibits 'transactions that defraud creditors'[497]. It applies whenever a transaction is entered into at an undervalue, and where the purpose of the debtor was to place the asset out of the reach of creditors who may have a claim against the now insolvent company. Although s423 is not limited to insolvency proceedings, and instead adopts a looser 'victim'[498] requirement, some have argued that it is a 'provision with untapped potential'[499] for liquidators as unlike ss238 and 239, there is no fixed time period in which the transaction is vulnerable to attack by the liquidator[500]. Equally appealing are the powers granted to the court, which are similar to those granted under s238 and 239, and are to restore the position prior to the transaction occurring – meaning it could potentially prove lucrative for the liquidator to pursue in order to increase the liquidation dividend.

Disappointingly, although superficially appealing, s423 is also fundamentally flawed for achieving revestment of property, which explains its low utilisation. The first of these detractions is the need for the transaction to have occurred at an undervalue[501]. This requirement is the same as for s238 claims[502], and so shares the same uncertainties. Thus, establishing the transaction had a negative impact upon its 'victims' may be troublesome for liquidators to evidentially prove.

The second detraction is the need to show that the 'purpose' of the transaction was to place the asset beyond the reach of the company's general creditors[503]. As with preference claims, the liquidator must establish the debtor's intention, and it is insufficient to establish that the transaction had the result of placing the asset beyond the reach of creditors[504]. The issue with establishing the requisite purpose was acknowledged in *Brady*

[497] It cannot, however, be used to challenge preferences: *Re Lloyd's Furniture Palace Ltd, Evans v Lloyd's Furniture Palace Ltd* [1925] Ch 853
[498] Victim includes both current creditors and parties that may later be prejudiced by the disputed transaction – a results-based test is utilised: *Fortress Value Recovery Fund v Blue Skye Opportunities* [2013] EWHC 14 (Comm)
[499] Milman D, *Facilitating Recovery,* (No.393) at 4
[500] Milman D*, Transactional Avoidance,* (No.373) at 83
[501] S423(1) Insolvency Act 1986
[502] Finch V and Milman D, *Corporate Insolvency Law,* (No.6) at 493
[503] Milman D*, Transactional Avoidance,* (No.373) at 83
[504] Keay A, *Transactions Defrauding Creditors,* (No.367) at 273

v Brady[505], which noted that purposes can have many shades and that no definitive definition exists for the term. Furthermore, determining a purpose is challenging from an evidential perspective[506]. This is especially the case for companies because, as acknowledged above, it is impossible for the company to have a mind of its own owing to it being an abstraction, and so the liquidator and court must both establish and prove which human controller within the company was responsible for the transaction and what their intention was[507]. As set out above, this is potentially troublesome for liquidators to evidentially prove.

Adding to the issues with establishing the requisite purpose are the courts' attitudes of whether the purpose must be dominant or substantial. The earlier cases to consider s423 adopted the requirement that rather than the purpose being the only reason for the transaction, it must be the dominant purpose for the transaction[508]. Although reducing the evidential burden for liquidators by allowing the existence of multiple potential purposes to exist concurrently, the need for dominance remains problematic when two or more equal purposes were in mind during the transaction, as it is impossible for the courts to determine which took precedence[509] - especially given the judiciary's reticence at imputing intentions to the defendant. Given these difficulties, the need for a dominant purpose has been doubted by some members of the judiciary[510], and in *IRC v Hashimi*[511] Arden LJ rejected the need for a dominant purpose and instead held that a 'substantial' purpose was required – that the debtor had positively intended to put the asset out of the reach of creditors amongst all of the existing purposes[512]. Her Ladyship also opined that purpose must be substantive, rather than consequential – meaning that if the transaction was entered into for alternative purposes, but happened to prejudice creditors, a claim could not be sustained. Thus, establishing the relevant purpose will be troublesome due to this high, and difficult to establish, burden of proof[513], and so the use of s423 for the

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505 *Brady v Brady* [1989] A.C. 755
506 *Royscott Spa Leasing Ltd v Lovett* [1995] B.C.C. 502
507 Keay A, *Transactions Defrauding Creditors,* (No.367) at 285
508 *Chohan v Saggar* [1992] BCC 502
509 Keay A, *Transactions Defrauding Creditors,* (No.367) at 276
510 *Pinewood Joinery v Starelm Properties* [1994] 2 BCLC 412; *The Law Society v Southall* [2001] BPIR 303
511 [2002] BCLC 489
512 Ibid, at 504
513 Milman D, *Transactional Avoidance in Insolvency,* (No.373) at 83

benefit of unsecured creditors has been heavily circumscribed[514]. Indeed, this is evidenced in two recent cases, where in *Rubin v Dweck*[515] the claim was defeated by showing the transaction's purpose was to avoid a divorce, and in *Withers v Harrison-Welch*[516] the purpose was shown as giving effect to a previous domestic arrangement. Consequently, although s423 provides yet another mechanism to attack pre-insolvency transactions, making out the relevant liability is challenging and economically inefficient for liquidators to make out.

Section 1.4: Do the Anti-Deprivation Provisions Achieve Their Objectives?

As contended above, in analysing the anti-deprivation provisions, it is necessary to scrutinise whether or not they are adequate at achieving their intended objectives: maintaining the integrity of the asset pool, preventing creditors from acquiring preferences at the expense of other creditors, and deterring poor director behaviour.

It is apparent that the four prerequisites needed to initiate the anti-deprivation provisions do not substantially impair their use by the liquidator, and neither do they substantially frustrate the protection of unsecured creditors. Indeed, the need for liquidation can be justified on the basis that prior to insolvency, the company has sufficient assets to repay its creditors, and therefore they have no interest in the company's running until the advent of insolvency. Linked to this is the need for diminution in value of the company's assets. This too does not negatively impact upon the unsecured creditors as without the company asset pool being diminished, the general body of creditors is in the same financial position, and so has no justification for seeking legal recourse[517] .

The need for the company to enter insolvency within the specific time period does, however, have the potential to limit the options of liquidators. By imposing 6- and 24-month limits[518], the creditors are compelled, unwittingly, to enter a race against time to instigate winding up. They may not, however, have the relevant information available to make an informed decision on whether to initiate the liquidation process, such as

[514] Keay A, *Transactions Defrauding Creditors,* (No.367) at 284
[515] [2012] BPIR 853
[516] [2012] EWHC 3077 (QB)
[517] Anderson H, *The Framework,* (No.217) at 179; Cork K, *Report,* (No.2) at para 1481-1484
[518] S240 Insolvency Act 1986

information of the company's perilous financial position or the improper conduct. Neither may they have the relevant time or financial resources, even if the data is available, to process it within the 6-month window[519]. Given many creditors may not be in a position to initiate liquidation proceedings in time, they would be statutorily barred from exercising their protections, and so many potential claims that are capable of increasing the size of the asset pool would be stifled.

Another relevant factor are the orders available to the court. S241 provides a large range of powers to the court that include transferring property to the company, requiring the payment of money to the liquidator for any benefits received or discharging a security interest over company property. The comprehensiveness of these orders, and the discretion of the court to make the one that is the most relevant, suggest *prima facie* that they are largely adequate mechanisms for maintaining the asset pool and deterring misappropriation of assets as the misappropriated property may be to be returned and then distributed according to the statutory priority of distribution.

Notwithstanding their apparent attractiveness, their enforceability can prove problematic owing to the need for a court order. Whilst true proprietary 'remedies', such as resulting or constructive trusts, arise upon the occurrence of the relevant facts and have priority over all subsequently created property interests[520], the anti-deprivation orders under s241 require the judgment of the court. Consequently, in practice they operate in a similar manner to the proprietary Canadian remedial constructive trust[521] – they only acquire effective priority against valid security interests created *after* the judgment[522], and so are vulnerable to any security interests validly created in the period between the occurrence of the transaction and the judgment being handed down. Given the lengthy timeframes involved in the liquidation and litigation process, this could be sizeable. Any order is also at risk to purchases by *bona fide* purchasers for value[523], which bar the liquidator from acquiring the property. Given the traditional arm's length negotiations that occur between commercial parties, a veil of ignorance frequently attaches to the third party of the

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[519] Finch V and Milman D, *Corporate Insolvency Law,* (No.2) at Chapter 3; Calnan R, *Proprietary Rights,* (No.71) at 33-34
[520] *Re Sharpe* [1980] 1 All ER 198, at 203, per Browne-Wilkinson J
[521] *Hunter Engineering v Syncrude Canada* (1989) 57 DLR (4th) 321
[522] S241(2) Insolvency Act 1986
[523] *Wilkes v Spooner* [1911] 2 KB 473; *Barclays Bank v O'Brien* [1994] 1 AC 180

preference or undervalue transaction, and as such the purchaser has a lack of notice of the impropriety of the transaction. This ignorance is compounded by the fluctuating and bamboozling commercial value of many assets[524], regularly preventing the existence of constructive notice[525], and resulting in *bona fide* purchases. Consequently, this means that many orders may not be enforceable against these innocent parties even if made.

The final aspects to limit the anti-deprivation provisions' effectiveness are the substantive elements. As seen above, s239 requires the liquidator to prove that the company subjectively 'desired' to prefer the recipient of the company's assets. As a consequence, and the exception that creditor pressure can negate a desire to prefer – a factual occurrence that is likely to occur – s239 is a difficult claim for liquidators to sustain, and so unable to offer unsecured creditors much protection or discourage from inappropriate behaviour[526].

Equally ineffective is s238, which owing to *Brewin Dolphin's* recognition of disparate collateral contracts as effective consideration, and the uncertainty surrounding whether security interests reduce the company's asset pool, s238 too is troublesome for liquidators to sustain. Finally, s423 combines the weaknesses of s239 – the need for a subjective 'purpose' to defraud creditors – and the weaknesses of s238 – the need for inadequate consideration – and so is even more troublesome to sustain than the other provisions.

The lack of protection ss239, 238 and 423 offer unsecured creditors can be seen empirically in the research of Williams[527], who sought to identify the number of actions brought under these legislative provisions. In his research, it was established that only 80 s238 actions, and 50 s239 actions, were initiated up to 2013. This equates to a combined 4.8 claims a year for the provisions. Given that in 2018 the U.K. had 4 million registered companies[528], this equates to next to nothing, and so it is clear that none of the provisions

[524] Establishing the true market value of the product may, therefore, be open to interpretation and debate. Also subject to fluctuation is where the selling party does not have the relevant expertise or negotiating position to demand the full value of the item.
[525] *Barclays Bank v O'Brien* [1994] 1 AC 180 at 195; *Credit Agricole Corporation and Investment Bank v Papadimitrou* [2015] UKPC 13
[526] Van Zwieten K, *Goode,* (No.13) at 665
[527] Williams R, *What Can We Expect to Gain from Reforming the Insolvent Trading Remedy?,* [2015] 78 MLR 55 at 60-61
[528] Companies House, *Incorporated Companies in the UK January to March 2018,* 26th April 2018

are adequate at either protecting the integrity of the asset pool nor deterring improper corporate behaviour, owing to their pitiful utilisation and fundamental flaws.

Section 2: Person Liability

As noted in Section 1, despite the anti-deprivation provisions being proprietary in nature, they operate in a similar manner to the remedial constructive trust[529], and so are of limited value to the liquidator should the defendant have limited financial resources to give effect to any judgment. To make up for the potential shortfall, liquidators can seek to impose personal liability – primarily on the company's directors – to boost the asset pool. This is achieved through the fraudulent and wrongful trading provisions of the Insolvency Act 1986. This section therefore analyses whether they are effective in enlarging the asset pool.

a) Fraudulent Trading

The primary mechanism for imposing liability on directors of companies engaged in the liquidation process is s213 Insolvency 1986 for fraudulent trading. This provision potentially makes the defendant, who can be either a director or party with knowledge of the fraudulent trading[530], liable to make a contribution to the company's assets for distribution to the general body of creditors. S213 requires that if the business of the company was carried out with the intent to defraud creditors of the company, or for any fraudulent purpose, the court can make an order requiring them to make a contribution to be made to the company's assets. The purpose, if not effect, of this provision is to discourage directors from carrying on business at the expense of the general body of creditors[531] by making them personally liable, from their own assets, for the losses caused by their dishonesty. Despite no time limit existing on the defendant's liability within s213 itself, liquidators must bring the claim within 6 years of their powers becoming exercisable[532], thereby granting the liquidator, in contrast to the anti-deprivation provisions, sufficient time to investigate and bring a claim.

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[529] *Hunter Engineering v Syncrude Canada* (1989) 57 DLR (4th) 321 at 348
[530] *Re Gerald Coop (Chemicals) Ltd* [1978] CH 262
[531] Cork K, *Report,* (No.2) at para 1776-1786
[532] S9 Limitation Act 1980

As with the anti-deprivation provisions, the courts are granted substantial remedial powers should a breach of s213 be established. They are able to make an order for the defendant to 'make such contributions (if any) to the company's assets as the court thinks proper'[533]. Although *prima facie* this grants a large amount of discretion in the orders that can be made, a series of restrictions have been put in place severely limiting the potential boon this could provide for liquidators. Firstly, s213 requires that a causal link between the loss and the fraudulent trading must be established[534], and limits the defendant's liability to losses related to the fraudulent trading itself[535], rather than the general losses sustained prior to the insolvency, substantially limiting the potential recoveries of liquidators. Secondly, it is to be used to compensate creditors rather than punish directors for improper behaviour[536]. This accordingly means that the provision cannot be used to act punitively and increase the size of the order to punish egregious conduct[537]. However, as the order is for the benefit of all the company's creditors rather than just its victims[538], s213 does have the potential to benefit the general body of creditors and increase their dividend payment – so long as the defendant has the requisite resources to give effect to the order.

S213, similarly with the anti-deprivation provisions, is also problematic to prove and greatly under used[539] despite the potential benefits it may provide for unsecured creditors. This stems from the barriers the courts have placed in their interpretation of the fraudulent intention. In the early case law, it was found that this required 'actual dishonesty involving, according to current notions of fair trading among commercial men, real moral blame'[540] – a troublesome to prove subjective/objective hybrid test in which the defendant must have considered that the trading was objectively dishonest[541], although the further

[533] S213(2) Insolvency Act 1986
[534] *Morphitis v Bernasconi* [2003] Ch 552
[535] Which maybe causally limited to only a small financial value
[536] Finch V and Milman D, *Corporate Insolvency Law,* (No.6) at 597
[537] *Morris v Bank of India* [2005] BCC 739
[538] *Esal (Commodities), Re* [1997] 1 BCLC 705 (CA)
[539] Keay A and Walton P, *Insolvency Law,* (No.222) at 668; Doyle L, *Insolvency Litigation,* (London: Sweet & Maxwell, 1999) at 144
[540] Per Maugham J, *Re Patrick and Lyon Ltd* [1933] Ch 786 at 790; later endorsed in *L Todd (Swanscombe) Ltd, Re* [1990] BCC 125 and *Re Bank of Credit and Commerce International SA (No.14)* [2003] EWHC 1868 (CA)
[541] Keay A and Walton P, *Insolvency Law,* (No.222) at 670

the defendant departed from the objective standard of honesty the more likely he was to be found dishonest[542]. It has been found that 'blind eye' knowledge – a deliberate decision to avoid confirming the existence of the suspected fact – is sufficient for actual dishonesty, thereby encompassing incompetent defendants[543]. However, one issue that has repeatedly troubled the courts has been the incurring of debts shortly before insolvency. Early case law suggested that the incurring of debt with the knowledge that it could not be paid as debts became due, but with the belief they could be discharged at some time in the future, was insufficient for fraudulent trading[544]. This contention was rejected in *R v Grantham*[545], however, where it was held fraudulent trading occurred when the defendant realised that the company's debts could not be paid as they fell due. Thus, as a consequence of the need for 'real moral blame', and the subsequent confusion as to its meaning and application, it is clear that proving dishonesty is challenging for liquidators bringing proceedings and creates uncertainty.

In *Morphitis*[546], this high bar of proving fraudulent trading was raised even further with Chadwick LJ's rejection of a composite interpretation of 'with intent to defraud', and instead the need to prove both intention and fraud separately was adopted. This differs from the criminal concept, which establishes intention should it be proven that the consequence of the action was virtually certain[547] - a lower standard of proof. Therefore, under s213 a higher evidential bar has been set that requires the liquidator to prove that not only was the trading fraudulent, but also establish that the transaction was entered into with the intention to defraud[548]. Although it has been put forward that such a requirement may be understandable for criminal liability[549], owing to the potential ramifications of conviction and incarceration, it has also been argued that it has made bringing a claim a challenge as every element must be clear cut, particularly given the evidential issues surrounding intention outlined above[550]. This divergence from the criminal law, and the challenge it presents to liquidators, has led some to call for the

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542 *Aktieselskabet Dansk Skibsfinansiering v Brothers* [2001] BCLC 324, at 330
543 *Manifest Shipping v Uni-Polaris Shipping* [2003] 1 AC 469
544 *Re White and Osmand (Parkstone Ltd) (*1960), (unreported)
545 [1984] 2 All ER 166
546 *Morphitis v Bernasconi* [2003] EWCA Civ 289
547 *R v Woolin* [1998] 3 WLR 382 at 389
548 Finch V and Milman D, *Corporate Insolvency Law,* (No.6) at 597
549 Ibid, at 597
550 Fletcher I, *The Law of Insolvency,* (No.62) at 831

Supreme Court, should it hear an appeal on the issue, to reject the interpretation set out in *Morphitis*[551]*;* however, the prospect of the Supreme Court hearing such an appeal is sparse given the paucity of claims initiated in the English courts. Consequently, the unhelpful conclusion of Chadwick LJ set out in *Morphitis* is unlikely to be overruled in the foreseeable future, and as such liquidators face a difficult if not impossible evidential bar to clear.

Put bluntly, as a result of *Morphitis* it is easy for defendants to escape liability for fraudulent trading, and Milman has concluded that "Civil actions brought to enforce s.213 of the Insolvency Act 1986 are very much long shots."[552], and so they are largely unsuitable for liquidators to pursue.

b) *Wrongful Trading*

Because of the shortcomings of the fraudulent trading provisions, the Cork Committee concluded that a new form of directorial liability should be created to remedy this lacuna. Cork concluded that as fraudulent trading was fatally hamstrung and unappealing to practitioners[553], a new and easier to prove civil remedy should be made available to liquidators[554]. This was termed 'wrongful trading'[555], and although controversial throughout the various Parliamentary stages[556], many academic commentators were of the opinion that it could be a 'great hope for the unsecured creditor'[557] due to its employment of objective standards of managerial behaviour[558]. It has been questioned, however, whether wrongful trading did turn out to be the unsecured creditors' 'great hope', or is in fact as flawed as s213.

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[551] Savririmathu A, *Morphitis in the Court of Appeal: Some Reflections,* (2005) 26 Co Law 245 at 248
[552] Milman D, *Company Directors - Their Duties and Liabilities Revisited,* [2004] CLN 1 at 3
[553] Cork K, *Report,* (No.2) at para 1776; Parry R, *Transaction Avoidance* (No.271) at 473
[554] Ibid, at 1778
[555] Although neither term appears in s214; Simmons M, *Wrongful Trading,* [2001] Insolvency Intelligence 12 at 12
[556] Fletcher I, *The Law of Insolvency,* (No.62) at 835
[557] See: Finch V and Milman D, *Corporate Insolvency Law,* (No.6) at 599; Oditah F, *Wrongful Trading,* [1990] LMCLQ 205
[558] Milman D, *Facilitating Recovery*, (No.393) at 3

S214 Insolvency Act 1986, which gave effect to Cork's proposals, states that where a company has entered liquidation, the liquidator, should they find evidence that at some time before the commencement of the liquidation, the director(s) of the company knew or ought to have concluded that there was no prospect of the company avoiding liquidation, and continued to trade at the expense of the company's creditors, may apply for an order that the director(s) is liable to make a contribution to the company's assets. Therefore, the liquidator must prove the 'moment of truth'[559] – that the defendant realised, or ought to have realised, the company was beyond rescue and thus ceased trading.

Thus, the purpose of s214, according to Keay, is to stop directors from passing on the cost of the company's debts and placing the risks of further trading[560] at the feet of its unsecured creditors and taking unnecessary or dangerous risks[561]. This is because, as Keay further points out, the creditors are the residual claimants to the company's assets, and so the directors have a duty to minimise their potential losses when they conclude there is no prospect of the recovery[562].

The substantive elements require the liquidator to prove that the defendant director knew or ought to have concluded that the company had reached the 'moment of truth' outlined above[563]. From the limited case law available, it is apparent that one easy to ascertain factor in determining whether the moment has occurred is should the company repeatedly fail to find the necessary funds to discharge their debts as they become due[564]. Hence, in *Rubin*[565] directors were found liable after the date they ought to have concluded that promised funds would not be forthcoming from an investor who had given numerous assurances the moneys would be provided but had failed to provide them. Similarly, in *Roberts*[566] it was found that the moment occurred when the directors knew their bank's funding conditions could not be met, and in *Re DKG Contractors*[567] the moment occurred when a supplier refused to supply. Although in these instances there was a clear event

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559 Fletcher I, *The Law of Insolvency,* (No.62) at 836
560 Trading beyond the 'moment of truth'
561 Keay A, *Wrongful Trading: Problems and Proposals,* [2014] 65 (1) Northern Ireland Legal Quarterly 63 at 66
562 Ibid, at 66
563 S214(2) Insolvency Act 1986
564 Finch V and Milman D, *Corporate Insolvency La*w, (No.6) at 599
565 *Rubin v Gunner and another* [2004] BCC 684
566 *Roberts (Liquidator of Onslow Ditching Ltd) v Fröhlich* [2011] EWHC 257 (Ch)
567 *Re DKG Contractors Ltd [1990]* B.C.C. 903

that triggered the requisite knowledge for the directors[568], this will regularly not be the case, and so the liquidators will be compelled to analyse the relevant evidence, including cash flow forecasts, the loss of employees, contracts and denials of credit[569]. Analysing this evidence, particularly if the evidence is oral or poorly recorded, will therefore be both time consuming[570] and costly for the liquidator to undertake, and makes the investigation process undesirable to undertake. Adding to the evidential issues is the entitlement of the director to conclude that the best interests of the creditors is to continue trading on the grounds that profitability will return in the future[571]. Thus, not only must the liquidator show that the director had sufficient knowledge, but they must also show that the director had no legitimate grounds for concluding that profitability will return – a factual outcome that is extremely difficult to make out given the volatility of consumer tastes and international markets, and the subjective nature of business.

Beyond the demand to show the requisite actual or constructive knowledge, the liquidator is also hampered by the need to prove that there was a causal link between the wrongful trading and losses of the creditors, and that the company was worse off as a result of the continued trading after the alleged moment of truth[572]. Thus in *Brooks v Armstrong*[573] it was held that as ceasing to trade at the point of realisation would have made the assets valueless, whereas continuing to trade would generate positive cash flows and provide for a going concern value, there was no causal link between the losses sustained during the trading period and the wrongful trading. Similarly in *Re Ralls*[574], it was concluded necessary to prove that the decision of the directors of a building firm to continue trading increased the liability to creditors after the moment of truth, and that as the net deficit of company debts decreased by £3,885, there was no causal link. It was additionally held that the alternative submission, that a casual loss had been sustained through the need to investigate and pursue the wrongful trading claim, was insufficient to establish a causal

[568] Werdnik R, *Wrongful Trading Provision - is it Efficient?,* [2012] Insolvency Intelligence 81 at 82
[569] Katz and Mumford, *Making Creditor Protection Effective,* Centre for Business Performance, ICAEW, 2010) Chapter 5; Werdnik R, *Wrongful Trading Provision - is it Efficient?,* [2012] Insolvency Intelligence 81 at 82
[570] To locate and analyse
[571] *Singla v Hedman* [2010] EWHC 902 (Ch) para 107
[572] *Liquidator of Marini v Dickenson* [2003] EWHC 334 (Ch); *Re Continental Assurance Co of London* [2001] BPIR 733
[573] *Brooks v Armstrong* [2016] EWHC 2839 (Ch)
[574] *Re Ralls Builders Ltd* [2016] EWHC 243 (Ch)

link. The liquidator must, if they wish to pursue a claim, undertake a commercial appraisal of both the company's debts and its going concern value – values that are once again tricky to accurately predict and so off putting and unrecoverable should no loss actually be sustained[575]. Additionally, following *Re Ralls,* this investigation must be undertaken with the knowledge that the financial risks, should no liability be imposed, fall squarely on the liquidator and the already small insolvent estate, with no hope of a contribution from the defendant.

Notwithstanding that the evidential and causation issues have proved problematic for liquidators, s214 does assist liquidators by abandoning the subjective test set out in *Re City Equitable Fire Insurance Co*[576]. In its place, the director is judged not only by their own subjective knowledge, skill and experience, but also the general knowledge, skill and experience of a reasonable director[577]. Consequently, the director is now judged by a minimum standard that they must meet[578]. This standard accordingly not only removes the loophole that incompetent or unqualified directors could escape liability, but also simplifies the task of the liquidator by removing the need to investigate the director individually – they can undertake their assessment of whether or not to pursue a claim with the surety that there is a minimum standard of care and skill required.

Despite the apparent surety this objectivity provides liquidators, issues still remain for the liquidator in proving the defendant fell below the level of care and skill required. Primarily this is that even reasonable directors may be unable to recognise when the moment of truth has occurred[579]. As noted by Simmons[580], if the company is being kept afloat with financial support, the directors will, in the majority of cases, have no reason to suppose that such support will be withdrawn. Thus, even if the company is technically insolvent, they will have the genuine belief that the company will survive, and the moment of truth will not arise. However, should the finance be withdrawn, it is unlikely to be with any warning, and whilst the directors are considering their options, debts are

[575] Finch V and Milman D, *Corporate Insolvency Law,* (No.6) at 600
[576] [1925] Ch 407
[577] S214(4) Insolvency Act 1986
[578] *Re Produce Marketing Consortium* [1989] 5 BCC 569
[579] However, if the company is hopelessly insolvent, no relief will be forthcoming: *Re Bangla Television Ltd (In Liquidation)* [2009] EWHC 1632 (Ch).
[580] Simmons M, *Wrongful Trading,* [2001] Insolvency Intelligence 12 at 13

likely to be incurred to keep the company afloat. The courts have therefore given directors a large margin of appreciation. Such leeway can be observed in *Brooks v Armstrong*[581], where both the first instance and appeal judges gave the benefit of the doubt to directors who were struggling to manage and keep afloat a distressed company, and the assertion by several commentators is that the courts are likely to be more generous with companies that only conduct a small amount of business[582]. Hence, should a liquidator seek to impugn the directors' lack of action, even the objective standard may not assist their claim, and as such the liquidator is further discouraged from pursuing a claim from uncertainty.

Finally, s214's effectiveness has been undermined by the judicial 'flip-flopping' in their approaches to s214[583]. In relation to the purpose of s214, the judiciary have either interpreted as being compensatory or penal. Whilst Knox J has treated it as compensatory[584] (entitling the liquidator to only recover the direct losses), other members of the judiciary have interpreted it as being punishing in nature. Thus, in *Re Sherbourne*[585] the judge, who was sympathetic to the directors who were hardworking, honest and well respected, found there was no liability as they were acting in 'difficult times'. In contrast, in *Re Purpoint*[586] liability was imposed on a director who failed to monitor their company's financial affairs, and in *Re DKG Contractors*[587] liability was imposed when the directors failed to abide by basic company law requirements. By the courts varying their approach to requiring contributions to be made, the liquidator is faced with uncertainty as to whether a compensatory approach, which will result in either a contribution or a culpability approach, which will vary from case to case and judge to judge, will be adopted, and the 'bite of the wrongful trading provisions is, therefore, diminished'[588].

Section 2.1: Does Personal Liability Protect Unsecured Creditors?

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[581] *Brooks v Armstrong* [2015] BCC 661; *Brooks v Armstrong* [2016] EWHC 2839 (Ch)
[582] See Parry R, *Transaction Avoidance,* (No.271) at 473; Keay A and Walton P, *Insolvency Law,* (No.222) at 658
[583] Finch V and Milman D, *Corporate Insolvency Law,* (No.6) at 602-603
[584] *Re Produce Marketing Consortium* [1989] 5 BCC 569
[585] *Re Sherborne Associates Ltd* [1995] BCC 40
[586] [1991] BCLC 491
[587] [1990] BCC 903
[588] Finch V and Milman D, *Corporate Insolvency Law,* (No.6) at 603

Similarly to the anti-deprivation provisions evaluated above, it is submitted that the imposition of personal liability, or the theoretical potential of the courts to impose liability at least, are ineffective at adequately protecting unsecured creditors owing to a number of fundamental shortcomings within both fraudulent and wrongful trading.

With s213, the courts have interpreted the section as requiring liquidators to show that there was 'actual dishonesty…real moral blame'[589]. Despite some conduct, such as wilful blindness, being held sufficient conduct, the courts have had more trouble with the incurrence of debts with the knowledge that they cannot be paid as they fall due – behaviour that is more likely to occur in a commercial context[590]. Adding to the issues associated with s213 is the almost impossible evidential burden set by the courts in *Morphitis*[591], by which the liquidator must separately prove the trading was fraudulent and intentional. Given the evidential limitations of proving intention, and the rejection of the criminal presumption of intention if the outcome was virtually certain, the liquidator faces an evidential burden heavier than a criminal prosecutor, without possessing the skill or expertise required to evidentially prove such conduct. This confusion, in practice, means that liquidators have no guidance on what form a successful claim will take. Hence liquidators are unwilling to take the financial and reputational risk[592] of undertaking such litigation, no recoveries will be made for the benefit of the asset pool nor the unsecured creditors.

The introduction of liability for wrongful trading has also failed to adequately protect unsecured creditors, despite the inclusion of a clear statutory imposition of an objective requirement on the directors of the company. However, aside from the courts' willingness to accept the factual matrix of repeated failures to pay debts as sufficient evidence[593], and these matrices being comparatively easy and economical to prove, the high evidential barriers they have set limit s214's effectiveness. These barriers necessitate liquidators expending large amounts of time and expense to acquire and analyse evidence for

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[589] *Re Patrick and Lyon Ltd* [1933] Ch 786 at 790
[590] *Re White and Osmand (Parkstone Ltd) (*1960), (unreported); *R v Grantham* [1984] 2 All ER 166
[591] *Morphitis v Bernasconi* [2003] Ch 552
[592] Which will result in a loss of prospective work and the associated financial penalty
[593] *Rubin v Gunner and another* [2004] BCC 684

alternative matrices – if the evidence even exists. This risk and high costs prohibit all but the largest insolvencies from engaging in this investigation, and thus severely inhibits its utilisation. Additionally, given that the liquidator must further prove a causal link between the between the wrongful trading (if that can be proven) and any losses sustained[594], a further evidential hurdle is placed in bringing a claim, and is a hurdle many claims fall at[595].

Finally, even if the liquidator is able to thread the eye of a needle and establish liability, they face not knowing what remedy will be granted. Despite the power for the court to order a director to make any contribution they see fit, the judiciary has had a schizophrenic response to this discretion, either concluding it should be used to punish[596] the defendant or merely compensate[597] the creditors for their losses[598]. In principle this means that even should the liquidator prove the existence of wrongful trading, they cannot guarantee what they would even recover. Finally, should the liquidator manage to achieve these two near impossible feats, if the director has suffered losses as a result of the failure of the company, and does not have the necessary financial resources to give effect to the order, which is likely if their personal wealth is linked to the fortunes of the company[599], the liquidator will be unable to recover the order *or* the costs of conducting the litigation. The existence of these substantial doubts means that liquidators cannot enter into litigation as the potential cost implications could be crippling not only to them, but also to those who fund the litigation[600] and the unsecured creditors if the asset pool has been used to fund the litigation.

Given the many flaws of s214, it is unsurprising that few liquidators have sought to utilise the provision. In Williams' research[601], he established that between 1986 and 2013, only

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[594] *Liquidator of Marini v Dickenson* [2003] EWHC 334 (Ch); *Re Continental Assurance Co of London* [2001] BPIR 733
[595] See *Brooks v Armstrong* [2016] EWHC 2839 (Ch)
[596] *Re Purpoint* [1991] BCLC 491
[597] *Re Sherborne Associates Ltd* [1995] BCC 40
[598] The judiciary's unpredictable interpretation of s214 can be likened to that of Lord Denning's judgments such as *DHN Food Distributors Ltd v Tower Hamlets London Borough Council* [1976] 1 WLR 852 and *Central London Property Trust Ltd v High Trees House Ltd* [1947] KB 130
[599] Williams R, *What Can We Expect to Gain from Reforming the Insolvent Trading Remedy?,* [2015] 78 MLR 55 at 77
[600] See Section 3 below
[601] Ibid, at 60-61

29 reported applications were made in relation to wrongful trading. This equates to 0.9 applications a year. Adding to the palpable anaemia is that of the 29 applications, only 11 were successful and resulted in contributions being made – a contribution being made only on average every 2.5 years and in 38% of cases. Consequently, it is clear the probability that unsecured creditors will ever recover is almost zero. Thus, Cook's description of wrongful trading as being a 'paper tiger'[602], rather than a genuine threat to misbehaving directors, is apt, as by discouraging liquidators from initiating litigation, unsecured creditors go unprotected.

Section 3: Funding of Liquidation Litigation

Notwithstanding the many limitations that exist on the use of the Insolvency Act mechanisms[603], they at least provide theoretical means through which the company's asset pool can be increased in size[604], and should this occur, a larger liquidation dividend distributed to the unsecured creditors. For these mechanisms to progress from being mere theoretical possibilities to practical realities, the liquidator must have the necessary funding made available to commence litigation. Indeed, aside from the substantive limitations of the creditor protections set out in the Insolvency Act, it is the lack of funding that is usually the biggest hurdle for a liquidator intending on pursuing a claim[605].

Equally, bringing claims against such well-resourced and advised defendants is financially problematic as they will seek to deny liability or prevaricate in making payments, and so the legal costs will have to be borne by the liquidator personally until

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[602] Cook C, *Wrongful Trading – Is it a Real Threat to Directors or a Paper Tiger?* [1999] Insolvency Lawyer 99 at 100

[603] McKenzie D, *Wrongful Trading – A Paper Tiger?,* [1995] JR 519

[604] Anderson H, *The Framework,* (No.217) at 176

[605] Hicks A, *Wrongful Trading – Has it Been a Failure?* (1993) 8 Insolvency Law & Practice 134 at 134; Walters A, *Foreshortening the Shadow: Maintenance, Champerty and the Funding of Litigation in Corporate Insolvency* (1996) 17 Co.Law. 165; Milman D and Parry R, *A Study of the Operation of Transactional Avoidance Mechanisms in Corporate Insolvency Practice,* (Wallingford; GTI Specialist Publishers, 1997); Walters A, *Creditor-Funded Litigation in Corporate Insolvency* (1997) 1 CfiLR 126; Parry R, *Funding Litigation in Insolvency* (1998) 2 CfiLR 121.

payment is, if ever, made[606]. As noted in *Re Exchange Travel*[607], the liquidator must therefore think carefully before deciding whether to pursue litigation – especially if the potential award is small in size. In *Re Exchange Travel* itself, the litigation costs exceeded the value of the claim, and thus in practice only high value claims, owing to the high legal costs, are likely to be initiated.

Furthermore, the liquidator is also under a duty to protect the insolvent estate for the benefit of unsecured creditors. Thereby, in pursuing expensive and uncertain litigation, either in terms of success or payment, the liquidator places the asset pool at risk[608]. Should this gamble prove to be unsuccessful, the liquidator will not be thanked as the asset pool will be reduced in size[609] and the unsecured creditors dividend be wiped out. This gamble is made even riskier by the ineligibility of companies and liquidators for legal aid to fund the litigation[610].

These restrictions[611] therefore led Cork to conclude that bringing litigation had become too difficult for liquidators, resulting in too few claims being brought to challenge illegitimate transactions[612], and leaving the general body of creditors unprotected. Despite this conclusion, Cork did not propose any remedy to the solution[613].

Notwithstanding the apparent obstacles in bringing litigation, there are a number of benefits to initiating litigation. For the unsecured creditors in particular, litigation can prove profitable owing to the destination of the recovered sums, as it has been held that such sums fall outside the scope of the floating charge[614]. Indeed, recoveries received by

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[606] Keay A, *Wrongful Trading: Problems and Proposals,* [2014] 65 (1) Northern Ireland Legal Quarterly 63 at 72
[607] *Re Exchange Travel (Holdings) Ltd (In Liquidation) (No3)* [1997] BCC 784, per Phillips LJ at 798
[608] Anderson H, *Insolvent Insolvencies*, (2001) 17 IL&P 87
[609] Keay A, *Pursuing the Resolution of the Funding Problem in Insolvency Litigation,* [2002] Insolvency Lawyer 90
[610] Sch 2 para 1 (g and h). See generally Munro R, *Assignment of Cause of Action,* [1998] IL&P 14(2) 148; Shaw P, *Liquidators' Assignments of Causes of Action: Part 2: Legally Aided Plaintiffs,* [1998] 14(3) IL&P 199
[611] Which existed at the time of the Cork Report
[612] Cork K, *Report,* (No.2) at para 1257
[613] Ibid
[614] *Re Yagerphone* [1935] 1 Ch 392, confirmed in *Re MC Bacon Ltd (No.2)* [1990] 3 WLR 646 per Millett J

the liquidator are held on trust for the general body of creditors as they were not the property of the company due to them only coming into being after the onset of liquidation[615], and so after the floating charge has crystallised[616]. Thus, if the litigation is successful, it is unsecured creditors, and not the secured creditors, who stand to benefit. This section will hence analyse the funding predicament of liquidators, before concluding the impact this had on the utilisation of the anti-deprivation and personal liability provisions of the Insolvency Act 1986.

Section 3.1: Re Leyland Daf

Prior to the far-reaching reforms brought about by the Companies Act 2006, the expenses of the liquidator, and the costs they incurred in winding up the company, could not be paid out of the assets subject to floating charges[617]. The reasoning in *Re Leyland Daf* was based on a distinction between the company's assets. It was held that 'free' assets (those not subject to a security interest) belonged both legally and beneficially to the company, and so were the company's assets and could be used to fund litigation proceedings. Those assets subject to a security interest, however, were only legally, and not beneficially, the property of the company[618]. According to Lord Millett, each 'fund' had to cover its own costs, and so the assets subject to a security interest were only compelled to cover the costs of their realisation, whereas the free assets were responsible for all the expenses associated with the winding up of the company[619].

Upon publication, some commentators came out in favour for this distinction. McCormack[620] argued that this distinction was favourable and fair to the floating charge holders, who no longer had to fund a process they (at least in part) did not participate in. As evocatively put, "the charge holder [prior to *Re Leyland Daf*] had to pay the costs of a liquidator who was trying to cut its throat rather like a totalitarian regime might require a condemned prisoner to fund the bullets for his own execution"[621] and given the proceeds

[615] *Re Oasis Merchandising* [1998] Ch 170
[616] See McCormack G, *Swelling,* (No.439) at 56
[617] *Re Leyland DAF* [2004] 2 AC 298, overruling *Re Barleycorn Enterprises Ltd* [1970] Ch 465
[618] The impact of their Lordships' conclusion was set out above in relation to transactions at an undervalue.
[619] Ibid, at 62
[620] McCormack G, *Swelling,* (No.439) at 60
[621] Ibid, at 60

of litigation could not be made available to the secured creditors, it was just that they should not contribute to the litigation. Support was also proffered by Armour and Walters[622], who argued that as the liquidation process is for the benefit of the general body of creditor and not the secured creditors, it is they who should fund it[623].

However, although the arguments put forward by McCormack and Armour *prima facie* are understandable, the obvious limitation of the submissions is that a major source of litigation funding is cut off from the liquidator[624]. Owing to the large percentage of a company's assets that are likely to be subject to security interests[625], it created the possibility that not only would litigation not be funded, but also the liquidator expenses would be unpaid[626] and result in losses for the liquidator. Consequently, it was argued that *Leyland Daf's* funding restrictions seriously undermined the public interest role of the liquidation process and the liquidator, as the funding gap and uncertainty meant liquidators were further disinclined to pursue litigation[627] - giving secured creditors free rein[628] and made the unsecured creditor protection provisions practically toothless.

Although *Re Leyland Daf* seriously undermined unsecured creditor protection, this has been reversed through s176ZA Insolvency Act 1986[629]. Under s176ZA, liquidators' expenses and the general liquidation expenses now have 'super priority' over the assets subject to floating charges if the free assets of the company are insufficient to cover the amounts[630], meaning that Lord Millett's division between 'free' and secured assets is now of much lesser importance, and the floating charge assets can be used to fund litigation. Notwithstanding S176ZA, the position of the fixed charge has remained untouched, and thus *Re Leyland Daf* partially applicable. Hence, should the insolvent company's assets

[622] Armour J and Walters A, *Funding Liquidation: A Functional View,* [2006] LQR 295 at 301
[623] Ibid, at 309
[624] Moss G, *Liquidators Stung for Costs and Expenses,* (2004) 17 Insolvency Intelligence 78
[625] See Chapter 1
[626] Welby R, *Antecedent Recoveries and Litigation Funding – A Practical Perspective,* (2006) Recovery 32
[627] *Re Pantmaeong Timber* [2004] 1 AC 158
[628] Mokal R, *What Liquidation Does for Secured Creditors and What it Does for You,* (2008) 71 MLR 699
[629] Inserted by s1282 Companies Act 2006
[630] S176ZA (1) Insolvency Act 1986.

be formed primarily of static, unchanging property[631] that are subject to fixed charges, these assets will remain beyond the reach of the liquidator and unable to finance litigation.

The effectiveness of s176ZA is further restricted by the Insolvency Rules' requirement that the liquidator acquire permission from the floating charge holders to use the floating charge assets to cover the litigation expenses[632] by creating a statement specifying the amount sought from the charged assets[633] for the charge holder. The charge holder has no restriction on the exercise of their discretion, and can exercise it solely in their best interests. This need for approval provides the charge holder a great deal of power to prevent the necessary funding being made available, especially as the liquidator cannot resubmit an application that has been rejected[634]. Keay notes that the creditor is likely to reject the application out of hand as, owing to *Re Oasis Merchandising,* they cannot benefit from the litigation due to their position as a secured creditor. However, Keay also notes that if the litigation is likely to recover a large amount, and that large amount could be used to decrease any shortfall faced by the charge holder, they may approve the request[635]. Despite the natural appeal of Keay's proposition, the likelihood of floating charge holders risking the assets to increase their returns is paltry, and similar to the reticence of unsecured creditors in funding litigation (see below). Hence, although s176ZA in principle increases the availability of litigation funds, in practice the likely reticence of charge holders to authorise the use of charged assets prevents any increase in the funding open to liquidators.

It can therefore be concluded that despite the recent legislative reforms by the Companies Act 2006 and the Insolvency Rules 2016, little has changed in the availability of insolvent company assets to fund litigation. It can be seen that although the floating charge assets *may* now be made available to fund litigation, the floating charge holders retain a discretionary and unchallengeable veto of their use. Given the charge holder is unlikely to want to risk the charged assets, they will in most cases be unavailable. The recent legislative reforms that also may not attempt to reform the position in relation to fixed

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[631] Such as factories, intellectual property or office buildings that are likely to be subject to a mortgage or fixed charge
[632] Rs 6.45(3) and 7.113(3) Insolvency Rules (England and Wales) 2016
[633] Rs 6.46(1)(b) and 7.114(1)(b) Insolvency Rules (England and Wales) 2016
[634] Keay A, *Litigation Expenses In Liquidations*, (2009) Insolvency Intelligence 113 at 115
[635] Ibid, at 116

charges, and so, if a company is subject to many fixed charges that cover the majority of the company's assets, little will be made available, and so acquiring the necessary funds from the insolvent estate remains problematic.

Section 3.2: Alternative Funding Sources

Given the issues associated with funding litigation from the company's asset pool[636], many liquidators are compelled to consider the use of outside sources of funding, with the most appealing being the general body of creditors themselves. This is because it is they, and not the secured creditors, who enjoy the proceeds from any litigation[637]. Also appealing to creditors, the proceeds can be used to indemnify them for the legal costs ahead of the other general creditors[638], preventing those that take the risk and provide the funding from losing out to those who contributed nothing. However, the attractiveness to those creditors is slightly tempered by the *pari passu* principle, which precludes them from acquiring an increased share of the proceeds, and instead they only receive their *pro rata* share.

Although *prima facie* funding litigation is appealing to the general body of creditors, many are reticent in providing the necessary funds[639]. A number of factors contribute to this reticence, with the most fatal being the uncertainty surrounding the litigation[640]. As outlined above, all of the potential causes of action are difficult to make out and sustain. Hence, potential contributors, after obtaining advice and similar conclusions, are unwilling to take the financial risk and 'throw good money after bad', and instead wish to cut their losses[641]. Secondly, creditors can be wary of the motives of the liquidator in pursuing litigation. As Wheeler has shown[642], owing to practitioner behaviour and

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[636] Werdnik R, *Wrongful Trading Provision - is it Efficient?,* [2012] Insolvency Intelligence 81 at 86

[637] *Re Oasis Merchandising*, (No.615); Van Zwieten K, *Goode,* (No.13) at 723

[638] *Re Exchange Travel (Holdings) Ltd (In Liquidation) (No3)* [1997] BCC 784

[639] See generally: Milman D and Parry R, *A Study of the Operation of Transactional Avoidance Mechanisms in Corporate Insolvency Practice,* (Wallingford; GTI Specialist Publishers, 1997); Milman D, *Litigation: Funding and Procedural Difficulties,* (1997) Amicus Curiae 27; Parry R, *Funding Litigation in Insolvency,* [1998] CfiLR 121 at 122

[640] Finch V and Milman D, *Corporate Insolvency Law,* (No.6) at 474

[641] Walters A, *Staying Proceedings on Grounds of Champerty: More Reasons to Question the Result in Oasis Merchandising?* (2000) Insolvency Lawyer 16 at 17

[642] Wheeler S, *Empty Rhetoric and Empty Promises: The Creditors' Meeting,* (1994) 2(3) JL & Soc 350

attempts to prevent others from taking the position of liquidator, creditors are bamboozled and mistrustful of the entire liquidation process. Should the liquidator, who does not have the trust of creditors, request they risk large sums, in addition to the losses they have already incurred, many speculate that the liquidator is merely seeking to string out the process and increase his expenses. Finally, because of the English legal system's approach to 'loser pays' in relation to litigation costs, and the courts' powers under s51 Senior Courts Act 1981[643], creditors are fearful that not only must they cover the costs of the liquidator, but also those of the defendant, potentially proving financially ruinous for them.

As a repercussion of the general body of creditors' reluctance, liquidators are obliged to seek further alternative funding arrangements from non-connected parties with the liquidation. This usually involves an outside funder, to whom the claim will assigned for a fixed sum, or involves the funder providing the funding to the liquidator on agreement that a share of the recovery will be made available. The advantages to the liquidator and general body of creditors of this structure are evident: there is no financial risk to either party and instead the risk is taken by the party providing the funding, the integrity of the insolvent company's asset pool remains intact for the benefit and distribution to both parties, and also the provision of finance also illustrates that an external and objective party has confidence in the proposed litigation. However, as illustrated in *Re Longmeade*[644], these upsides are not always sufficient to entice the general body of creditors to agree to such a funding arrangement. In *Re Longmeade* itself, the liquidator negotiated a funding agreement with an external funder that posed no risk to the insolvent estate. However, the company's biggest creditor, HMRC, objected as the primary defendant was another government department and so they wished to avoid the negative publicity of one government department suing another. Although Snowden J agreed with the liquidator and rejected HMRC's contention it had a legitimate objection to the pursuance of the litigation, he also concluded the liquidator should consult with the creditors if there are 'legitimate' objections to the litigation[645]. If one unsecured creditor

[643] To "determine by and whom to what extent the costs are to be paid". Orders can be made against those that have a substantial connection to the proceedings – *Symphony Group v Hodgson* [1994] QB 179, although exceptional circumstances are necessary for an order to be made against such a party; *Dolphin Quays Development v Mills* [2007] EWHC 1180 (Ch)
[644] *Re Longmeade Ltd (in Liquidation)* [2016] EWHC 356 (Ch)
[645] Ibid, at 66

has sufficient leverage to influence the liquidator, such as an institutional lender that regularly provides fee work, they may be able to stifle litigation which would otherwise protect smaller unsecured creditor despite the lack of financial risk.

The courts' approach to third party funding of insolvency litigation has also hampered the effectiveness litigation[646]. Generally, external funding involves the sale of a bare cause of action for an agreed sum or share of sums recovered. However, it was held in *Re Oasis*[647] that if the liquidator sought to sell the recoveries of a s214 claim the sale did not fall within the exception to champerty. In reaching this conclusion, the Court of Appeal drew a distinction between claims that were available before the onset of liquidation, and so belonged to the company itself and could be assigned, and those claims that only became available once liquidation has occurred, which belonged personally to the liquidator to be used in favour of the company and which could not be assigned. As the anti-deprivation and personal liability provisions are contingent on the commencement of liquidation, *Re Oasis* precluded them from being funded by assignment of the proceeds. This therefore meant that "Effectively, office-holders are, in many cases, left with little alternative but to turn their backs on litigation"[648] as there was no viable mechanism to acquire third party funding.

Following sustained academic criticism of *Re Oasis'* restrictiveness[649], recent legislative reforms have sought to improve the potential third-party funding arrangements open to the liquidator. Under s246ZD Insolvency Act 1986[650], liquidators are now able to assign the rights of action of fraudulent trading, wrongful trading, transaction at an undervalue, and preference claims. The potential, therefore, exists for liquidators to sell these claims to the highest bidder and make the proceeds available to the unsecured creditors, particularly as s176ZB Insolvency Act 1986[651] reaffirms that the proceeds belong to the general body of creditors and not secured creditors.

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[646] Walters A, *Staying Proceedings on Grounds of Champerty: More Reasons to Question the Result on Oasis Merchandising?,* (2000) Insolvency Lawyer 16
[647] [1997] 2 WLR 764
[648] Keay A, *Pursuing the Resolution of the Funding Problem in Insolvency Litigation,* [2002] Insolvency Lawyer 90
[649] Ibid; Walters A, *Staying Proceedings on Grounds of Champerty: More Reasons to Question the Result on Oasis Merchandising?,* (2000) Insolvency Lawyer 16
[650] Inserted by s118 Small Business, Enterprise and Employment Act 2015
[651] Inserted by s119 Small Business, Enterprise and Employment Act 2015

Once again, though, the *prima facie* reform brought about by this method of funding is illusory. This is because although assignment is now possible, it does not make it an attractive proposition to potential funders. Given the high financial costs of pursuing litigation, the company providing the necessary funds will seek to minimise the potential risks by only funding those claims where the prospect of success is high and the defendant has assets commensurate to their liability. Such a turn of circumstances occurred in *Re Longmeade,* where the prospect of success for a claim was high and the defendant, HMRC, owing to their position as a government department, had almost limitless access to assets. The majority of claims, however, have a low prospect of success owing to the substantive limitations set out above, and defendants with limited assets[652], seriously discouraging potential purchasers[653].

Also limiting are the needs of potential funders should they take the risk and purchase the cause of action[654]. Owing to the high value of the potential claim, liquidators stand to recover substantial amounts if success. If this was self-funded, the majority of the proceeds could therefore be made available for the unsecured creditors. However, if cause of action is purchased, then in order to make a profit, a 'significant discount' will have to offered to the purchaser to interests them[655]. Given this, it is foreseeable that the improvement in the unsecured creditors' dividend will be muted if such an assignment occurs.

<u>Section 4: Conclusion</u>

This chapter has analysed the anti-deprivation and personal liability provisions set out in the Insolvency Act 1986, and concluded that they offer inadequate protection to unsecured creditors. Their ineffectiveness stems from neither set of provisions providing sufficient mechanisms to revest assets in an insolvent company nor deter parties from seeking to misappropriate company assets. This is despite five separate statutory

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[652] Particularly directors whose financial security is tied to their companies: Williams R, *What Can We Expect to Gain from Reforming the Insolvent Trading Remedy?,* [2015] 78 MLR 55 at 76
[653] Ibid, at 68
[654] Ibid, at 69
[655] Ibid, at 69

mechanisms existing with the express intention of protecting the general body of creditors.

As seen from the analysis above, the flaws in the legislative provisions are many, but most fall into three categories: remedial, substantive and evidential. Taking the remedial limitations first, all the provisions have *prima facie* satisfactory remedial powers that allow the court to order the revestment of property into the company. However, owing to the potential orders' reliance on the court's judgment to become effective, they are at risk of dispositions of property to *bona fide* purchasers for value and the defendant either having insufficient assets to give effect to the judgment or granting beneficial interests to third parties – and having no proprietary rights granting them priority to the assets. As such, many potential claims face the prospect of succeeding and being unable to enforce the successful judgment.

Secondly, the substantive requirements of the provisions hinder their utilisation. Within the preference provisions, rather than an objective test, it is necessary for the liquidator to prove that the defendant company subjectively 'desired' the end result. As demonstrated, this subjective element is almost impossible for the liquidator to successfully make out. The problems associated with preferences is also mirrored in the fraudulent trading provisions, which following *Morphitis* require the liquidator to prove the defendant separately defrauded creditors and that they did so intentionally, diverging significantly from the criminal law standards which set a much lower bar and is much easier to prove. As a result, fraudulent trading is next to impossible for liquidators to make out.

Finally, there are many evidential limitations to the provisions. In order to establish a transaction occurred at an undervalue, the liquidator faces not only the issue of proving the market value of the transaction but must also disentangle many potential collateral contracts that could be argued to have provided the company with valuable consideration. Similarly, the liquidator must also establish the chain of causation in wrongful trading claims, and prove that the trading caused the loss – a link that many claimants have failed to adequately prove.

Compounding these issues even further is the funding regime available to liquidators. As seen above, liquidators historically did not have access to large sections of the company's asset pool to fund litigation, with *Re Leyland DAF* concluding that secured creditors were not required to contribute to litigation costs. Although legislative reform has attempted to reverse this issue through granting access to secured assets, floating charge holders retain the right to refuse use of the assets, preventing their use by the liquidator. Equally frustrating have been attempts to provide access to third party funding, which have not proven effective. Hence, even if the liquidator possesses as valid claim that will revest property to the company for the benefit of the unsecured creditors, it is unlikely that such a claim will receive the necessary funding.

As a result of these severe limitations, and given the justifiable existence of the protections, it is submitted that unsecured creditors require an alternative method of protection to increase their liquidation dividend, one that lies outside the law of insolvency. The need to go beyond the law of insolvency, rather than reform the Insolvency Act's statutory provisions, stems from the remoteness that substantial reform will be forthcoming. Presently, owing to competing political priorities, including matters with the European Union and Covid-19, there is limited Parliamentary resources. As seen in the Queen's Speech of 2017[656], the present Government's focus is on other social issues including NHS funding and national infrastructure. Secondly the recent reforms enacted by the previous Government through the Business, Enterprise and Employment Act 2015 focused on expanding the availability of the Insolvency Act provisions, rather that fundamentally reforming them. Seemingly, there is thus no appetite for serious reform as occurred with the Enterprise Act 2002 and the abolition of the administration receiver. This is evidenced further in the recent Government response paper, which failed to include developed plans on how to reform this area of insolvency law, instead calling for greater consultation[657]. Thus, it is unlikely that major legislative reform to remedy the Insolvency Act will occur in the foreseeable future, and so alternative methods must be considered. Indeed, Beale has described the response as "...the English courts [and

[656] https://www.gov.uk/government/speeches/queens-speech-2017

[657] Department for Business, Energy and Industrial Strategy, *Insolvency and Corporate Governance: A Government Response,* (26th August 2018) 37

Parliament] have done nothing for the plight of unsecured creditors, apart from occasionally expressing sympathy for that plight..."[658].

It is further submitted that in order to remedy the lack of protection, any proposal must have three necessary qualities. The first of these is that it must be capable of increasing the assets pool of an insolvent company. These assets must then be available to the general body of creditors through the liquidation dividend. Owing to the issues of the anti-deprivation provisions, this remedy should be proprietary in nature to ensure priority to any assets. Secondly, the remedy should have clear and easy to establish provisions, enabling the liquidator to be confident of initiating litigation – as opposed to the uncertainty faced under the present Insolvency Act provisions. Finally, any potential remedy should be attractive to third party litigation financiers, as it is unlikely the company will have insufficient assets to fund such litigation itself.

Given the need for any potential remedy to possess these features, this thesis analyses the resulting trust in Chapters 5 and 6, where it is posited that it can meet all three requirements by returning assets to the company, having clear and predictable rules, and being attractive to third party litigation funders. Before that, however, the theoretical conclusions reached in this chapter are tested against real world case studies to identify whether they hold up to scrutiny.

[658] Beale H, *The Law of Security and Title-Based Financing,* 3rd edn (Oxford: OUP, 2018) at 14

Chapter 4: Case Studies of Carillion and British Homes Stores

Chapter 3 of this thesis analysed and set out the theoretical limitations of the anti-deprivation and personal liability provisions of the Insolvency Act 1986. It was concluded that as a consequence of the provisions' evidential and substantive requirements, in addition to the issues of funding the necessary litigation to enforce them, none of the provisions, nor the provisions collectively, provided an adequate or effective means of protecting unsecured creditors by means of revesting assets in now insolvent companies.

Despite Chapter 3 establishing the theoretical limitations of the provisions, both it and the existing literature have not provided empirical evidence concerning their effectiveness. Hence, a case study into whether the provisions afford adequate protection for unsecured creditors would provide the necessary empirical data to substantiate Chapter 3's conclusions.

This chapter will therefore seek to provide the necessary empirical evidence of the Insolvency Act's provisions through two case studies of companies that entered liquidation with substantial liabilities to unsecured creditors. These case studies will challenge the conclusions of Chapter 3 and analyse whether the theoretical conclusions have application in practice. The chapter will also fill a gap in the existing literature by providing empirical evidence of the provision's limitations. It must be noted, however, that the cases studies pertain only to the issues of the Insolvency Act, and are not applicable to the analysis of the resulting trust in Chapter 5 and 6 owing to their factual matrices not giving rise to a resulting trust. They will, however, assist in identifying areas that are not covered by the Insolvency Act, which areas require address, and also assist in identifying the limitations of the assistance the resulting trust can provide.

The two companies that form the basis of this chapter's case studies are Carillion Plc, which became insolvent in January 2018, and British Home Stores (BHS), which entered insolvency in August 2016. Both will be analysed to determine whether the provisions would have provided any protection to the companies' unsecured creditors, and also to provide evidence of the provisions' limitations in real world application.

As noted in Chapter 1, both companies were chosen for several reasons.

First, both companies made headlines for their poor corporate governance and high-profile corporate mistakes[659]. Carillion entered insolvency having made a number of costly and notorious takeovers, and was also known to have bid for contracts at below cost price whilst declaring large dividends. Similarly, BHS was famously sold by Sir Philip Green for £1 after years of large dividends having been declared, and also had a pension deficit of £571 million at the time of its collapse. Given these actions, it is *prima facie* possible that the Insolvency Act 1986 provisions may be applicable to these insolvencies.

Secondly, the unsecured creditors of the two companies face losing substantial amounts of money from the respective insolvencies. Carillion entered insolvency owing £2 billion to creditors, of which only £30 million was covered by insurance policies[660]. When BHS entered insolvency, it owed £1.3 billion to creditors[661], and so far, only £36 million has been repaid. Thus, both case studies will provide empirical evidence of how creditors fare in the liquidation process and also whether the provisions provide adequate protection.

Thirdly, both companies were subject to Parliamentary enquiries as a consequence their corporate behaviour and societal impact. This means that Select Committee reports were published, outlining the conduct of the respective boards and companies. Consequently, there is sufficient evidence, publicly available, to analyse and determine the applicability and effect of the provisions.

This chapter has 2 parts. Part 1 is the case study of Carillion and its insolvency, with Section 1 setting out the actions of Carillion. Section 2 analyses these actions'

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[659] Wearden G, *Carillion Collapse Exposed Government Outsourcing Flaws – Report*, (2018) 9 July: https://www.theguardian.com/business/2018/jul/09/carillion-collapse-exposed-government-outsourcing-flaws-report; Monaghan A, *Philip Green Escapes Company Director Ban for BHS £1 Deal*, (2018) 27 March: https://www.theguardian.com/business/2018/mar/27/philip-green-escapes-company-director-ban-for-bhs-1-deal

[660] BBC, *Carillion Collapse: Insurers Pay out £30m to Suppliers*, (2018) 25 January; https://www.bbc.co.uk/news/business-42811707

[661] https://publications.parliament.uk/pa/cm201617/cmselect/cmworpen/54/5404.htm

applicability to the Insolvency Act's provisions. Part 2 is the case study of BHS and its insolvency, with Section 3 setting out the actions of BHS. Section 4 analyses these actions' applicability to the Insolvency Act's provisions. Finally, there is a conclusion on the empirical results of the case studies and whether the empirical evidence supports or contradicts the theoretical conclusions of Chapter 3. Each case study will be analysed in turn, before overall conclusions are reached in the final section of this chapter.

Part 1:

Case Study 1: Carillion

Prior to its collapse in January 2018, Carillion gave the appearance of a stable company that declared regular dividends and carried out a large number of private and public sector contracts. However, on 10th July 2017, the company issued a warning that profits would be £845 million lower than expected[662]. When it released its interim financial results in September 2017, an extra £200 million write-down was declared[663]. These combined losses represented the accumulative profits for the previous 7 years, and net debts were calculated at being £405 million. The reaction of the financial markets was swift and unequivocal – Carillion's share price tumbled 70% - from 192p on 7th July to 57p on 12th July.

As a result, Carillion began to seek compromise agreements with its creditors and lenders. On 25th January 2018, such a compromise between the company and its creditors was concluded to be unviable, and so the company was placed into liquidation. Although the company could theoretically have entered administration, this was not a viable option owing to Carillion's debt to asset ratio in January 2018; it owed £2 billion to creditors and only had £29 million in liquid assets, making a turnaround impossible. Such was the perilous state of Carillion's finances that accountancy firms EY and PwC rejected offers

[662] House of Commons Library, *Briefing Paper: The Collapse of Carillion,* (2018) No. 8206 at 4
[663] House of Commons Business, Energy and Industrial Strategy and Work and Pensions Committees, *Carillion: Second Joint Report from the Business, Energy and Industrial Strategy and Work and Pensions Committees of Session 2017–19*, (2018) HC 769 at 37-38

to become administrators[664] owing to the lack of assets and fears their fees would go unpaid[665].

The collapse of Carillion was problematic owing to the debts incurred and the work it carried out. To the private sector Carillion provided facilities management services, including cleaning, construction and project management services. However, more impactful were its public sector contracts, including school meals, hospital maintenance and construction[666], defence accommodation for 50,000 families and track renewals on the rail network. Even though Carillion had global business operations, its primary business was located in the UK, and its entrance into liquidation required the Government to cover the Official Receiver's costs to maintain the operation of its public sector contracts, with an initial cost projected to be £150 million[667].

This section will therefore briefly outline Carillion's history and the reasons for Carillion's eventual failure. It will then analyse and illustrate how the existing anti-deprivation and personal liability provisions have failed to protect creditors.

Section 1: Carillion and its Entry into Insolvency

Section 1.1 The Origins of Carillion

Carillion Plc was created in 1999 as a consequence of its demerger from the Tarmac Group[668], covering the group's former construction and maintenance subcontractor businesses - Tarmac Construction and Tarmac Professional Services. Tarmac was required to spin off these businesses into a new entity owing to a period of rapid expansion through acquisitions, which led to substantial losses[669]. Thus, Carillion, a company that

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[664] In rejecting the opportunity to be appointed administrators, and Carillion being forced to enter liquidation, any going concern value became impossible to achieve – thereby worsening the outcome for unsecured creditors event further.

[665] http://www.bbc.co.uk/news/business-42710795; see also Sarah Albon, Chief Executive of Insolvency Service, who echoed this to the House of Common Select Committees - HC Deb 15 January 2018, Col 624

[666] https://www.theguardian.com/business/2020/jan/16/how-carillion-collapse-stymied-two-state-of-the-art-hospitals

[667] *Carillion: Second Joint Report,* (No.663) at 7

[668] https://www.insider.co.uk/news/what-is-carillion-construction-firm-11853236

[669] *Carillion: Second Joint report,* (No.663)

would experience financial pressures 19 years later, would come into existence on the back of financial trouble as a result of short-term acquisitions.

Following on from its previous existence within the Tarmac Group, Carillion, under its Chief Executive Officers[670], elected to expand its facilities maintenance business through a number of takeovers[671]. These acquisitions included[672]:

- GT Rail Maintenance (2001: £34 million)
- Citex Management Services (2002: £11.5 million)
- Entreprenad (2003: £6.2 million)
- Planned Maintenance Group (2005: £51.5 million)
- Mowlem (2006: £350 million)[673]
- Alfred McAlpine (2007: £565 million)[674]
- Vanbots (2008: £14.3 million)
- Eaga (2011: £298 million)[675]
- The Bouchier Group (2011: £24 Million)
- Facilities Management business of John Laing (2013)
- Rokstad Power Corporation (2014: £33 million)

As seen immediately above, the majority of Carillion's outlay was on three companies: Mowlem, Alfred McAlpine and Eaga for a combined £1.213 billion. Hence, although Carillion had become one of the major construction and facilities management companies

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[670] Initially John McDonough and later Richard Howson,

[671] Chapman R, *Ineffective Risk Management and the Collapse of Carillion,* (2018) 8(12) PM World Journal 3; Bhaskar K and Flower F, *Financial Failures and Scandals: From Enron to Carillion,* (London: Routledge, 2019) at 178

[672] https://web.archive.org/web/20090605180251/http://www.ukbusinesspark.co.uk/can92223.htm

[673] Carillion, *Annual Report and Accounts (2006); Making Tomorrow a Better Place:* http://www.annualreports.co.uk/HostedData/AnnualReportArchive/c/LSE_CLLN_2006.pdf

[674] Carillion, *Annual Report and Accounts (2008); Making Tomorrow a Better Place:* http://www.annualreports.co.uk/HostedData/AnnualReportArchive/c/LSE_CLLN_2008.pdf

[675] Carillion, *Annual Report and Accounts (2011): Making Tomorrow a Better Place:* http://www.annualreports.co.uk/HostedData/AnnualReportArchive/c/LSE_CLLN_2011.pdf

in the United Kingdom, such growth had not been organic, and instead had been as a result of costly and short-term acquisitions.

The reason and need to engage in such a flurry of acquisition, according to Chapman[676] and the House of Commons Select Committee inquiry[677], was the board's business model. By operating in low margin and highly competitive markets, there were inherent risks of losing out to rival bids and incurring even further squeezed profit margins. By removing competitors, Carillion was able to acquire pre-existing contracts and lock out rival bids, protecting its access to revenue and business at the cost of high acquisition prices.

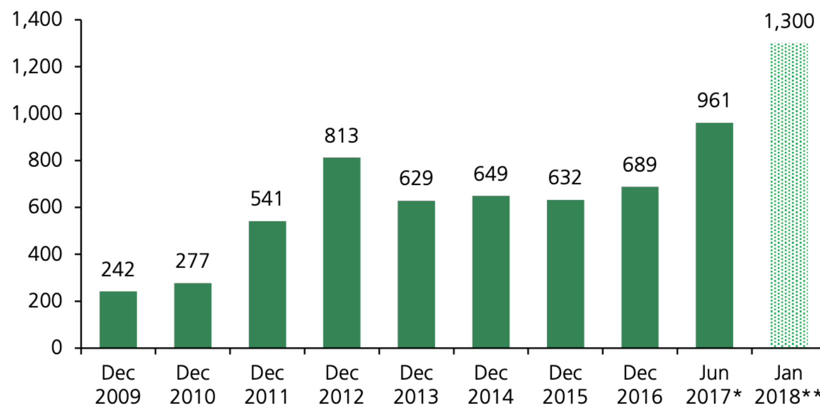
Section 1.2 The Rise of Debt in Carillion

Coupled with Carillion's adoption of a business model requiring the acquisition of rival firms, the company also experienced an exponential growth in its debts. Carillion's borrowing increased from £242 million in 2009 to £689 million in 2016, reaching an estimated £1.3 billion in 2018[678]. This steady increase is set out in Figure 1 below.

Figure 1: Carillion's Total Borrowing: 2009-2018[679]

[676] Chapman R, *Ineffective Risk,* (No.671)
[677] *Carillion: Second Joint Report,* (No.663) at 13
[678] House of Commons Library, *Briefing Paper,* (No.662) at 15-17; *Carillion: Second Joint Report,* (No.663) at 36-44
[679] House of Commons Library, *Briefing Paper,* (No.662) at 15

Carillion's loans
Total owed, £ millions



Source: Carillion's annual financial statements; * Interim financial statement for the six months ended 30 June 2017; ** Financial Times (16 Jan 2017)

Note: Total loans is the sum of bank overdrafts, bank loans, finance lease obligations and other loans.

In addition to its traditional forms of debt, Carillion was also able to acquire further debt through increasing the length of time taken to pay supplier invoices. Despite signing up to the Prompt Payment Code[680], which requires 95% of invoices to be paid within 60 days and that steps be taken to adopt payment within 30 days, Carillion was well known for taking much longer, with some suppliers having to wait 126 days to have invoices paid[681]. Although the effect on suppliers is analysed below, for Carillion itself the use of 'reverse factoring'[682] meant it had further access to cheap credit, with the amounts owed under the scheme rising from £212 million in 2009 to £761 million in 2016[683].

The size of Carillion's debts was further exacerbated by the board's rejection of the opportunity to inject equity into the company as it was seeking to expand[684]. Instead, they

[680] Letter from FSB to the Chairs of the House of Commons Business, Energy and Industrial Strategy and Work and Pensions Committees, *Carillion: Second Joint report from the Business, Energy and Industrial Strategy and Work and Pensions Committees of Session 2017–19,* (2018) HC 769 - https://www.parliament.uk/documents/commons-committees/work-and-pensions/Correspondence/Letter-from-Chairman-of-FSB-to-the-Chairs-relating-to-Carillion-inquiry-31-January-2018.pdf

[681] House of Commons Library, *Briefing Paper,* (No.662) at 2

[682] Although not in itself illegal, creditors are to some extent protected from delays to payment by the Late Payment of Commercial Debts (Interest) Act 2002, which permits creditors to charge interest on unpaid debts after 30 days

[683] House of Commons Library, *Briefing Paper,* (No.662) at 16

[684] *Carillion: Second Joint Report,* (No.663) at 14

focused solely on financing the expansion through debt, and although some directors would later acknowledge the flawed nature of the policy[685], the policy meant that should it become impossible to meet the repayments, as occurred in January 2018, the company had no fall-back position and many would go unpaid.

Section 1.3: Failed Projects

As noted, Carillion engaged in a number of high profile and costly acquisitions in order to grow the business quickly. The three costliest acquisitions were all for figures substantially above the value of their tangible net assets[686]. The difference between the tangible net value and purchase price was accounted for as 'goodwill' – the intangible assets of the company being purchased. This includes the brand, the skills and experience of the workforce, and any 'synergies' that might be achieved by combining the two companies[687]. However, owing to the intangible nature of the 'asset' being acquired, it is extremely difficult to ascribe the correct value to any goodwill.

In acquiring Mowlem, Alfred McAlpine and Eaga, Carillion purchased £431 million, £615 million and £329 million of goodwill receptively[688]. Thus, Carillion's acquisition of a number of its important rivals came at a large premium that had no tangible hold in reality[689]. Indeed, by 2016, the goodwill value of its acquisitions accounted for £1.6 billion, or 35% of the company's gross assets and double its net assets of £730 million[690].

The goodwill value, although clearly inflated at the time of the purchases, was also never impaired in its annual accounts. As noted, Carillion and its auditors, KPMG, never reduced the balance-sheet value of the goodwill despite some its acquisitions performing poorly. Eaga was recorded as having a goodwill value of £330 million[691]. Whilst this may,

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[685] Letter from Philip Green, non-executive director and later Chairman of BHS, to the House of Commons Business, Energy and Industrial Strategy and Work and Pensions Committees, 20th February 2018 - https://www.parliament.uk/documents/commons-committees/work-and-pensions/Carillion%20report/Letter-from-Philip-Green-to-the-Committee-re-Carillion-20-02-18.pdf
[686] *Carillion: Second Joint Report,* (No.663) at 13
[687] Ibid, at 13
[688] Ibid, at 13
[689] Chapman R, *Ineffective Risk*, (No.671)
[690] *Carillion: Second Joint Report,* (No.663) at 52
[691] Ibid, at 53

theoretically, have been correct at the time of the purchase owing to the company making £31 million in profits, in the five subsequent years[692] it made losses totalling £260 million[693] - meaning any goodwill value had almost entirely evaporated. Hence, Carillion's refusal to appropriately update the goodwill value of its acquisitions meant that its accounts drastically overstated the value of its assets, and thereby allowed it to acquire levels of credit well above what it should have had access to – ensuring that when it entered liquidation there would not be enough residual value to pay creditors as the stated asset values were illusory.

In addition, Carillion also encountered costly and loss-making contracts both domestically and overseas. Considering its overseas operations first, contracts such as those with Msheireb Properties in Qatar, were hugely unprofitable and cost the company £100s million. The Msheireb contract was for the building of residential, hotel and office buildings but ended in the two companies suing and countersuing each other for £200 million, and Carillion had to eventually write off the £200 million allegedly owed[694].

The domestic contracts were also unprofitable for Carillion. As Richard Howson confirmed, after 2012 Carillion "did not have any money to buy competitors, as we had done in the past. We had to win our work organically. We had to bid and we had to win [...]"[695]. This need for business meant that Carillion was required to bid for and win contracts at a price that did not cover the costs of carrying out the contracts. Furthermore, by bidding at such low prices, should it encounter any issues with those contracts, it would not have the margins necessary to cover any financial hits. Such was Carillion's parlous financial position that it was required to deliberately bid for contracts at low prices to create the impression that it was a business with good prospects, rather than one that was experiencing cash flow problems[696].

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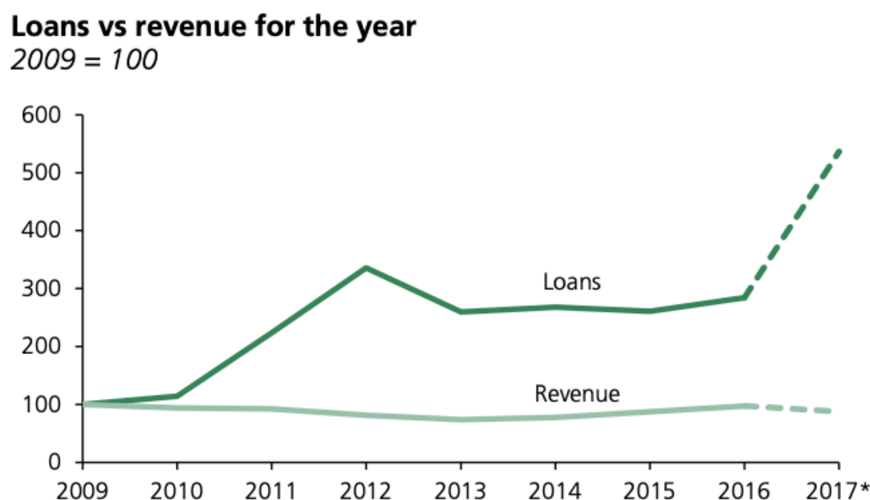
[692] After being renamed Carillion Energy Services
[693] *Carillion: Second Joint Report,* (No.663) at 13
[694] *Carillion: Second Joint Report,* (No.663) at 15
[695] Richard Howson, former Chief Executive, Carillion, giving oral evidence to the House of Commons Business, Energy and Industrial Strategy and Work and Pensions Committees on 6th February 2017: http://data.parliament.uk/writtenevidence/committeeevidence.svc/evidencedocument/work-and-pensions-committee/carillion/oral/78103.pdf
[696] Bhaskar K and Flower F, *Financial Failures,* (No.671) at 179

The impact of this policy was evidenced in the company's revenue. Between 2009 and 2016, when revenues should have been increasing, revenue actually fell 2%[697]. At Carillion's lowest point in 2014, revenue was actually 26% lower than what was achieved in 2009, whilst its debt levels continued to rise.

Figure 2: Carillion's Falling Revenue[698]



Carillion's failed business models of firstly acquiring its rivals for inflated prices, and secondly bidding for contracts at below cost price, were a recipe for disaster[699]. Although the policies enabled Carillion to create the appearance of possessing substantial assets, through entering into contracts that brought in less than they cost to carry out, Carillion was also in a position where it did not have enough revenue to cover costs, ensuring that it was always increasing its debt levels. Hence, the Carillion business model was bound to fail[700].

Section 1.4: Dividends

Carillion, throughout its near 20-year history, had an established record of increasing the dividend paid to shareholders year after year. In its final annual report, it proudly noted

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[697] House of Commons Library, *Briefing Paper,* (No.662) 16
[698] Ibid, at 17
[699] Bhaskar K and Flower F, *Financial Failures,* (No.671) at 179
[700] *Carillion: Second Joint Report,* (No.663) at 16

that "the board has increased the dividend in each of the 16 years since the formation of the Company in 1999"[701].

However, as seen immediately above, Carillion's ability to declare an ever-increasing dividend diminished as its failed business models increased its debt levels whilst also decreasing its revenue[702]. As the Select Committee powerfully put it, "In reality, Carillion's dividend payments bore little relation to its volatile corporate performance." [703]. This included three quarters of its revenue paid out as dividends from 2009-2016 (£554 million[704]), and in the period 2012-2017 £333 million more in dividends was paid out than it generated in revenue[705].

So wedded were the Carillion board to the policy that it continued until the July 2017 profit warning was issued, and the final dividend of £55 million was paid a month beforehand. The justification provided for adopting such a policy was "balancing the needs of many stakeholders", including pensioners, staff and shareholders.[706] However, when it was proposed in January 2017 that the last dividend should not be paid so as to conserve cash and pay down debt, there was severe opposition[707]. Other board members argued that instead it was better to maintain market confidence and deal with debt reduction 'at the right time'[708].

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[701] Carillion, *Annual Report and Accounts (2016): Making Tomorrow a Better Place:* *http://www.annualreports.co.uk/HostedData/AnnualReports/PDF/LSE_CLLN_2016.pdf*
[702] *Carillion: Second Joint Report,* (No.663) at 18
[703] *Carillion: Second Joint Report,* (No.663) at 17
[704] The House of Commons Library, *Briefing Paper,* (No.662) at 19
[705] This potentially amounts to a breach of s830 Companies Act 2006, which states a company may only pay dividends out of realised profits. The dividend may, therefore, have been unlawful and ultra vires. Although it may result in the directors having to repay the dividend (*Bairstow v Queens Moat Houses Plc* [2001] EWCA Civ 712; *Re Exchange Baking Co, Flitcroft's Case* (1882) LR 21 Ch D 519), this issue is outside of the scope of this thesis.
[706] Richard Adam, Finance Director, Carillion, giving oral evidence to the House of Commons Business, Energy and Industrial Strategy and Work and Pensions Committees on 6th February 2016 - http://data.parliament.uk/writtenevidence/committeeevidence.svc/evidencedocument/work-and-pensions-committee/carillion/oral/78103.pdf
[707] *Carillion: Second Joint Report,* (No.663) at 17
[708] Keither Cochrane, https://www.parliament.uk/documents/commons-committees/work-and-pensions/Carillion%20report/Carillion-Board-minutes-26.1.17.pdf

Figure 3: Carillion's Dividend Payments[709]

Dividends vs cash, £ millions

For the year	Cash from operations	Dividends paid	Cash left
2009	184	53.4	130
2010	131	59.1	72
2011	120	64.6	55
2012	-16	70.4	-87
2013	-62	74.6	-137
2014	156	75.7	80
2015	120	76.8	44
2016	116	78.9	37
2016	116	24.5	91
2017 H1*	-270	54.4	-325
Total 2009-2016	*748*	*554*	*194*
Total 2012-2016	*313*	*376*	*-63*
*Total 2012-2017**	*43*	*376*	*-333*

Section 1.5: Pension Scheme Obligations

The final cause of Carillion's entry into liquidation, as with BHS in this chapter's second case study, was its pensions deficit. This accounted for 13 separate pension schemes that had 27,000 members[710].

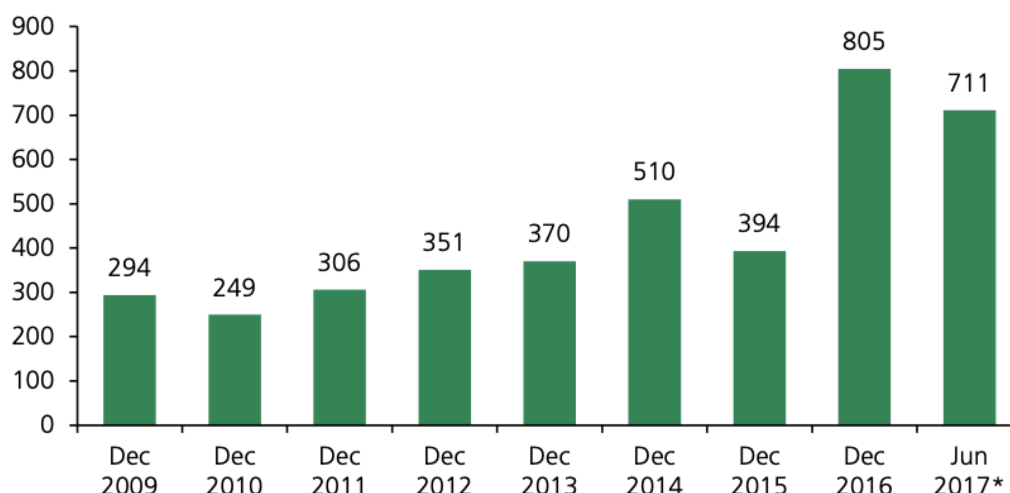
The size of Carillion's pension scheme deficits was not unreasonable for the majority of the company's history, with the Select Committee's analysis concluding the deficits were not 'unusually high' and 'may well have been manageable'[711]. The policy of acquiring rival firms, however, led to a sharp increase in the size of the pension scheme deficits. In acquiring Mowlem and Alfred McAlpine, Carillion took on pension deficits of £156 million[712]. By 2011, these two pension schemes' deficits had increased to a combined £424 million[713]. When added to the deficits of the other schemes, by 2018 Carillion's total pensions deficit totalled close to £800 million[714].

Part of the reason for the deficit was Carillion's reluctance in, and active attempts to avoid, meeting its statutory funding obligation[715]. It was found that in 2011, whilst the

[709] The House of Commons Library, *Briefing Paper,* (No.663) at 19
[710] Ibid, at 15
[711] *Carillion: Second Joint Report,* (No.663) at 19
[712] Ibid, at 20
[713] Ibid, at 20
[714] Letter to the House of Commons Business, Energy and Industrial Strategy and Work and Pensions Committees from Oliver Morley MBE, Chief Executive of Pension Protection Fund one 3rd April 2018 - https://www.parliament.uk/documents/commons-committees/work-and-pensions/Carillion%20report/Letter-from-PPF-to-Chair-3-April-2018.pdf
[715] *Carillion: Second Joint Report,* (No.663) at 21

pension Trustee calculated that the deficit was £770 million and required recovery payments of £65 million a year for 14 years to rectify, Carillion argued that the deficit was only £620 million and that payments of £33.4 million for 15 years were necessary – contributions at nearly half the level suggested. This led the independent adviser to the Trustee to conclude that Carillion had an "aversion to pension scheme deficit repair funding"[716]. Furthermore, in 2017, following the July profit warning, Carillion was permitted to defer pension contributions amounting to £25.3 million in the period September 2017 and April 2018 on the basis that otherwise it would enter insolvency.

Figure 4[717]:



Carillion's policy towards its pension schemes was to actively contribute the minimum necessary to keep them operational, and as a consequence a large deficit was run up. Compounding this desire to contribute the bare minimum, by engaging in prolific acquisition of rivals, the extent of the deficits was greatly magnified. Consequently, by

716 https://www.parliament.uk/documents/commons-committees/work-and-pensions/Correspondence/Letter-from-Gazelle-Director-to-Carilion-Trustees-relating-to-pension-scheme-contributions-23-February-2012.pdf; https://www.parliament.uk/documents/commons-committees/work-and-pensions/Carillion%20report/Letter-from-Simon-Willes-Executive-Chairman-Gazelle-re-Carillion-290318.pdf

717 The House of Commons Library, *Briefing Paper,* (No.662) at 22

the time of Carillion's entry into insolvency, the pension deficits would make up a large proportion of the debts owed.

Section 1.6: Conclusions on Carillion's Failure

From the above, it is apparent that the demise of Carillion was as a consequence of a number of interconnecting factors. By adopting a policy of acquiring rivals to gain market share, Carillion was required to pay inflated acquisition prices that did not reflect the true value of the companies being acquired. This in turn required Carillion to drastically increase its debt levels, and upon acquiring its rivals, meant it was obliged to take on board their pre-existing pension deficits. Once the acquisitions had been made, Carillion was then required to guarantee income through obtaining contracts, but to ensure it acquired the contracts, it was necessary in many instances to bid at levels below the value of the contract, ensuring decreased revenue levels. Finally, by prioritising dividend payments, Carillion would never have the assets available to pay creditors should it be discovered that its business model was unsustainable. This is evidenced by the debt levels upon Carillion's entrance into liquidation – it had £7 billion in liabilities but only £29 million in assets[718].

Despite the undoubted effect of Carillion's business model and decisions, much of the blame must also be attributed to the management culture and objectives of the Carillion board[719]. As concluded by the Select Committee: "Carillion's rise and spectacular fall was a story of recklessness, hubris and greed. Its business model was a relentless dash for cash, driven by acquisitions, rising debt, expansion into new markets and exploitation of suppliers…Carillion was unsustainable. The mystery is not that it collapsed, but that it lasted so long."[720]

Consequently, Carillion's demise was a result of two primary reasons – an unstable business model and poisonous corporate culture that was unwilling to identify and address the problems facing the company.

[718] *Carillion: Second Joint Report,* (No.663) at 7
[719] Chapman R, *Ineffective Risk Management and the Collapse of Carillion*, (2018) 8(12) PM World Journal 1 at 1
[720] *Carillion: Second Joint Report,* (No.663) at 3

The impact of the liquidation has been especially harsh on Carillion's unsecured creditors. Whilst the pension schemes had a deficit of nearly £800 million, this was covered by the Pension Protection Fund, ensuring that the majority of payees would be protected[721]. However, suppliers, Carillion's largest body of unsecured creditors, were not so fortunate. At the time of Carillion's collapse, 30,000 suppliers were unpaid, being owed a combined £2 billion[722]. Whilst insurers paid out close to £30 million to some suppliers[723], this equates to only 1.5% of total sums owed.

The cause of creditors being owed so much, as outlined above, was Carillion's use of 'reverse-factoring', whereby Carillion would agree to pay suppliers on a reduced timeframe, in return for accepting a reduction in the contract price. The extended timeframes utilised by Carillion, although not illegal in themselves, were protected by the Late Payment of Commercial Debts (Interest) Act 2002[724], which permits creditors to claim 8% interest after 30 days of non-payment. However, unsecured creditors are generally unwilling to use the mechanisms available as claiming interest from client's would be 'commercial suicide' due to the souring of business relationships and 'involve too much hassle'[725]. This was particularly the case for the creditors of Carillion owing to its dominant market position. Consequently, 'reverse factoring', and increasing a company's level of debts at their creditor's expense, was relatively easy to achieve for Carillion.

In "abusing its dominant market position by making small suppliers wait for payment"[726], and owing almost £500 million as result of reverse factoring alone[727], some suppliers, who were unable to recover the amounts owed, were forced to enter insolvency themselves. This is seen in the example of Vaughan Engineering Ltd, which was required to enter administration in March 2018, causing 200 employees to lose their jobs as it could

[721] https://www.pensionsage.com/pa/IS-recovers-413m-from-Carillion-PPF-dividend-still-unknown.php
[722] *Carillion: Second Joint Report,* (No.663) at 7
[723] BBC, *Carillion collapse: Insurers pay out £30m to suppliers*, (2018) 25 January; https://www.bbc.co.uk/news/business-42811707
[724] See also the Late Payment of Commercial Debts Regulations 2002 (SI 2002/1674)
[725] Finch V and Milman D, *Corporate Insolvency Law,* (No.6) at 137
[726] *Carillion: Second Joint Report,* (No.663) at 24
[727] Bhaskar K and Flower F, *Financial Failures,* (No.671) at 197

not recover £830,000 owed by Carillion. This was cited as a substantial reason for them entering insolvency[728]. Hence, along with the other companies the Select Committee took evidence from, it is apparent that Carillion's suppliers took the brunt of the side effect of the company's collapse.

Section 2: Application of the Anti-Deprivation and Personal Liability Provisions

Given the actions of Carillion and its board members outlined above, it is necessary to consider whether any of the remedies outlined in Chapter 3 – the anti-deprivation and personality liability provisions of the Insolvency Act 1986 – offer a mechanism through which the impact may be minimised. As the remedies were outlined and analysed in detail in Chapter 3, this section will only briefly summarise the requirements of the statutory provisions before applying them to the factual matrix of Carillion.

Section 2.1: Preferences

The first potential remedy that may be applicable to Carillion's insolvency is the existence of a preference. According to s239(4), a preference occurs whenever a company does anything or suffers anything to be done which has the effect of putting a creditor in a position which, in the event of the company's liquidation, will be better than had that thing not been done. However, as concluded in Chapter 3, s239 is hamstrung by the requirement that the now insolvent creditor 'desired' the preference and the subjectivity incorporated by Millet J[729] - especially should a creditor be forceful in their demands for repayment[730], which would prevent the 'desire' from being present.

Given the limitations of s239, it is unlikely that any of the reported acts by Carillion constitute a preference.

The first set of potential acts to constitute a preference, the policy of declaring excessive dividends, cannot constitute a preference for two fundamental reasons. First of all, as the final dividends were declared to the company's shareholders, who are not (in that capacity

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[728] *Carillion: Second Joint Report,* (No.663) at 25
[729] *Re MC Bacon,* (No.429) at 86
[730] Ibid, at 86

at least) creditors of the company, the fundamental requirement of the necessary relationship between the parties is not met. Secondly, from the evidence available, it is apparent that Carillion's intention behind declaring the dividend was not to prefer the shareholders, and was instead to maintain market confidence in the company and the share price in order to allow the company to continue trading. Whilst the competence of adopting such a policy is open to question, the fact that it was adopted by the Carillion's board is not[731]. Hence, should any of the shareholders have been creditors to Carillion, and have benefited from the declaration of the dividend, then no preference would have occurred as there was no subjective desire to prefer and merely an intention to keep the company trading[732].

The second potential set of acts are the payment of contractors and suppliers in the 6 months before Carillion entered liquidation. As stated above, Carillion continued to pay them up until it entered insolvency. Notwithstanding that the Select Committee did not expressly deal with this issue, it strongly appears from the evidence that there was no attempt to prefer any creditors. It seems that Carillion, in continuing to pay its creditors, was merely attempting to meet its contractual obligations and maintain the company's operations, rather than prefer those creditors who were paid in the six months prior to Carillion's entry into insolvency. Indeed, the report makes no reference to any creditors receiving individual or special treatment, and so it is extremely unlikely that as preference was given to any of the creditors.

Section 2.2: Transactions at an Undervalue

The second potential remedy available to Carillion's creditors is s238 Insolvency Act 1986, which prohibits the disgorgement of the company's assets at an undervalue either when the company has entered insolvency or disgorgements that cause the company to

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[731] Richard Adam, Finance Director, Carillion giving oral evidence to the House of Commons Business, Energy and Industrial Strategy and Work and Pensions Committees, 6th February 2017- http://data.parliament.uk/writtenevidence/committeeevidence.svc/evidencedocument/work-and-pensions-committee/carillion/oral/78103.pdf

[732] See Keay A and Walton P, *Insolvency Law,* (No.222) at 630

become insolvent as a result of the transaction[733]. This typically involves transactions for little or no consideration[734].

It was concluded in Chapter 3 that the primary issue with establishing that a transaction was at an undervalue was proving that any consideration received was 'significantly below market value'[735]. As confirmed in *Brewin Dolphin,* this means that it is "what a reasonably well-informed purchaser is prepared" to pay[736], and is usually the market value where there is one or expert evidence where a market does not exist. However, it is only the value that the company ascribes to the transaction that is relevant for the purposes of s238[737]. Hence, should the asset have an inherent market value, but no value to the company[738], there will be no transaction at an undervalue. Moreover, the defence provided for under s238(5)(a) undermines the objectivity of s238 as it means that the company can defend the transaction so long as it can show that there were sufficient ground for believing the transaction was in the company's interests – bringing a subjective element to s238 claims.

Within the context of Carillion, similarly to the potential for preference claims, it is unlikely that a successful s238 claim could be initiated. The first set of actions, the dividend, is unlikely to be viewed as a transaction at an undervalue. Firstly, it is unforeseeable that the courts, even with the help of expert evidence, could ascribe the correct value to Carillion's dividends owing to the fact that such payments by a company are pure business decisions by the board, taking into account numerous and competing issues – preventing a 'true value' ever being ascribed. Secondly, even if the courts were to conclude that a true value could be ascribed, given the well documented policy underlying the board's declaration of dividends, and the board's belief that doing so was necessary to maintain market confidence in Carillion, mean that any transaction would be covered by the s238(5)(a) defence as there would have been reasonable ground to believe the transaction benefited Carillion.

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[733] The transaction must also occur within the 6 months prior to company entering insolvency
[734] S238(4) Insolvency Act 1986
[735] Chapter 3, Section 1.3(b)
[736] *Philips v Brewin Dolphin,* (No.467) at 154
[737] *Re Thoars (No2), Reid v Ramlort Ltd* [2004] EWCA Civ 800; *Re M.C. Bacon Ltd (no.2)* [1990] BCLC 324 at 340
[738] Because the company cannot make use of it – such a mining company owning the intellectual property to a hybrid car engine

The second ground on which s238 may be utilised is the active policy of bidding for, and acquiring, contracts at below their cost price. As outlined above, Carillion engaged in the policy of under-bidding for contracts so as to guarantee revenue[739]. Whilst a poor policy to adopt, and *prima facie* transactions at an undervalue owing to the fact that they are below market value, they are unlikely to be viewed as being *significantly* below market value. Whilst it is true that several were entered into at below cost price[740], the difference between the cost and projected contract price is unlikely to be easy to be proven and subject to fierce challenge. Moreover, given the position Carillion was in, and its need for revenue to cover existing liabilities, it is probable that the s238(5)(a) defence would also be applicable on the ground that acquiring some revenue, even at below cost price, was better than not acquiring the contract in order meet the existing liabilities. Furthermore, it is likely that Carillion would be able to argue that although some contracts were unprofitable, others were, and that those profits could cover the shortfall on the loss-leading contracts. Hence, it is unlikely any s238 claim would be successful owing to the procedural limitations of s238 and subjective beliefs of Carillion's board.

Section 2.3: Transactions Defrauding Creditors

The final anti-deprivation provision that may be available to Carillion's creditors is transactions defrauding creditors, set out in s423 Insolvency Act 1986. S423 applies where a transaction has been entered into that was at an undervalue and the intention behind the transaction was to place the asset out of the reach of any creditors who may have had a claim against the now insolvent company. Chapter 3 concluded, however, that s423's requirement that a transaction be at an undervalue results in the same uncertainties as outlined in relation to s238 above[741]. Furthermore, by requiring that the substantial 'purpose'[742] of the transaction was to place the asset beyond the reach of the company's creditors, the claimant must prove that the company *intended* to place the asset beyond

[739] Richard Howson, former Chief Executive, Carillion, giving oral evidence to the House of Commons Business, Energy and Industrial Strategy and Work and Pensions Committees on 6th February 2017: http://data.parliament.uk/writtenevidence/committeeevidence.svc/evidencedocument/work-and-pensions-committee/carillion/oral/78103.pdf
[740] *Carillion: Second Joint Report,* (No.663) at 42
[741] Finch V and Milman D, *Corporate Insolvency Law,* (No.6) at 493
[742] *Random House UK v Allason* [2008] EWHC 2854 (Ch)

their reach, rather than merely achieving that result[743] - which is problematic for liquidators to achieve owing to the evidential limitations.

However, in *BTI 2014 LLC v Sequana*[744], there is potentially an example of how a successful s423 claim could be made out, particularly in relation to the payment of dividends shortly before a company enters insolvency. The facts of *Sequana* illustrate this potential. The appeal focused on the payment of two dividends in December 2008 and May 2009, totalling €580 million. The company declaring the dividends had ceased trading and the purpose of declaring them was to enable the parent company to sell the subsidiary declaring the dividend and remove the liability from the group's balance sheet. The parent company had lent €585 million to the subsidiary, and the dividends were used as set off against this debt. However, the subsidiary company also had substantial, but undefined, liabilities relating to clean up costs over river pollution in the United States.

It was held[745] that the December 2008 dividend payment was not caught by s423 on the basis that the parent company (which was making the corporate decisions) had not settled on the intention to sell subsidiary at that point, and the parent company had a well-known policy of standing by its subsidiaries[746]. Thus, the requisite purpose of a s423 claim had not been made out. However, in relation to the May dividend, it was concluded the parent company had settled on the policy of selling its subsidiary, of removing the subsidiary's clean-up costs liability from the group and generally wished to be free of a 'very hair situation'[747]. It was therefore held that as the purpose of the May dividend was to enable the sale of the subsidiary and reduce any potential liability, the requisite purpose of putting the subsidiary's assets beyond the reach of its creditors had been formulated, and the dividend was a transaction defrauding creditors. Moreover, it was also concluded that a dividend is capable of being a transaction at an undervalue on the basis that it is a transaction, and that like gifts, there is no need for the transaction to be bilateral in nature[748].

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743 *IRC v Hashmi* [2002] 2 BCLC 489
744 [2019] EWCA Civ 112
745 The Court of Appeal judgment is subject to appeal to the Supreme Court
746 [2019] EWCA Civ 112 at 68
747 Ibid, at 70
748 Ibid, at 58

In the context of Carillion, *Sequana* potentially puts the last dividend payment in June 2017 within the remit of s423. As seen in *Sequana,* where a dividend payment is made shortly before the company enters liquidation, it is potentially a transaction defrauding creditors. However, it must be noted that it is possible to distinguish between Carillion and *Sequana.* As noted above, Carillion issued the dividend as a result of a fixed and unwavering general policy that was intended to maintain confidence in the company and portray the company as being financially solid. Hence, its intention was overwhelmingly concerned with the preservation of the company. However, in *Sequana,* the intention was to minimise liability to the parent company and ensure that it, and not any potential creditors, would have access to the subsidiary's assets. It can therefore be seen that whilst *Sequana's* May dividend was concerned with ensuring access to the subsidiary's assets, Carillion merely intended the June dividend to maintain the appearance of financial security. Consequently, it is extremely unlikely that any court would conclude that Carillion's dividend intended to defraud it creditors, and instead was merely the biproduct of an unfeasible business strategy to keep the company operating.

Section 2.4: Personal Liability of Carillion's Directors

In addition to the anti-deprivation provisions, the personal liability provisions of the Insolvency Act may be applicable. Given the conduct of Carillion's directors, it is possible that Carillion's liquidator[749] could potentially initiate proceedings to increase the size of the asset pool that is eventually made available to the unsecured creditors. Indeed, such was the nature of the conduct of Carillion's board that the Select Committee expressly raised the possibility of Carillion's directors having breached the wrongful trading provision[750].

Section 2.4(a): Fraudulent Trading

As set out in Chapter 3, under s213 Insolvency 1986, should the business of the now insolvent company have been carried on with the intent to defraud creditors, or for any fraudulent purpose, the court can declare that any individuals who were knowing

[749] S213 Insolvency Act 1986
[750] S214 Insolvency Act 1986

participants to the fraudulent trading must make a contribution to the company's assets[751]. However, following *Morphitis,* the liquidator must prove the intention to defraud and the fraud separately. This means that the mere fact that the transaction did defraud is insufficient[752], and instead the liquidator must also prove that the defendant actively intended to defraud. Given the issues associated with proving a defendant's subjective intention, s213 has an almost impossible evidential barrier to be effectively litigated.

Within the context of Carillion, it is unlikely that the board's actions amounted to fraudulent trading. As concluded above, although the policy of declaring large and unsustainable dividends was a poor business policy, it was not intended to fraudulently place assets beyond the reach of creditors and neither had the board turned a 'blind eye'[753]. Moreover, given that Carillion continued to pay its creditors as the debts became due, it is unlikely that Carillion would be found to have acted fraudulently as they did not realise that the debts could not be paid as they fell due until they had insufficient assets to pay them, thereby not falling within the *R v Grantham*[754] ground of fraudulent conduct that they had realised debts could not be paid as they came in. Hence, it is unlikely that the board of Carillion would be liable for breaching s213.

Section 2.4(b): Wrongful Trading

The final possible protection for Carillion's unsecured creditors is wrongful trading, a potential liability the Select Committee raised in its report[755]. Set out in s214 Insolvency Act 1986, wrongful trading occurs where prior to the company entering insolvency, the director(s) of the company knew or ought to have concluded that there was no prospect of the company avoiding liquidation, and continued to trade at the expense of the company's creditors. The liquidator is thereby required to prove the 'moment of truth'[756] – that the defendant realised, or ought to have realised, the company was beyond rescue and thus ceased trading.

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[751] Van Zwieten K, *Goode,* (No.13) at 758
[752] *R v Woolin* [1998] 3 WLR 382 at 389
[753] *Manifest Shipping v Uni-Polaris Shipping* [2003] 1 AC 469
[754] [1984] 2 All ER 166
[755] *Carillion: Second Joint Report,* (No.663) at 66-67
[756] Fletcher I, *The Law of Insolvency,* (No.62) at 836

In determining whether the 'moment of truth' has occurred, the easiest factor, as seen in *Rubin*[757] and *Roberts*[758], indicating that the director should be aware that there was no prospect of the company avoiding liquidation is should the company repeatedly fail to find the necessary funds to discharge debts as they become due[759]. Where there is no clear trigger for directors having the requisite knowledge, liquidators will be compelled to analyse the available evidence, including cash flow forecasts, the loss of employees, contracts and denials of credit[760]. This is in tandem with having to prove that the directors had no legitimate grounds for believing that the company may have a turn in fortunes[761]. Consequently, proving that the moment of truth has occurred, in all but the clearest of cases, is extremely difficult for liquidators to achieve.

In the context of Carillion, the Select Committee report considered that the 'moment of truth' potentially occurred in January 2018, when the Government refused to provide the guarantees necessary to keep Carillion operating[762]. They reasoned that despite Carillion having negotiations with the Cabinet Office, the board could not have realistically relied on the Government providing the necessary guarantees, given that it was clear Government policy that they would not provide private sector bailouts. They therefore concluded that the directors were aware that 'only a bailout from Government could save the company'[763] from January 2018. Given this, they proffered that necessary ingredients for wrongful trading could have been present.

It is submitted that whilst they were correct to acknowledge that Carillion's board became aware that the company could not survive after January 2018, this was insufficient to constitute wrongful trading. The first reason is that the board could argue that they had a genuine belief that the Government would provide the necessary guarantees. This is founded on the basis that given Carillion operated a large number of key public sector contracts – contracts that were vital to providing public services – it is plausible that the Government would provide some assistance to ensure their continued operation. Whilst

[757] *Rubin v Gunner and another* [2004] BCC 684
[758] *Roberts (Liquidator of Onslow Ditching Ltd) v Fröhlich* [2011] EWHC 257 (Ch)
[759] Finch V and Milman D, *Corporate Insolvency Law,* (No.6) at 599
[760] Katz and Mumford, *Making Creditor Protection Effective,* Centre for Business Performance, ICAEW, 2010) Chapter 5;
[761] S214(2) Insolvency Act 1986; *Singla v Hedman* [2010] EWHC 902 (Ch)
[762] *Carillion: Second Joint Report,* (No.663) at 66-67
[763] Ibid, at 67

this might not have been a full bailout, it may have been enough to satisfy the existing lenders. Given that the Government were engaged in talks for several days[764] with Carillion, the directors had valid, objective grounds to believe that continued financial support may have been provided[765]. It was only after these negotiations came to nothing that it would have been unreasonable to truly believe financial relief would not have been available. Secondly, it is also unlikely that wrongful trading occurred as Carillion did, on the day that it entered liquidation, have £29 million in cash[766]. Hence, when it entered insolvency it could still (for a very brief time period) continue to pay its debts as they became due, and so the 'moment of truth', unlike in *Rubin* and *Roberts,* did not occur. Instead, Carillion entered liquidation and ceased trading when it reached this stage, thereby ensuring that creditors did not suffer any avoidable losses and that wrongful trading did not probably occur.

Part 2:

Case Study 2: British Homes Stores (BHS)

Section 3: BHS and its Entry into Insolvency

This chapter's second case study is of British Homes Stores (BHS), a company that infamously stopped trading in August 2016 when it entered insolvency as a result of mounting debts and poor trading performance. Its collapse led to 11,000 jobs being lost and £1.3 billion being owed to creditors[767]. One in four stores also remain vacant, 4 years after its collapse[768].

[764] Davies R, *Carillion Crisis: UK Government Locked in Last-Ditch Rescue Talks,* The Guardian 14th January 2018 - https://www.theguardian.com/business/2018/jan/14/carillion-crisis-government-locked-last-ditch-rescue-talks
[765] Simmons M, *Wrongful Trading,* [2001] Insolvency Intelligence 12 at 13
[766] The House of Commons Library, *Briefing Paper,* (No.662) at 9
[767] Hudson A, *BHS and the Reform of Company Law,* (2016) 37 Company Lawyer 364
[768] Simpson E, *One in Four BHS Stores Remain Vacant Four Years After Collapse*, BBC News 30 August 2020 - https://www.bbc.co.uk/news/business-53918891

This section will therefore briefly outline BHS' history and the reasons for BHS' eventual failure. It will then analyse and illustrate how the existing anti-deprivation and personal liability provisions have failed to protect creditors.

Section 3.1: BHS' Early History and Purchase by Sir Philip Green

British Home Stores (BHS) was founded in 1928 by US entrepreneurs. Despite initially wishing to replicate Woolworth's six-pence business model[769], the price ceiling was doubled to one shilling, and subsequently to five shillings[770]. This permitted the company to branch out and offer goods Woolworths could not, such as home furnishings.

Following the Second World War, the company abandoned its strict price business model and adopted a looser relationship with cost, permitting the five-shilling price limit to be ignored where pertinent. Such was the success of this strategy, that by the end of 1960s, BHS had 94 stores and 12,000 employees. In the 1970s BHS established itself as a true department store, and by 1980, the company had managed to increase revenues and income to £366.4 million and £41.8 million respectively[771]. This increase was primarily attributed to contained costs, rather than by growing actual sales, however.

By the 1980s, sales began to slump, and to safeguard the business it merged with Habitat/Mothercare plc in 1986, to create Storehouse plc[772]. Using the expertise of Habitat's founder, Sir Terence Conran, BHS once again remodelled its image to appeal to younger consumers. However, this was not successful, and alienated its core and older consumer base, resulting in a fall in sales, with profits plummeting to £11.3 million by 1989[773]. During the 1990s, a number of CEOs were appointed in short succession, however, profits substantially increased, rising to £77.4 million by 1996.

From BHS' early history, it is apparent that despite being buffeted by the prevailing economic climate, and occasionally pursuing misdirected business strategies, the

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769 https://www.bbc.co.uk/news/business-36436576

770 Warnby G, *Storehouse,* [1993] 21(3) International Journal of Retail Distribution and Management 27 at 27

771 http://www.fundinguniverse.com/company-histories/bhs-plc-history/

772 Warnby G, *Storehouse,* (No.770) at 29

773 Ibid, at 32

company enjoyed a prolonged period of economic stability. Even in the company's least successful period at the end of the 1980s, it was still able to declare a profit of £11.3 million. Moreover, BHS was able to reinvent itself on a number of occasions, meaning it continually met the shopping habits of consumers and remain a fixture, if not spectacular household brand, on the high-street as a public company[774].

BHS' trajectory and management culture would radically change with Philip Green's acquisition of the company in 2000. Sir Philip, as he would later become, was able to acquire BHS and make it part of his sprawling retail group for £200 million, although this headline figure belied the fact that the company had £44.78 million in cash reserves, meaning the true cost was just over £150 million[775].

Section 3.2: The Performance of BHS under Sir Philip Green's Ownership

Initially, it appeared that the takeover of BHS by Sir Philip Green had led to a turnaround for the company, revitalising its profitability[776]. Indeed, in the early years following the takeover (2002-2004), profits were £208 million[777]. This led the Select Committee investigating the eventual collapse of BHS to conclude that "The improvement in BHS's profitability in the early years of Sir Philip's tenure is indisputable."[778]

However, despite the increase in profits, turnover stagnated. As seen in Figure 5, apart from a small increase in 2009, BHS' turnover did not increase. Instead of increasing turnover, the increase in profits was achieved through cost-cutting measures and squeezing suppliers[779]. Consequently, rather than BHS growing organically during Sir Philip Green's tenure, the company's size and resources remained the similar to those before the takeover.

Figure 5[780]:

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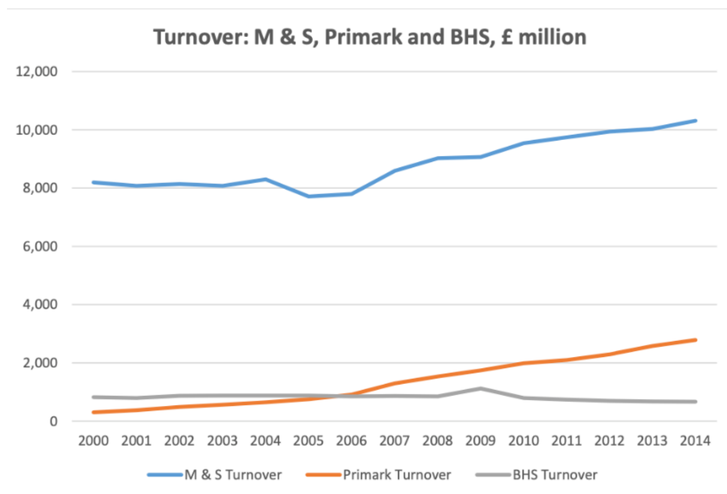
[774] Hudson A, *BHS,* (No.767) at 365
[775] Ibid, at 367
[776] House of Commons Work and Pensions and Business, Innovation and Skills Committees, *BHS,* (2016) HC 54 at 5
[777] Ibid, at 5
[778] Ibid, at 6
[779] Ibid, at 6; Hudson A, *BHS,* (No.767) at 367
[780] Ibid, at 7



Exacerbating this stagnation was the policy concerning dividend payments[781]. Whilst BHS did make a profit of £208 million during 2002-2004, it declared dividends of £414 million for the same period[782] – almost double the level of profit. Although Sir Philip defended the dividends by suggesting that they be viewed in the context of 2002-2004 (when BHS was profitable), which must be acknowledged is a legitimate consideration, by removing more money than the company was making in profit, it was ensured that BHS' cash reserves were being depleted[783]. The knock-on effect was that when BHS entered a sustained period of decline in the early 2010s, it did not have the financial resources to fund or implement a turnaround strategy. This is illustrated in Figure 6, which evidences that in the 13 years between Sir Philip's takeover and BHS' eventual sale in 2014, net assets swung from a net positive of £228.8 million in 2001 to a net deficit of £323.0 by 2014.

Figure 6[784]: BHS' Balance Sheet 2001-2014

[781] This potentially amount to a breach of s830 Companies Act 2006, which states a company may only pay dividends out of realised profits. The dividend may, therefore, have been unlawful and *ultra vires*.
[782] Ibid, at 5
[783] Ibid, at 5
[784] Ibid, at 6

		£ million
	2001	2014
Total assets	501.0	295.3
Total liabilities	-205.4	-551.6
Net assets:	295.6	-256.3
of which:		
Share capital	66.7	66.7
Accumulated reserves	228.8	-323.0

Source: BHS Company Accounts

Section 3.3: Divestment of Property from BHS s

Other than through the declaration of dividends, longer term mechanisms for divesting BHS of assets included the charging of 'fees' for services[785]. This involved companies ultimately owned by the Green family charging BHS for services including administration and distribution. In 2013, for example, companies owned by the Greens received £58 million in payment[786]. The Green family were also able to divest assets through bonds, with one bond of £19.5 million and paying out 8% interest per annum[787] ultimately being held by Sir Philip's wife[788]. This was later redeemed for £28,975,000 and resulted in a profit of £9,475,000. In total, the process of charging fees to BHS extracted £595 million from the company[789] – assets that were extracted through legitimate, but ultimately injurious, means and indirectly received by Sir Philip Green and his family and not available to creditors.

The final substantial means utilised to divest assets from BHS was through the outright sale of property[790]. This was demonstrated by the sale of several BHS stores to Carmen

[785] Hudson A, *BHS,* (No.767) at 368
[786] *Financial Times*, 28 April 2016, *How Much Money Did The Greens Make*?: https://www.ft.com/content/0e291562-0d52-11e6-b41f-0beb7e589515
[787] *BHS,* (No.776) at 40
[788] The bond was held by Tacomer Ltd, which was also ultimately owned by Lady Green
[789] *Financial Times*, 28 April 2016, *How Much Money Did The Greens Make?*: https://www.ft.com/content/0e291562-0d52-11e6-b41f-0beb7e589515
[790] Letter from Lady Green to the House of Commons Work and Pensions and Business, Innovation and Skills Committees, 4th July 2016 - https://www.parliament.uk/documents/commons-committees/work-and-pensions/Correspondence/Lady-Cristina-Green-response-to-committees-04072016-Redacted.pdf

Properties Ltd – a company owned ultimately by Lady Green. Ten stores were included in the transaction, and BHS received £106 million. Whilst the moneys received were accounted for as profit, BHS continued to operate from those stores, and thereby paying rent to Carmen. By the time the properties were resold to BHS in 2014 for £70 million as part of BHS' overall sale, it had paid £153 million in rent. In another transaction, land was sold to another company ultimately owned by Lady Green, Mildenhall Holdings Ltd[791]. Between 2005 and 2012, as BHS was still making use of the property, £2.7 million was paid to Mildenhall in rent. Consequently, whilst BHS may have received the market value of the its assets, by charging it rent for the continued use of stores sold, the Green family were eventually able to extract more from BHS than they provided in purchase moneys.

Section 3.4: The Sale of BHS

By 2014, the financial position of BHS made it undesirable for Sir Philip to keep it as part of his retail empire[792]. One reason, explored in detail below, was the pension deficit of £139 million[793]. Adding to this undesirability, BHS "had been loss making for a number of years, and suffered from a poor market position, expensive lease arrangements…"[794] This meant that by 2014 BHS was, at best, a going concern that credible buyers would be wary of taking on.

The perilous state of BHS is indicated in the parties who seriously considered purchasing the company. The first serious buyer was Paul Sutton. However, despite drawing up a business plan entitled 'Project Albion', Mr Sutton's history of bankruptcy and fraud conviction[795], and use of Sir Philip's name 'as a reference in Monaco' – a personal affront that risked his personal reputation – meant that 'Project Albion' was aborted[796].

[791]*BHS,* (No.776) at 39
[792] This had been renamed as Arcadia in 2009
[793] Hudson A, *BHS,* (No.767) at 369
[794] *BHS,* (No.776) at 22
[795] *BHS,* (No.776) at 22
[796] Ibid, at 22

On Mr Sutton becoming an unviable candidate, a new candidate, Dominic Chappell – Mr Sutton's former driver and later associate[797] - was able to come to the fore[798]. Mr Chappell presented a business plan to Sir Philip that would involve purchasing BHS for £1 without any debt or pension liabilities. However, Mr Chappell "had scarcely, if any, more credibility than Paul Sutton as a suitable buyer for BHS"[799] due to having been declared bankrupt (which Sir Philip was aware of), having no retail experience and, as later reported, having been compelled to leave a venture after it was found he had divested the company of £315,000 for his personal use[800]. Mr Chappell did, however, have two key characteristics: he had not been found guilty of a crime and had not attempted to use Sir Philip's name for personal advantage in Monaco[801].

As part of Mr Chappell's proposal for purchasing BHS from Sir Philip Green, it was stated that Retail Acquisitions Limited[802] (RAL) would provide £120 million of working capital and £35 million of equity[803]. The working capital, rather than being a "£120 million term loan facility" secured on BHS property, was later established as being merely 3, £40 million tranches, that were available once the previous tranche had been repaid. Hence, it was fundamentally a £40 million rolling loan – three times smaller than actually proposed. Even more problematic, however, were the conditions imposed on the rolling credit arrangements – conditions that meant "no one reading those letters…would believe that finance was available [...] the conditions could not be met".[804] Thus, in reality, the proposed working capital that RAL was to rely on was never truly available, and was indeed merely a mirage to cloak a lack of funding.

Section 3.5: Revised Terms of Sale

In addition to the illusory nature of the working capital, Mr Chappell was also unable to acquire the £35 million of equity needed to meet the terms of the takeover, despite

[797] Ibid, at 23
[798] Ibid, 23: "as Mr Sutton "stepped back" from BHS, "Dominic stepped forward"
[880] *BHS,* (No.776) at 23
[800] Ibid, at 23
[801] Ibid, at 24
[802] The company set up by Mr Chappell to purchase BHS
[803] Ibid, at 31
[804] Stephen Bourne, former director of RAL; Work and Pensions Committee & Business Innovation and Skills Committee, *Oral Evidence: Pension Protection Fund and Pensions Regulator* HC 55, Wednesday 8 June 2016

'frantically looking for it'[805]. To surmount the lack of funding, it was proposed that Marylebone House, which was owned by Wilton Equity Ltd[806], should be purchased by Mr Chappell for £35 million and be immediately sold for £45 million[807] – ensuring that there would at least be £10 million in equity. However, even this imaginative financing method failed to come to fruition owing to Marylebone House eventually being sold to the Arcadia group for £53 million[808]. Instead, Sir Philip was compelled to organise the finance himself, and involved a loan from HSBC guaranteed by Arcadia[809].

Even more problematic was the reality of BHS' and RAL's financial position on 'day one' of the takeover being completed. Officially[810], BHS was to have £94 million in 'cash and facilities'[811], including the £24 million loan facility arranged with HSBC. Sir Philip also agreed to write off the majority of inter-company debt between BHS and Arcadia[812] in return for a £40 million secured loan[813]. However, as established, this too was illusory owing to substantial liabilities shortly coming due[814]. From the revised terms of RAL's takeover and the 'true' financial position of BHS on 'day one' of the takeover, it is clear that RAL did not have the necessary financial resources to purchase BHS – let alone have sufficient resources to prop up a going concern that was in a parlous financial position. Hence, given this financial blackhole, it was guaranteed that once RAL became the owners of BHS, it would be necessary to sell assets and incur debts to keep the company operating – a strategy that would assure BHS' demise.

Section 3.6: BHS under RAL and the Disposal of BHS' Assets

As outlined above, Sir Philip Green's primary motivation for selling BHS was its poor financial performance and greatly diminished asset pool. Given these factors, and that

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[805] Ibid
[806] A company controlled by the Green family
[807] *BHS,* (No.776) at 33
[808] Ibid, at 33
[809] Ibid, at 33
[810] The ultimate owners of the Arcadia Group
[811] *BHS,* (No.776) at 34
[812] £216 million - The Pensions Regulator, *Regulatory Intervention Report: Issued under section 89 of the Pensions Act 2004 in Relation to the BHS Pension Schemes*, June 2017 at 20
[813] *BHS,* (No.776) at 36
[814] *BHS,* (No.776) at 36

BHS was a clear going concern, RAL needed to implement a far ranging and comprehensive turnaround strategy to return it to sustainable profitability.

The main threat to sustainability was the uncompetitive rents it was paying for its stores, making a number of stores wholly unprofitable[815]. Prior to the takeover by RAL, Sir Philip Green's high-profile personal wealth acted as a strong deterrent in negotiations with landlords perturbed that they, rather than Sir Philip, should make economic sacrifices. In divesting BHS from the Arcadia group, it was hoped that RAL's ownership would enable these rent negotiations to become successful.

To return BHS to profitability, £26.7 million in savings related to stores and a further £23.9 million increase in revenues from 'trade initiatives' were required[816]. To achieve the required increases from the trade initiatives it was necessary to increase like-for-like sales by 1% and improve margins by a further 1%. However, rather than increasing sales, like-for-like sales fell by 0.2%[817] - further increasing the pressure to achieve property related savings.

The most high-profile property disposal was BHS' flagship Oxford Street store, which RAL were advised needed to be disposed of by September 2015 to provide a vital increase in working capital. However, even though the store was eventually sold in April 2016, it failed to provide the expected income – despite claims it had been sold for between £70-90 million, it was eventually sold for a mere £50 million, which was further reduced by £600,000 paid to RAL as a 'fee' for completing the transaction. Even more problematic, owing to the fact that the store had been used to secure a loan, none of the proceeds were received by BHS and were instead used to partly discharge the secured debt[818]. Consequently, the flagship policy of providing BHS with the necessary working funds – the sale of its flagship store – failed to provide the company with any income.

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815 Ibid, at 47

816 BHS Business Plan, March 2015: https://www.parliament.uk/documents/commons-committees/work-and-pensions/Correspondence/BHS-plan-presentation-redacted.pdf

817 House of Commons Work and Pensions and Business, Innovation and Skills Committees, *BHS,* (2016) HC 54 at 48

818 Letter from Michael Hitchcock to the House of Commons Work and Pensions and Business, Innovation and Skills Committees, 12th June 2016: https://www.parliament.uk/documents/commons-committees/work-and-pensions/Correspondence/From-Michael-Hitchcock-1206216.pdf

Further property sales also occurred[819]. Stores in Carlisle and Colchester were sold in February and June 2016 respectively, and a store in Liverpool was sold for £17 million in November 2015. However, the Liverpool store had previously been used to secure a credit facility, and so none of the proceeds were made available to BHS itself. A further sale of the Southampton store in February 2016 for £7 million was also used to discharge a credit facility, and the sale of the Sunderland store for £2.4 million likewise saw the proceeds being used to partly discharge a secured loan. More alarming, however, were RAL's attempts to subtract £400,000 from the transaction in fees – although they were later returned upon challenge. Adding to financial problems was RAL's decision to purchase the Darlington store from its landlord for £2.4 million, substantially depleting RAL's already limited asset pool.

RAL was, however, able to successfully sell the Atherstone warehouse for £15 million. However, as RAL had secured £5 million to fund its takeover of BHS against the warehouse, £5 million, plus a further £2.2 million in interest and fees, was used to discharge RAL's secured loan. RAL also took a further £200,000 from the transaction in 'fees'. Thus, only £7.2 million (representing all of the profit made from the property disposals) was received by BHS to contribute to the working capital[820]. It must also be noted that although BHS was eventually able to reduce the rents on its retained stores by around £30 million through a CVA[821], owing to the late date at which this occurred (March 2016), it was unable to affect BHS' hopes for survival.

Continuing with the policy adopted under Sir Philip's tenure as BHS' owner, RAL also extracted assets from the company by charging it fees for services provided. As seen immediately above, RAL charged fees relating the disposal of BHS' stores, although in a number of instances they were compelled to return the fees charged after pressure was applied. Other fees and salaries levied on BHS by RAL included £7 million to cover the payment of RAL's advisers and board members' transaction fees through the form of a

[819] Ibid.
[820] *BHS,* (No.776) at 49
[821] Letter from Mike Sherwood to House of Commons Work and Pensions and Business, Innovation and Skills Committees, 12th July 2016: https://www.parliament.uk/documents/commons-committees/work-and-pensions/Correspondence/Mark-Sherwood-response-12-07-2016.pdf

loan. Such was RAL's abuse of levying fees and taking out loans, it was estimated that £11 million in fees and £12 million in loans were levied against BHS, with only £6 million being repaid by the time of BHS' entrance into insolvency[822]. Hence, RAL was able to remove £17 million from BHS – further weakening its already precarious financial position and removing much needed working capital.

Examples of the fees charged by RAL can be seen in transactions involving Mr Chappell directly. He personally received a total of £2.6 million in salary and fees[823], and also benefited from a £1.5 million interest free loan that was never repaid[824] and a further £90,000 personal loan[825]. Further activity included an attempted transfer of £1.5 million to BHS Sweden (not part of the actual BHS Group), which was owned by Mr Chappell's long-term friend. This attempted transaction occurred the day before BHS would eventually enter insolvency. Notwithstanding the moneys' eventual return after intervention, £50,000 was not returned, and again illustrates RAL's policy of depleting BHS' assets through fees and loans, leaving it with little in the way of working capital or substantial assets.

From RAL's actions as owners of BHS it is apparent that their business 'plans' failed to alter the company's performance and ultimately led to its demise. Firstly, despite plans to increase sales by 1%, sales in fact fell by 0.2% - 1.2% below the growth forecasted as being necessary to sustain BHS has a viable business. Moreover, by decreasing, rather than increasing sales, greater pressure was placed on plans to dispose of BHS' property to generate the necessary working capital. However, the properties sold, apart from one

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[822] Letter from Michael Hitchcock, (No.818)

[823] Letter from Dominic Chappell to House of Commons Work and Pensions and Business, Innovation and Skills Committees, 10th June 2016: https://www.parliament.uk/documents/commons-committees/work-and-pensions/Correspondence/Dominic-Chappell-to-BIS-and-Work-and-Pensions-Committees-10-June-2016.pdf

[824] Ibid; Letter from Edward Parladorio the House of Commons Work and Pensions and Business, Innovation and Skills Committees, 14th July 2016: https://www.parliament.uk/documents/commons-committees/work-and-pensions/Correspondence/From-Edward-Parladorio-14-07-2016.pdf

[825] Although this was repaid within 10 days after legal advice was taken - Letter from Darren Topp to House of Commons Work and Pensions and Business, Innovation and Skills Committees, 21st June 2016: https://www.parliament.uk/documents/commons-committees/business-innovation-and-skills/Correspondence/2015-20-Parliament/From-Darren-Topp-re-BHs-collapse-21-06-2016.pdf

exception, failed to provide BHS with any increase in working capital as the proceeds were almost exclusively used to discharge secured loans. Whilst these disposals did thereby minimise any impact on BHS' secured creditors, it failed to increase its working capital – indeed the purchase of the Darlington store actually decreased BHS' working capital. This decrease was compounded by the continuation of the policy adopted by Sir Philip Green of charging BHS fees and requiring the company to grant loans that personally benefited members of RAL – removing £17 million from BHS in the process. Through these actions RAL ensured that BHS would eventually enter into a position where it would have insufficient assets to continue trading and would be compelled to enter insolvency[826].

Section 3.7: BHS Pension Scheme

Finally, BHS' pension schemes were also problematic – issues that neither Sir Philip nor RAL sought to effectively remedy. BHS' pension schemes had 19,000 members[827] and were managed by a board of trustees that was separate from the company's commercial operations[828]. As illustrated in Figure 7, in 2000, when Sir Philip completed his takeover of BHS, the pensions schemes had a combined surplus of £43 million. However, within 6 years, this had become a net deficit of £7 million. By the time of BHS' eventual sale to RAL, the pension deficit stood at £345 million.

Figure 7: Trends in BHS Pension Surplus/Deficits[829]

[826] *BHS,* (No.776) at 51, 53
[827] The Pensions Regulator, *Regulatory Intervention Report: Issued under section 89 of the Pensions Act 2004 in Relation to the BHS Pension Schemes*, June 2017 at 7
[828] *BHS,* (No.776) at 51, 10
[829] Ibid, at 10

Pension surplus/deficit, £ million
Data from triennial actuarial valuations at 31 March

	Main scheme	Senior scheme	**Total**
2000	26	17	**43**
2003	12	16	**28**
2006	-19	11	**-7**
2009	-148	-18	**-166**
2012	-211	-22	**-233**
2015	-315	-30	**-345**

Source: BHS pension trustee minutes, 27 Sep 2000, 21 May 2003, 16 Aug 2006, 29 June 2010, 24 July 2012, 19 May 2015
Note: 2015 valuation has not yet been finalised.

The Select Committee concluded that the cause of BHS' pension schemes deficit was Sir Philip's refusal to make the necessary contributions to maintain the schemes' sustainability[830]. This was despite a written request from the chair of the board of trustees for assurance of long-term commitments to the pension schemes[831]. In reply, it was stated that rather than make contributions to the pension scheme, it was more lucrative to invest in the business[832]. Given the conclusions reached above that rather than invest in BHS, Sir Philip removed BHS' assets through dividends and the charging of fees, necessary pension scheme contributions were not made so as to increase the assets that could be removed from BHS. This ensured that should BHS enter into financial difficulties, the pension scheme would be unable to pay its members' promised returns. Indeed, the level of Sir Philip's wish not to contribute sufficient amounts to the pension schemes is seen in his lobbying of the then Pensions Minister, where he put his desire to reduce his pension liabilities in a "rather aggressive manner"[833]. Although attempts were made to address the

[830] Ibid, at 11; see also BHS Pension Trustee Minutes, 11th June 2002, 24th November 2006, 13th February 2007, 26th August 2009 - https://www.parliament.uk/documents/commons-committees/work-and-pensions/BHS-pension-scheme-minutes-27-September-2000.pdf

[831] Letter from Dr Margaret Downes to Paul Coackley, 29th August 2005 - https://www.parliament.uk/documents/commons-committees/work-and-pensions/Correspondence/BHS-trustee-minutes-15022006-incl-Downes-letter-29082005.pdf

[832] BHS Pension Trustee Minutes, 20th November 2007 - https://www.parliament.uk/documents/commons-committees/work-and-pensions/Correspondence/BHS-trustee-minutes-15022006-incl-Downes-letter-29082005.pdf ; 25th November 2008 - https://www.parliament.uk/documents/commons-committees/work-and-pensions/Correspondence/BHS-trustee-minutes-15022006-incl-Downes-letter-29082005.pdf

[833] Letter from Rt Hon Steve Webb to the House of Commons Work and Pensions and Business, Innovation and Skills Committees, 13th June 2016 - https://www.parliament.uk/documents/commons-committees/work-and-pensions/Correspondence/From-Steve-Webb-13-06-2016.pdf

deficit[834], these were insufficient[835] and were eventually called off as it was concluded that that making the pension schemes self-sufficient was too costly and that a sale of BHS was preferable[836].

Upon the eventual sale of BHS to RAL, the annual £10 million contributions agreed in 2012 were to be guaranteed for 3 years, with Taveta and RAL meeting the obligation equally[837]. However, no plan or promise was made for the period following the initial three years, although RAL were, along with plans for raising sufficient working capital, unable to competently draw up a rescue plan for the pension schemes[838] – resulting in the eventual deficit of £345 million.

Section 3.8: Overall Conclusion:

From the above analysis it is clear that BHS entered insolvency as a consequence of prolonged mismanagement, with the primary issue being the adoption of several poor business strategies. Under the ownership of both Sir Philip Green and RAL, BHS failed to increase turnover to a level necessary to sustain its viability and cover its expenditure. Whilst in the early years of Sir Philip's tenure of ownership profitability was achieved through reducing costs, revenues actually decreased – resulting in less money flowing through the business and making it harder to cover liabilities. Under RAL, although they sought to instigate a turnaround plan, this required them to increase sales by 1% - something they failed miserably to achieve, and instead caused sales to decrease by 0.2%. This in turn resulted in additional pressure on the company's working capital, and precipitated an urgency to dispose of more of BHS' assets to enable it to continue covering liabilities.

As noted above, the declaration of dividends that exceeded BHS' profits during Sir Philip's ownership exacerbated the issue of flatlining revenue, as it stripped cash reserves

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[834] *BHS,* (No.776) at 11-12

[835] "This was an extraordinary length of time to recover a scheme in distress." *BHS,* (No.776) at 12

[836] *BHS,* (No.776) at 13

[837] Ibid, at 16

[838] Ibid, at 17-19; Safari N, Gelter M, *British Home Stores Collapse: The Case for an Employee Derivative Claim,* (2019) 19(1) Journal of Corporate Law Studies 43 at 49

from BHS, further reducing its working capital.[839] Moreover, the fees and rents charged to BHS by companies controlled by both the Green family and RAL added to this, removing additional assets from BHS' working capital and weighing down profits. Finally, RAL's failure to dispose of stores in a prompt enough manner ensured they were compelled to pay unsustainable rents on unprofitable stores, and by disposing of stores that had been provided as security for loans, very little of the proceeds were actually received by BHS to improve its working capital position.

Whilst much of the blame for BHS' demise must be placed on the failed business model that resulted in insufficient revenue coming into BHS and assets being stripped from the company, blame must also be attributed to the owners of BHS from 2000-2015. It was Sir Philip Green who instigated the policies of removing assets from BHS through excessive dividends and the charging of fees which, as noted above, ensured that BHS did not have sufficient working capital to be self-sufficient. Moreover, it was Sir Philip who elected not to fund BHS' pension schemes to a sufficient level, and it was Sir Philip who, in a desperation to dispose of BHS, did all in his power to facilitate its sale to an unsuitable purchaser – RAL and Dominic Chappell. Whilst RAL failed to turn around BHS and were also a large cause of BHS' demise, for the most part they merely continued and expanded upon policies instigated by Sir Philip.

Hence, through the accumulated effect of these actions by BHS' successive owners, the company was allowed to gradually decline both financially and as a retail brand, and when it eventually entered a period of crisis, had insufficient resources to initiate and sustain a turnaround strategy – evidenced by its eventual entry into insolvency shortly after agreeing a CVA with its creditors.

The impact of BHS' entry into insolvency has been stark. The immediate effect was the loss of 11,000 jobs in BHS itself[840], and although harder to quantify, the job losses in the supply chain will have been just as impactful[841]. However, the impact on the pension scheme has been minimised by the actions of the Pension Regulator following their

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[839] This potentially amounts to a breach of s830 Companies Act 2006, although this issue is outside of the scope of this thesis.
[840] *BHS,* (No.776) at 4
[841] Hudson A, *BHS,* (No.767) at 369

investigations into the pension schemes, with Sir Philip Green agreeing to contribute £364 million to the pension schemes[842], and Dominic Chappell being ordered to contribute £9.6 million[843]. This ensures contributors will receive 88% of the value of their scheme benefits[844].

However, it is BHS' unsecured creditors who have been most impacted by BHS' insolvency. Owing to the substantial debts incurred by BHS (£998 million[845]) to its creditors and, as seen above, the majority of BHS' properties being subject to charges, very little has been made available. Although the insolvency practitioners have been able to increase the size of the asset pool by agreeing with Sir Philip that a floating charge held by him over BHS' assets should be released[846], this only increased the assets by £36 million – a very small increase considering the size of the amounts owed. Indeed, this equates to a 3.63p interim dividend for unsecured creditors. Given that there will be no dividend from the Prescribed Part owing to BHS not having any floating charges over its assets[847], it is unlikely the final dividends will be bigger than the interim dividend given the limited assets being disposed of by the liquidators[848].

Section 4: Application of Anti-Deprivation and Personal Liability Provisions

Owing to the conclusions reached in Section 3 of this chapter, and the clear impact that the actions of Sir Philip Green and RAL have had on BHS' creditors, as with Carillion, it is necessary to consider whether any of the remedies outlined in Chapter 3 offer mechanisms through which this impact could be reduced. Due to Sir Philip owning BHS through his control of Taveta within the two-year period (the relevant time) before BHS entered insolvency[849], although he did not own BHS at the time of its insolvency, it is

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[842] The Pension Regulator, Nov 2018 - https://www.thepensionsregulator.gov.uk/-/media/thepensionsregulator/files/import/pdf/regulatory-intervention-section-89-bhs.ashx
[843] https://www.thepensionsregulator.gov.uk/en/media-hub/press-releases/2020-press-releases/dominic-chappell-ordered-to-pay-9-5m-into-bhs-pension-schemes
[844] The Pensions Regulator, *Regulatory Intervention Report: Issued under section 89 of the Pensions Act 2004 in Relation to the BHS Pension Schemes*, June 2017 at 35
[845] Kleinman M, 28th January 2018 - https://news.sky.com/story/bhs-creditors-get-36m-payout-two-years-after-chains-collapse-11226790
[846] Ibid.
[847] Notice of Progress Report in Voluntary Winding Up, *SHB Realisations Ltd (Formerly BHS Limited),* January 2020 at 4
[848] Ibid, at 3
[849] Within the "relevant time" period for connected parties after a transaction was entered into

possible he may be liable under the Insolvency Act 1986 provisions[850]. As the remedies have been set out in detail in Chapter 3, and have been summarised by Section 2 in relation to Carillion, this section will merely analyse their applicability to BHS, and will not summarise the Insolvency Act 1986 provisions themselves. The Select Committee report itself called for the Insolvency Service to investigate, requesting that it look at the 'loans and fees removed from the company as well as questionable decisions…'[851]

Section 4.1: Preferences

The first set of actions by RAL that may constitute a preference are the sale of stores to third parties. It may be argued that because some of the stores were sold in the 6-month period before BHS entered insolvency, they constituted a preference. However, two factors prevent these sales from being preferences. Firstly, as these sales were entered into with unconnected parties[852] in order to try and raise working capital and limit liabilities on unprofitable stores, it is apparent that there was no *desire* to prefer the eventual purchasers of the properties[853]. Additionally, owing to all of the properties disposed of being subject to security interests, and the majority of the disposals only being used to cover existing liabilities, the recipients – the secured lenders - merely received the assets they would have been entitled to once BHS entered insolvency, as so were not placed in a better position than had the disposals not occurred.

Secondly, the fees by charged by RAL to BHS (excluding those relating to the disposal of BHS' properties) could also potentially constitute a preference. This primarily is because it is apparent, as the Select Committee concluded[854], that RAL sought to withdraw as many assets from BHS as possible, and ensure that their own position was improved. Hence, the requisite *desire* was present. However, in the context of preferences, it is unlikely that the fees charged would constitute a preference as they were charged for *services* provided – they were for services[855] that had RAL not provided them, they would have been provided by other parties. Given the contractual nature of the fees,

[850] S240(1)(a) Insolvency Act 1986
[851] *BHS,* (No.776) at 52
[852] Parties who were not creditors of BHS
[853] *Re MC Bacon,* (No.429) at 86
[854] *BHS,* (No.776) at 55
[855] It is likely that the need for these services would be deemed a commercial decision

and the need for the services provided, proving that RAL were placed in a better position than had the transaction not occurred would not be possible. This analysis would also apply to the fees charged by Sir Philip and his controlled companies, both prior, and subsequent, to the sale of BHS. Given that Sir Philip and his companies were providing services integral to BHS' operation (payroll, IT services etc), they were mere contractual agreements for services that would need to have been paid for, irrespective of the provider.

The fees charged by RAL for the disposal of BHS' properties cannot, however, be justified on the same grounds. As concluded by the Insolvency Service, RAL did not have the authority to legitimately charge BHS for these services, and the moneys (£1 million) rightfully belonged to BHS[856]. Notwithstanding the illegitimate nature of RAL charging the fees though, the charging of these fees, when not authorised to do, would not constitute a preference. Although RAL did have an intention to maximise their financial position from their ownership of BHS, as they are likely to have believed (even if negligently or recklessly) that they were entitled to the 'fees' when they imposed them on a BHS, it is probable that the requisite desire was not present for them to constitute a preference.

Also potentially constituting a preference is the attempted transfer of £1.5 million of BHS' assets to BHS Sweden. The Insolvency Service, as with fees charged for disposing of BHS' properties, concluded that RAL did not have the right to transfer the assets[857]. *Prima facie,* given the timing of the transfer - the day after BHS' board discussed entering administration – it is apparent it was an attempt to place a party in a better position had the transfer not occurred. However, neither the Select Committee nor the Insolvency service concluded that BHS Sweden was a creditor of BHS. Hence, given they were not creditors of BHS, s239 would not be applicable to this transaction as it limited to transfers made to creditors.

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[856] Insolvency Service, 5th November 2019 - https://www.gov.uk/government/news/former-bhs-director-disqualified-for-10-years; Jonathan Eley, Financial Times, 5th November 2019 - https://www.ft.com/content/e3fc8742-ffd3-11e9-be59-e49b2a136b8d

[857] Insolvency Service, 5th November 2019 - https://www.gov.uk/government/news/former-bhs-director-disqualified-for-10-years; Jonathan Eley, Financial Times, 5th November 2019 - https://www.ft.com/content/e3fc8742-ffd3-11e9-be59-e49b2a136b8d; Jonathan Eley, Financial Times, 29th January 2019 - https://www.ft.com/content/ccf3222c-42a4-11ea-abea-0c7a29cd66fe

The final potential preference was the £7 million loan to cover the fees payable to RAL's board members and advisers. However, whilst this too may *prima facie* appear to be a preference, as the loan enabled the advisers and board members to be paid with assets that would otherwise not be available, it could be submitted that the purchase of BHS could not have proceeded without the services provided by these parties. Given the need for BHS' sale and the removal of Sir Philip's personal wealth to enable rent renegotiations with its landlords, it may be submitted that BHS lacked the desire to prefer these creditors as the services provided fees charged were necessary to enable the transaction to be concluded. Hence, that loan is unlikely to constitute a preference.

Finally, in relation to the actions of Sir Philip, as with Carillion, it is unlikely the declaration of the dividends between 2002-2004 would constitute a preference. As with Carillion, given that the dividends were not declared to Sir Philip in his position as a creditor, they would not constitute a preference.

Section 4.2: Transactions at an Undervalue

Also potentially applicable to the actions of RAL and Sir Philip is s238 Insolvency Act 1986, and the transaction at an under-value provisions. Within the context of RAL's ownership, the set of actions that would *prima facie* be caught by s238 is the disposal of BHS' stores and the Atherstone warehouse. As noted in Section 3.6, this involved the sale of several BHS stores, including the flagship Oxford Street store – which was sold for between £20-40 million less than projected[858]. Notwithstanding the appearance of a large disparity between the originally stated and the actual sale price, it is unlikely that this transaction or the other disposals would fall foul of s238. The reasoning is that although the actual sale price was below the originally stated price, the delay in completing the transaction, and the known worsening of BHS' financial position, would have enabled the purchaser to negotiate on the price, thereby meaning that the true market value for a company in BHS' position[859] was closer to the £50 million eventually received.

[858] Letter from Michael Hitchcock to the House of Commons Work and Pensions and Business, Innovation and Skills Committees, 12th June 2016: https://www.parliament.uk/documents/commons-committees/work-and-pensions/Correspondence/From-Michael-Hitchcock-1206216.pdf

[859] A company desperately in need of funds to continue trading

Moreover, neither the Select Committee, the witnesses nor the Insolvency Service raised any concerns as to the value received for the other properties disposed of. Hence, subject to having detailed valuation reports for the property disposals, which are unavailable, it is unlikely the property disposals were at an undervalue.

However, the transfer of property to BHS Sweden would likely constitute a transaction at an undervalue. Given the lack of authority to transfer the £1.5 million, and BHS Sweden not providing any consideration for the assets, it is apparent that it would constitute a transaction at an undervalue given that BHS had discussed entering insolvency the day before the transaction was completed – meaning the company was already technically insolvent[860]. Despite the apparent breach of s238, given that all of the moneys transferred were recovered (minus £50,000)[861], any revestment of assets is likely to be small (£50,000), and be outweighed by the litigation costs.

Similarly, the disposal of BHS' properties under the tenure of Sir Philip Green may also have constituted transactions at an undervalue. Although the Select Committee report did not query the value received for the properties and whether they were below market value, it did raise concerns over the subsequent leaseback agreements that were entered into. Given that *Brewin Dolphin* confirmed that interconnected contracts should be considered as one for the purposes of determining whether market value was acquired[862], the leaseback agreements may have meant the transactions were at an undervalue. However, as with the disposal of property by RAL, it is unlikely that the disposal of property by Sir Philip constituted a transaction at an undervalue. This is primarily because although the sale and leaseback scheme may have been disadvantageous to BHS, and led to higher costs in the long-term[863], the transactions themselves appear *prima facie* to have been at commercially representative terms, with the Select Committee not criticising the terms of the transaction, and instead focussing on their long-term effects. Hence, it is probable that the transactions were at market value. Moreover, owing to the time of the transactions, which occurred in the early years of Sir Philip's tenure, even if the transactions were not at market value, they were outside the 2-year time limit for s238 to apply[864].

[860] See also Section 4.1(b) of this Chapter
[861] *BHS,* (No.776) at 51
[862] *Philips v Brewin Dolphin,* (No.467)
[863] As rent is generally higher than mortgage payments
[864] Ss239(2) and 240(1)(b) Insolvency Act 1986

Consequently, it is unlikely that any disposals of property undertaken by RAL or Sir Philip constituted a transaction at an undervalue.

The final possible transactions at an undervalue, the dividends declared by Sir Philip between 2002-2004, are unlikely to be a transaction at an undervalue. As with the dividends declared by Carillion, it is unforeseeable that the courts, even with the help of expert evidence, could correctly ascribe the correct value to the dividends owing them being pure business decisions and a true value being impossible to ascribe.

Section 4.3: Transactions Defrauding Creditors

More likely to be applicable is transactions defrauding creditors under s423.

Dealing first with RAL's actions, it is unlikely that the property disposals undertaken by RAL will constitute transactions defrauding creditors. Firstly, as concluded in Section 4.2, it appears that RAL was able acquire the market value of the properties that were disposed of, thereby preventing the transactions being at an undervalue. Secondly, owing to proceeds being distributed to secured creditors (minus any fees successfully charged by RAL), it is also apparent that as the assets were made available to creditors, there was no intention to defeat the claims of creditors.

Similarly, it is unlikely that the fees charged by RAL for services provided will constitute a transaction at an undervalue. As concluded in Section 4.1, it is probable, should additional evidence be obtained, that fees charged by RAL, owing to BHS' need for them to operate, were at, or reasonably close to, market value. Moreover, owing to BHS' need for the services provided, it is arguable that there was no intention of defeating the claims of creditors. Whilst it may be argued BHS could have acquired the services from alternative suppliers, and through RAL providing the services they were ensuring that they, and not other creditors, had access to BHS' assets, owing to the legitimate nature of the contract to provide the services[865] (even if undesirable from a business sense), it is unlikely that it could be successfully argued that they constituted an intention to defeat the claims of other creditors as they too were legitimate creditors.

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[865] Excluding the fees charged for the disposal of BHS' properties

As acknowledged in Sections 4.1 and 4.2, the two exceptions to the analysis immediately above are the fees charged by RAL for the disposal of BHS' assets and the transfer to BHS Sweden. Given the timing of the transfer to BHS Sweden – the day after discussions occurred to place BHS into insolvency – and the lack of consideration from BHS Sweden, it is almost unquestionable that the primary purpose of the transaction was to remove assets that would otherwise have been available to BHS' creditors, and so was a transaction defrauding creditors. Nonetheless, given that RAL are likely to have believed, even if mistakenly or negligently, that they were entitled to charge BHS for services in disposing of its properties, the requisite desire to defraud creditors, as opposed to maximising RAL's position, is unlikely to be present in regard to these fees.

Finally, it is also apparent that the actions of Sir Philip Green will not have constituted transactions defrauding creditors. As with RAL, given that the Green family companies were able to, *prima facie,* acquire the properties purchased from BHS at market price, and the subsequently entered into lease agreements for the properties sold also appear *prima facie* to have been for market value, it is unlikely that they constituted a transaction at an undervalue. Furthermore, given that BHS was solvent at the times of the transactions, it is also improbable that there was an intention of defeating the claims of legitimate creditors as they could have their debts adequately discharged. Moreover, as with the fees levied by RAL, owing to BHS requiring the services provided, and Sir Philip thereby being a legitimate creditor, it is unlikely the fees charged by Philip will constitute transactions defrauding creditors.

Section 4.4: Personal Liability of BHS' Directors

As with Carillion, the directors of BHS may be personally liable under the Insolvency Act for failing to act appropriately in the interests of creditors shortly before the company entered insolvency. Similarly to the directors of Carillion, given the conduct of Sir Philip Green during his tenure as a BHS director[866], and RAL's conduct[867] during their tenure as owners of BHS, it is possible that BHS' liquidator[868] may initiate proceedings against

[866] Appointment of Director, 288a Form, Mr Philip Nigel Ross Green, 14/03/2000
[867] Appointment of Director, AP01 Form, Mr Dominic Joseph Andrew Chappell, 11/03/2015
[868] S213 Insolvency Act 1986

these the former directors to compel them to make personal contributions to BHS' asset pool.

Section 4.4(a): Fraudulent Trading

Under s213, should the business of the now insolvent company have been carried on with the intent to defraud creditors, or for any fraudulent purpose, the court can declare that any individuals who were knowing participants to the fraudulent trading must make a contribution to the company's assets[869].

Dealing first with Sir Philip, it is necessary to divide their actions into two time periods: those in the early years of his tenure of ownership (2000-2014), and those in the lead up to the sale of BHS to RAL (2014-2015). The tenure of Sir Philip's ownership of BHS can be split into these two periods as, under the first, Sir Philip was actively involved in the fortunes of BHS and intended for it to remain a part of his retail group through his continued and almost unwavering support, whereas in the second he was seeking to actively sell the company and limit any liabilities.

Analysing the conduct between 2000-2014, it is unlikely that Sir Philip and the other directors' actions amounted to fraudulent trading as there was no intention to defraud. As concluded above in Section 3, Sir Philip was able to withdraw many of BHS' assets through the declaration of large dividends, the sale of BHS' properties and the charging of fees. However, whilst these actions undoubtably placed BHS in a poorer financial position with fewer assets, and greatly improved the financial position of the Green family, they were not intended to defraud creditors as when the actions occurred, and for a long period afterwards, BHS was still able to pay its creditors. Indeed, no evidence was submitted to the Select Committee to rebut the view that Sir Philip intended to honour BHS' debts during this period. Moreover, the loans made available to BHS by the wider Taveta group were primarily to enable BHS to continue meetings its liabilities – illustrating the continued intention of Sir Philip to meet BHS' liabilities.

[869] Van Zwieten K, *Goode,* (No.13) at 758

The second period of Sir Philip's tenure, 2014-2015, is also unlikely to be deemed as an instance of fraudulent trading. This is because, although, as concluded in Section 3, Sir Philip was fixed on his desire to dispose of BHS, it appears he never intended for BHS to fail to meet its liabilities. For whilst he sought to minimise his liability to BHS' debts by selling BHS, he attempted to ensure its continued survival under new ownership. Furthermore, given the actions of Sir Philip in personally facilitating RAL's acquisition of (some) working capital, and guaranteeing to make pension contributions for three years after ceasing to be BHS' owner, it is apparent that whilst he was not willing to continue taking liability for BHS' debts nor willing to continue providing all of the working capital required by BHS, there was no intention to defraud creditors. Moreover, the sale (and the removal of Sir Philip's assistance) was necessary to enable the renegotiation of BHS' rents to occur – the biggest liability for BHS and stumbling block to it achieving sustainability.

The actions of RAL during their tenure of ownership may, however, constitute fraudulent trading. Taking the disposal of BHS' properties first, as with the preference and transaction defrauding creditors provisions, it is unlikely that these actions constituted fraudulent trading. As concluded above, owing to the proceeds from the property disposals being (for the most part) used to partially discharge secured debt, and so consequently the proceeds going to creditors, it is apparent that there was no intention to defraud BHS' creditors.

However, RAL's actions in regards the charging of fees to BHS, and the imposition of loans on BHS, are more problematic in regards fraudulent trading. Concerning the imposition of fees, it could be argued the by imposing fees on BHS, and using their position as directors to ensure payment, RAL were defrauding BHS' other creditors. However, as noted above, given that the fees can, to some degree, be argued as being for legitimate services provided, and so made RAL a genuine creditor, they are unlikely to be seen as defrauding creditors.

Notwithstanding this conclusion, the loans imposed on BHS by RAL, and Dominic Chappell in particular, could arguably be deemed as fraudulent trading. In particular, this

relates to the £1.5 million interest free loan that was never repaid by Mr Chappell[870], and the £12 million in loans levied against BHS by RAL, of which only £6 million was repaid[871]. Despite it being noted that other loans were taken out[872], these were repaid, and so cannot constitute fraudulent trading. However, the other unpaid and partially repaid loans could be argued to constitute fraudulent trading if, when they were taken out, RAL/Dominic Chappell knew the loans would never be repaid, as this would knowingly divest BHS of assets – assets that diligent creditors may have relied on for repayment. Given the high evidential barrier required for fraudulent trading, and possibility that RAL did not realise that BHS could not continue to pay its debts as a consequence of these transactions, it is impossible for this thesis to provide a confident conclusion without further evidence as to RAL's intentions with regards these loans.

Section 4.4(b): Wrongful Trading

The final possible remedy for BHS' unsecured creditors is the wrongful trading provisions set out in s214 Insolvency Act 1986. Given the time period between Sir Philip's sale of BHS and its eventual entry into insolvency, and the fact that BHS continued to pay its debts during his tenure of ownership[873], s214 will not apply to the actions of Sir Philip as the 'moment of truth' could not have occurred.

Notwithstanding the inapplicability to Sir Philip Green, s214 does potentially apply to RAL as there are several occasions in which the 'moment of truth' may have occurred.

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[870] Letter from Dominic Chappell to the House of Commons Work and Pensions and Business, Innovation and Skills Committees, 10th June 2016: https://www.parliament.uk/documents/commons-committees/work-and-pensions/Correspondence/Dominic-Chappell-to-BIS-and-Work-and-Pensions-Committees-10-June-2016.pdf; Letter from Edward Parladorio to House of Commons Work and Pensions and Business, 14th July 2016: https://www.parliament.uk/documents/commons-committees/work-and-pensions/Correspondence/From-Edward-Parladorio-14-07-2016.pdf

[871] Letter from Michael Hitchcock to the House of Commons Work and Pensions and Business, Innovation and Skills Committees, 12th June 2016: https://www.parliament.uk/documents/commons-committees/work-and-pensions/Correspondence/From-Michael-Hitchcock-1206216.pdf

[872] Letter from Darren Topp to the House of Commons Work and Pensions and Business, Innovation and Skills Committees, 21st June 2016: https://www.parliament.uk/documents/commons-committees/business-innovation-and-skills/Correspondence/2015-20-Parliament/From-Darren-Topp-re-BHs-collapse-21-06-2016.pdf

[873] Meaning there was not real prospect of BHS entering insolvency at that moment in time

The first occasion at which RAL may have identified that the moment of truth had occurred is upon their acquisition of BHS. Owing to BHS being a going concern, and the large pension deficit, it maybe be arguable that they should have realised BHS could not avoid insolvency. However, as stated in evidence submitted to the Select Committee by Edward Parladorio[874], RAL did not consider BHS to be technically insolvency owing to the following factors:

a) £200 million of inter-company debt to was to be written off[875] by Arcadia;
b) Support had been promised to resolve the pension deficit;
c) Support had also been promised to resolve issues with trade credit insurance;
d) The available cash resources upon purchasing BHS;
e) The property that could be disposed of to raise working capital;
f) The devised turnaround plan for BHS.

Given these factors, and the likelihood that, in experienced and competent hands, BHS' fortunes could have been 'turned around', it is unlikely that the moment of truth would have occurred upon RAL's acquisition of BHS as it was still a viable business that could continue to pay its creditors from its assets.

The second occasion at which RAL may have breached s214 is after the 2015-16 Christmas trading period, on account of poor trading conditions. However, given that BHS/RAL sought legal advice from Weil Gotshal concerning the possibility of BHS having become insolvent[876], and no recommendations were forthcoming from this legal advice to place BHS into insolvency, it is again unlikely that RAL had reached the moment of truth as the legal advice had not yet advocated that course of action.

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[874] Letter from Edward Parladorio to the House of Commons Work and Pensions and Business, Innovation and Skills Committees, 14th July 2016; https://www.parliament.uk/documents/commons-committees/work-and-pensions/Correspondence/From-Edward-Parladorio-14-07-2016.pdf

[875] £216 million out of £256 million owed - The Pensions Regulator, *Regulatory Intervention Report: Issued under section 89 of the Pensions Act 2004 in Relation to the BHS Pension Schemes, June* 2017 at 20

[876] Letter from Edward Parladorio to the House of Commons Work and Pensions and Business, Innovation and Skills Committees, 14th July 2016; https://www.parliament.uk/documents/commons-committees/work-and-pensions/Correspondence/From-Edward-Parladorio-14-07-2016.pdf

The final occasion may have been shortly after BHS had successfully negotiated its CVA, as the cash flow forecasts had deteriorated. In particular, there was[877]:

- A £7 million shortfall over the Easter trading period;
- The expectation of continued poor trading until September 2016, leading to another £7 million loss;
- A £10 million shortfall from the property disposals; and
- The inability to obtain trade credit, resulting in a further shortfall of £10 million.

Moreover, on 18th April 2016, RAL's belief that Arcadia would continue to support BHS was disabused, when they were informed that Arcadia would no longer continue to support the struggling business. It is submitted that, although the poor Easter and projected trading performance (combined with BHS' already precarious financial position) were sufficient for RAL to realise that BHS could no longer avoid insolvency, the removal of Arcadia's support meant that the realisation was unavoidable. Indeed, the board agreed on 21st April for BHS to enter insolvency after attempts to find new sources of credit failed[878]. However, BHS did not actually enter insolvency until 25th April, owing to last minute attempts to sell the company to a trade buyer.

It is submitted that the delay between Arcadia's confirmed withdrawal of support on 18th April, and the agreement to enter into insolvency on 21st April, may not be enough to constitute a breach of s214 owing to the attempts to acquire new sources of credit that could have provided enough working capital and ensured BHS' immediate future – sources that BHS were indeed advised to seek from Arcadia[879]. However, given RAL's attempts to transfer £1.5 million to BHS Sweden in the period between agreeing to enter insolvency on 21st April and its eventual entry on 25th, it is submitted that despite attempts to sell BHS to a trade buyer, RAL knew these did not have any probability of success; hence the attempted transfer of the property to BHS Sweden. Consequently, it is submitted that the moment of truth occurred on 21st and RAL's refusal to place BHS into

[877] Ibid.
[878] Ibid.
[879] Ibid.

insolvency on 21st constitutes a breach of s214 as they knew that BHS had no prospect of avoiding insolvency.

Section 5: Conclusions

This chapter has, by analysing Carillion and BHS in two case studies, provided empirical evidence as to the effectiveness of the Insolvency Act 1986's anti-deprivation and personal liability provisions. In doing so, this chapter has sought to interrogate the conclusions reached in Chapter 3 that these provisions, both singularly and collectively, do not provide effective or efficient remedies to unsecured creditors, thereby leaving them without sufficient protection.

In case study 1, it was concluded that none of the Insolvency Act's provisions were applicable to the actions of Carillion itself or its directors. With regards the preference provisions, it was concluded that the requisite, subjective desire to prefer was not present. It was also concluded that there were no instances of a transaction at an undervalue owing to either the market value having been received, it being impossible to determine the true market value of the transaction or the defence available under s238(5)(a) Insolvency Act being applicable. Similarly, owing to the lack of transactions at an undervalue, there were no instances of transactions defrauding creditors. Finally, it was also concluded that Carillion's directors did not have an intention to defraud creditors owing to their actions being attributable to their dogmatic policy of declaring dividends, and that there was no instance of wrongful trading owing to the board placing Carillion into insolvency at the same time that the 'moment of truth' occurred.

These conclusions come despite, as set out in Section 1, that the actions of Carillion's directors, and the policies adopted and implemented by them, were responsible for Carillion's eventual collapse – reckless policies whose outcome were apparent. Consequently, the Insolvency Act provisions are unable to provide Carillion's unsecured creditors with any protection from the acts of its directors. This is as a result of the provisions' inherent restrictions identified in Chapter 3.

In case study 2, concerning BHS, it was concluded that unlike Carillion, it is possible that some of the Act's provisions were applicable to the actions of RAL. Notwithstanding the

inapplicability of the preference provisions owing to BHS Sweden not being a creditor, it was concluded the transfer to BHS Sweden was potentially a transaction at an undervalue, a transaction defrauding creditors, and would also evidence a possible instance of wrongful trading.

However, two issues arise from what, *prima facie,* appears to be an effective application of the Insolvency Act's provisions.

The first issue is that even though several of the provisions appear to be applicable, they all apply to a small number of RAL's actions, meaning that there is substantial overlap and repetition in their coverage. For example, as concluded above, the attempted transfer of £1.5 million to BHS Sweden is likely to constitute a transaction at an undervalue, a transaction defrauding creditors and will also be relevant in proving wrongful trading. Hence, despite the appearance of the provisions having broad applicability, only a small number of RAL's actions were caught by them.

Moreover, as also concluded, the provisions have no applicability to Sir Philip Green's actions. This is even though, as also concluded above, Sir Philip engaged in many of the same actions as RAL. Additionally, it was also noted that it was Sir Philip's actions – primarily the wholesale removal of BHS' assets through dividends and fees – that were the predominant and long-term causes of BHS' collapse. Consequently, it is once again highlighted that the provisions have limited applicability and failed to adequately protect BHS' creditors.

Finally, it must also be noted that the amounts recovered from any litigation are likely to be small. Given nearly all the £1.5 million transferred to BHS Sweden was returned, it would not be possible to recover a substantial amount from that transaction. Moreover, whilst it would be possible to recover the unpaid loans and fees wrongly charged for the disposal of BHS' properties, the amounts recoverable (a combined £8.5 million), are unlikely to substantially improve the creditors' final dividend owing to near £1 billion owed to creditors. Also relevant are the litigation expenses necessary to recover the assets[880] and the fact that, owing to RAL and Dominic Chappell's precarious financial

[880] Which this thesis is unable to estimate, but are likely to be substantial

positions, the likelihood that very little would actually be recoverable from RAL or its directors as the liquidator would not have priority to any of RAL's assets. Indeed, given these factors, it may transpire that any litigation costs would outweigh any sums revested in BHS. In regard to liability for wrongful trading, as a result of the discretionary nature of the court's powers, it is difficult to predict what, if any, award the court would make. Given these factors, it would potentially be difficult for the liquidators to acquire the necessary funding owing to the inherent lack of uncertainty as to how much could actually be recovered.

From these two case studies, it becomes apparent that the anti-deprivation and personal liability provisions are only operable in 'clear cut' instances of unacceptable company and director behaviour. As demonstrated by Carillion, despite it being clear that its directors' actions actively led to the unsecured creditors not having their debts discharged, the Insolvency Act's provisions had no applicability. As also demonstrated by BHS, although RAL were clearly in in breach of the provisions, it is unlikely that any meaningful amounts will be recovered. Indeed, the primary and long-term causes of BHS' collapse – the poor business strategy and removal of assets instigated by Sir Philip Green – are outside of the scope of the Insolvency Act provisions altogether.

The case studies also make clear that two predominant issues affect unsecured creditors in the event of insolvency. First, the use of delayed payments and reverse factoring, enables companies to substantially increase the credit that can be made available to them, and thereby place a greater risk of non-payment on to the shoulders of unsecured creditors. As noted, whilst there are statutory provisions to enable unsecured creditors to charge interest after 30 days of non-payment[881], they are largely ineffective. Moreover, whilst there may be instances of wrongful trading should debts be incurred after the 'moment of truth', such instances are likely to extremely infrequent. The Insolvency Act provisions also do not otherwise provide any means of protecting unsecured creditors from such practices. Hence, should a company engage in the widespread use of delayed payments and then enter insolvency, it is the unsecured creditors who will take the brunt of any shortfall in distributable assets.

[881] Late Payment of Commercial Debts (Interest) Act 1998; Late Payment of Commercial Debts Regulations 2002 (SI 2002/1674)

The second issue, the excessive declaration of dividends, ensures that should such a policy be adopted by a company that eventually enters insolvency, the consequential a depletion of assets will result in there being insufficient assets to discharge unsecured creditor debts – compounding the use of delayed payments. As noted, although such a policy may be a breach of s830 Companies Act 2006, such policies are not caught by the Insolvency Act 1986 provisions unless there is substantial evidence that the dividend was a transaction defrauding creditors, as occurred in *Sequana.* Owing to the high evidential barrier to establishing that a dividend amounted to a transaction defrauding creditors, as seen in the two case studies, it is unlikely that the Insolvency Act's provisions will be able to protect unsecured creditors from such policies.

It is therefore apparent that the conclusions reached in Chapter 3 have been substantiated by the empirical evidence gathered in this chapter.

It can be seen that the conclusions on the remedial limitations of provisions – the reliance on court judgments to revest property in the now insolvent company – are proven in the empirical data. In the case of Carillion, no remedies are available. Moreover, although RAL and Dominic Chappell are likely to be in breach of the provisions, it is unlikely any substantial amounts will be recoverable due to their limited assets and the liquidator's lack of priority to those already insubstantial assets. Hence, the liquidator faces the prospect of succeeding and being unable to enforce any successful judgments.

It is also apparent that the substantive limitations of the provisions are also evidenced in the empirical evidence. As seen with Carillion, it was the lack of a relevant subjective intention – or the difficulties in proving the relevant intention – which resulted in the preference, transaction defrauding creditors and fraudulent trading provisions being inapplicable. Moreover, despite intention not preventing the transaction defrauding creditors and fraudulent trading provisions being applicable to BHS, this is only because the evidence available for the actions of RAL was readily available and clearly demonstrated the relevant intentions. Thus, as with the remedial limitations, the conclusions of Chapter 3 have been borne out in the empirical evidence of this chapter.

Finally, the evidential limitations have also been proven. As seen with both Carillion and BHS, proving that a transaction was at an undervalue is extremely difficult to do so. Taking the dividends declared by both companies as an example, although these transactions were extremely detrimental to both companies, and no consideration was received, it is likely to be impossible to prove that they were at an undervalue either because the defence under s238(5)(a) is available, or because it is impossible to determine if there was an undervalue. Similarly, the sale of BHS' properties to Sir Philip and their subsequent leaseback, despite being disadvantageous and costing BHS more in the long-term, do not fall within the definition of a transaction at an undervalue – evidencing the limitation identified in Chapter 3.

Consequently, given the limitations of the Insolvency Act, Chapters 5 and 6 will analyse how the resulting trust may provide a mechanism through which creditors may increase the size of the asset pool, and thereby minimise the impact of any losses.

Chapter 5: The Potential Uses of the Resulting Trust in Liquidation

The resulting trust is a category of trust whereby property transferred from one party (the transferor) to another party (the recipient) 'jumps back' to the party that transferred the property[882]. This is achieved through the recipient holding the property on trust for the transferor, who can then order the recipient – who is now a trustee – to transfer the property back to himself. Thus, the resulting trust is an equitable mechanism that returns the legal interest in property to the party who owned the property before it came into the recipient's hands. This occurs where the transferor gratuitously transferred the property to the recipient or provided the means through which the recipient was able to acquire the property[883].

According to many commentators[884], resulting trusts fall into the two classes identified by Megarry J in *Re Vandervell's Trusts (No2)*[885]: the 'automatic' and 'presumed' resulting trusts[886]. Under the 'automatic' resulting trust, a trust arises where there is a failure of an express trust[887] or there is an excess of trust assets after the terms of the trust are carried out and no gift over is present. Under the 'presumed' resulting trust, a trust arises whenever a party gratuitously transfers property to another or provides the necessary funds for another party to purchase property. In both of these contexts, should it be proven that the transfer of property or purchase moneys were intended to be a gift or loan then the presumptions will be rebutted, and no trust imposed[888].

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[882] Gardner S, *An Introduction to the Law of Trusts*, 3rd edn (Oxford: OUP, 2011) at 288; Millett P, *Restitution and Constructive Trusts,* (1998) LQR 399 at 401. Alternatively, it is treating the parties' relationship at an earlier time - Worthington S, *Back Door Security Devices,* (1999) IL 153 at 153

[883] Hayton D, *Underhill and Hayton: Law of Trusts and Trustees,* 19th edn (London: LexisNexis, 2016) at 431

[884] Rickett C and Grantham R, *Resulting Trusts: The Trust Nature of the Failing Trust Cases,* (2000) LQR 15 at 15; Gardner S, *An Introduction,* (No.882); Hayton D, *Underhill and Hayton:* (No.883); Thomas G, *The Law of Trusts*, (No.185)

[885] [1973] 3 WLR 744

[886] *Re Vandervell's Trusts (No2)* (1974) Ch 269 at 289

[887] Such as one of the three certainties being absent

[888] *Dyer v Dyer* (1788) 2 Cox Eq 92

Megarry J's classification of the resulting trust faces two issues: Lord Browne-Wilkinson's criticism in *Westdeutsche*[889], where his Lordship concluded that no distinction should be drawn between trusts arising from the failure of an express trust and transfer of property, and the consequential effect that Megarry J's classification is no longer the official parlance for classifying the resulting trust. Notwithstanding these issues, it nevertheless remains a useful mechanism for describing and understanding the two categories of resulting trust[890] - even if it is not conceptually correct. The categorisation will therefore be adopted by this thesis for merely classifying the various forms of the resulting trust. The alternative, and more authoritative, classification put forward by Lord Browne-Wilkinson likewise identifies the two 'circumstances' in which the resulting trust arises, but refuses to label them in the same manner - making it more challenging to effectively discuss the resulting trust and distinguish their uses[891]. However, through this classification it can be discerned that the resulting trust is a mechanism through which property can be recovered from the possession of another and returned to its original owner. This is as a consequence of the beneficial interest in the property being 'retained' by the transferor[892] and not being transferred to the recipient.

As identified in Chapters 1 and 3, this thesis is analysing whether there is an alternative and more effective means of protecting the unsecured creditor from the ill effects of the liquidation process than those set out under the Insolvency Act 1986. It is submitted that the resulting trust may provide a mechanism through which property can either be returned to the company's asset pool for distribution through the liquidator[893], or by segregating property that would otherwise constitute part of the company's asset pool and then returning the property directly to what would otherwise be an unsecured creditor. This latter use of the resulting trust would prevent assets falling into the clutches of any floating charges created over the company's general assets by segregating them from the company's asset pool. In either form, the retention of a beneficial interest allows for the

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[889] *Westdeutsche,* (No.186) at 708
[890] See Section 3.2 of this chapter. Gardner S, *An Introduction,* (No.882) at 288; Hayton D, *Underhill and Hayton,* (No.883) at 434
[891] *Westdeutsche,* (No.186) at 708
[892] Calnan R, *Proprietary Rights,* (No.71) at 83; Glister J and Lee J, *Hanbury & Martin's Modern Equity,* 21st edn (London: Sweet & Maxwell, 2018) at 228; *Lavelle v Lavelle* [2004] 2 FCR 418 at 13-14; Loi K, *Quistclose Trusts and Romalpa Clauses: Substance and Nemo Dat in Corporate Insolvency,* (2012) LQR 412 at 416, 417
[893] This distribution would be in accordance with the statutory priority of distribution

reacquisition of property. As concluded in Chapter 2, the unsecured creditors of a company in liquidation are justified in receiving such protection, and whilst the resulting trust may not operate as a true unsecured creditor protection[894], it does have the potential to increase the asset return rates to creditors. It is also concluded in Chapter 6 that the resulting trust is capable of meeting the three requirements for an improved creditor protection set out in Chapter 3: returning assets to the company, having clear and predictable rules, and being attractive to third party litigation funders[895].

The primary justification for analysing the resulting trust in this thesis, as opposed to the express or constructive trust, is that little analysis has been undertaken into the potential use of the resulting trust in the context of liquidation. Indeed, the existing literature is limited to reviewing the negative impact of the resulting trust[896], as opposed to the potential positive outcomes it may provide for the unsecured creditors. This was best seen in the analysis of Tribe[897] and Tarling[898], both of whom limited their analysis to the potential negative impacts of the resulting trust. This thesis' analysis of the resulting trust is therefore seeking to fill a lacuna in the existing literature.

The Potential Impact of the Trust in Insolvency

The potential use of the trust generally within the context of insolvency is well documented. First of all, as noted above, the trust grants the beneficiary a right *in rem*[899]. The beneficiary is thus able to assert their rights to property against the world at large, and obtain priority over all others who may have a claim to the property. Within the resulting trust this is because the beneficial interest was retained by the transferor[900]. Furthermore, with the resulting trust arising upon the occurrence of the transfer, rather

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[894] See Chapter 6 Section 4
[895] See Chapter 6 Section 3.1
[896] McCormack G, *Proprietary Claims and Insolvency*, (No.188); Tribe J, *Who Would be a Creditor? Prest in the Supreme Court and the Effects of Trusts on Insolvency*, (2013) 3 CRI 91; Tarling R, *The Resulting Trust and the Unsecured Creditor*, (2016) CL 299
[897] Tribe J, *Who Would be a Creditor?,* (No.896)
[898] Ibid; Tarling R, *The Resulting Trust and the Unsecured Creditor*, (2016) CL 299
[899] Thomas G, *The Law of Trusts*, (No.185) at 705; *Re Goldcorp Exchange Ltd* [1995] 1 AC 74; Moffatt G, *Trusts Law*, 5th edn (Cambridge: CUP, 2009) at 796; McCormack G, *Proprietary Claims and Insolvency*, (No.188) at 2; Virgo G, *The Principles of Equity and Trusts,* 3rd edn (Oxford: OUP, 2018) at 212
[900] Calnan R, *Proprietary Rights,* (No.71) at 83

than from the date that judgment is given[901], there is no gap in time in which the resulting trust is not imposed, and will have priority over all subsequent events[902]. This is in marked contrast to the anti-deprivation provisions analysed in Chapter 3, where it was concluded that the available remedies are greatly undermined by the need for a judgment to give them effect – thereby preventing them from having priority should claims arise between the relevant act and the handing down of the court's judgment.

Consequently, assets subject to a resulting trust will have priority over any subsequent security interests created by the recipient, and so will be made available to the beneficiary and not any secured creditors[903]. Indeed, s283(3)(a) Insolvency Act 1986 explicitly acknowledges that assets subject to a valid trust do not form part of the company's asset pool[904], and the onset of insolvency can never form the basis of querying the beneficial interest of the beneficiary[905]. Moreover, the transferred property is not available to any individuals other than the transferor[906]. Finally, the priority afforded beneficiaries can be justified by the lack of discretion afforded to the judiciary[907]. All forms of trust recognised in England arise upon the occurrence of identifiable facts, which is in contrast to the remedial constructive trust[908], which arises at the discretion of the court. The beneficiaries' priority can thereby be justified as an operation of law, rather than the discretionary whims of the judiciary, and so is both predictable and morally permissible[909]. Thus, the trust generally has previously been used, or attempted to be used, as a device to assist unsecured creditors who would otherwise lose out under the insolvency regime by not having the privileged position as a secured or preferential creditor[910]. The resulting trust, however, has not been analysed in such a context.

[901] Thomas G, *The Law of Trusts*, (No.185) at 731-732; Evans S, *Property, Proprietary Remedies and Insolvency: Conceptualism or Candour,* (2000) 5 Deakin LR 31 at 35. However, this is questioned at 36.
[902] Except for the restrictions imposed by the rules of tracing
[903] Tribe J, *Who Would be a Creditor?*, (No.896) at 93
[904] McCormack G, *Proprietary Claims and Insolvency*, (No.188) at 7; s283(3)(a) Insolvency Act 1986 and *Heritable Reversionary Company Ltd v Millar* [1892] AC 588 at 614:
[905] Oakley A, *Proprietary Claims and Their Priority in Insolvency,* (1995) 54 CLJ 377 at 379
[906] Moffatt G, *Trusts Law*, (No.899) at 795; Cork K, *Report,* (No.2) at para 1045
[907] Allton N, *The Boundaries of Proprietary Claims,* (1997) 13 QUTLJ 276 at 277; Oakley A, *Proprietary Claims,* (No.905) at 380
[908] *Re Polly Peck No2* [1998] 3 All ER 812
[909] See Chapter 6 Section 4
[910] Moffatt G, *Trusts Law*, (No.899) at 796

It must also be noted, however, that the use of the trust is not always beneficial for unsecured creditors in instances of insolvency, as a consequence of the trust not only returning property in one direction. As stated above, the trust can be used to return property transferred by an insolvent company, which can then be distributed to the unsecured creditors[911]. However, should the resulting trust arise over property that would otherwise form part of the asset pool, that property would no longer be available to the general body of creditors[912]. Whilst it is argued that this can be justified in many instances as it merely prevents parties from becoming unsecured creditors in the first place, it is undeniable that it has potentially negative impacts upon the general body of creditors and other interested, innocent third parties[913].

Given this potential of the resulting trust to both help and hinder the position of unsecured creditors, and the lack of previous analysis, this chapter will examine how the resulting trust can be utilised within the liquidation process for the benefit of the unsecured creditors[914]. Following from this introduction, it will examine both how property can be returned to the insolvent company and how it can be returned directly to potential unsecured creditors. Due to the large amount of analysis required, it will focus solely on the potential uses and whether or not the resulting trust can provide liquidators or third parties with a predictable and easy to establish mechanism of assisting unsecured creditor. Chapter 6 will then examine the limitations and effectiveness of these possibilities, and conclude whether or not it meets the requirements set out in Chapter 3 for an alternative mechanism for protecting unsecured creditors.

This chapter adopts the following structure. Section 1.1 analyses the theoretical underpinning of the resulting trust and concludes that it relies upon Equity 'imputing' an intention to the transfer of property. Section 2 then analyses the purchase price and gratuitous resulting trusts, concluding how and when they might be utilised in the context of liquidation. Section 3 considers the automatic and *Quistclose* trust.

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[911] Evans S, *Property,* (No.901) at 42
[912] McCormack G, *Proprietary Claims and Insolvency*, (No.188) at 14-15;
[913] Watt G, *Trusts and Equity*, 8th edn (Oxford: OUP, 2018) at 145;
[914] Worthington S, *Back Door,* (No.882) at 161

Section 1 - Defining the Resulting Trust[915]

Section 1.1 - The Role of Presumptions

It is unquestionable, when reviewing the authorities and commentary, that the resulting trust is predicated upon on a number of legal presumptions[916]. These applicable presumptions were originally developed by the Courts of Equity to resolve quarrels over the ownership of property, and have survived the fusion of the Common Law and Chancery Courts through the Judicature Acts[917].

These presumptions formed, and continue to form, the method by which Equity is able to supplement and navigate a clear way through any uncertain factual matrices the judiciary encounter, and provide for a default resolution to a dispute[918]. This role of the resulting trust presumptions was recognised by Lord Upjohn[919], where his Lordship commented that "in reality the so-called presumption of a resulting trust is no more than a long stop to provide an answer where the relevant facts and circumstances fail to reach a solution."

Thus, the resulting trust operates as the default mechanism for determining who is the correct owner of transferred property, and does so through a series of presumptions. In doing so, it plays a fundamental role in determining property rights, and who is entitled to property. In the context of this thesis this is the determination of what will, and what will not, form part of the insolvent company's asset pool.

It must be acknowledged at this stage, however, that the presumptions can be rebutted provided that a party, usually (but not always) the recipient, adduces *sufficient* evidence to rebut the presumption that the transferor retains a beneficial interest in the property[920].

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[915] Although some have sought to redefine the resulting trust as arising to prevent unjust enrichment, this has been almost universally rejected by the English judiciary
[916] *Jones v Kernott* [2011] UKSC 53; *Stack v Dowden* [2007] 2 AC 432; *Westdeutsche* (No.186); Chin J, Rabinowitz A and Quinn A, *The Presumptions of Resulting Trust and Beneficiary Designations; What's Intention Got to Do with it?,* (2016) 54 Alta LR 41 at 44
[917] Judicature Acts 1873 and 1875
[918] Thomas G, *The Law of Trusts*, (No.185) at 755
[919] *Vandervell v IRC* [1967] 2 AC 291 at 313; see also *Re Cochrane's Settlement Trusts* [1955] 1 All E.R. 222
[920] *Westdeutsche,* (No.186) at 708

Although analysed fully in Chapter 6, it can briefly be stated that this thesis' submission is that merely casting doubt over the transferor's intentions, rather than proving an ulterior intention, is insufficient to rebut the presumption. Instead there must be actual evidence of a loan or gift[921].

The theoretical foundations of the presumptions made by Equity are two key conceptions over transfers of property. Under the first, the presumption against gifts, it is presumed that outside of the relationships that form the doctrine of advancement[922], an owner of property does not intend a transfer of property to form a gift[923]. Alternatively, Equity concludes that the transferor must have intended to keep the property for himself unless he has received consideration in return for the transfer of the property[924]. One of the reasons for Equity making this conclusion is to prevent property being misappropriated against the owner's consent, and providing a mechanism for him to recover it should this occur[925]. Equity's conclusion can be justified when contrasted with the doctrine of advancement, where the law presumes a gift rather than retention of an equitable interest[926]. It is submitted that as advancement applies to transfers between close family members, it is correct for Equity to presume such transfers of property are gifts because of the obligations and emotional connections between the parties. However, once a transfer occurs between more distantly connected parties without the same obligations or emotional connections, Equity cannot presume that a gift took place as very few individuals are of a sufficiently generous personality to make such transfers[927].

Similarly, under the second conception, Equity also presumes that should a transferor provide the purchase moneys for the acquisition of property, he intends to take a beneficial interest in the property acquired, with the property being beneficially owned in

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921 *Standing v Bowring* (1885) 31 Ch D 282; *Aveling v Knipe* (1815) 19 Ves 441

922 See *Bennett v Bennett* (1879) 10 ChD 474; *Tinker v Tinker* [1970]; *Collier v Collier* [2002] EWCA Civ 1095

923 Pearce R and Warren B, *Pearce and Stevens' Trusts and Equitable Obligations*, 7th edn (Oxford: OUP, 2018) at 154; Chambers R, *Resulting Trusts,* (Oxford: OUP, 1997) at 12. See also Megarry VC in *Re Sick and Funeral Society of St John's Sunday School,* [1973] Ch 51; Hackney J, *Understanding Equity and Trusts,* (London: Fontana Press, 1989) at 148-149

924 *Ali v Khan* [2002] EWCA Civ 974

925 *Lynch v Burke* [1995] 2 IR 159

926 *Collier v Collier* [2002] EWCA Civ 1095

927 Stubbins M, *The Gratuitous Transfer and Petrodel: Reform or no Reform?,* [2016] 22 (5) Trusts and Trustees 516

proportion to the contributions made[928]. As with the first conception, this too can be justified on the basis that not all parties are of a generous spirit.

Having established the centrality of the presumptions to the resulting trust, it remains necessary to consider exactly *what* is being presumed by Equity. Despite consensus existing over the presumptions, debate rages both in the authorities and scholarly commentary about what form the presumptions take, with the nature of the presumptions affecting the applicability and utility of the resulting trust. There are two predominant formulations being available for how the presumptions underpinning the resulting trust should be conceptualised[929]: the 'positive' and 'negative' formulations[930].

The first, the 'positive' formulation, is that the transferor intended to retain a beneficial interest, and so the recipient holds on trust until the transferor demands the return of the property. This version of the presumptions was authoritatively adopted by Lord Browne-Wilkinson in *Westdeutsche*[931]*,* where he referred to the 'common intention' of the parties that the recipient should not benefit from the transfer of property[932]. As his Lordship stated, the presumption is "giving effect to the common intention of the parties. A resulting trust is not imposed by law against the intentions of the trustee (as is a constructive trust) but gives effect to his presumed intention."[933] This formulation has a large degree of academic support[934], most notably from Mee[935], who concludes that it fits best within the understanding the courts have historically adopted.

Alternatively, and in stark contrast, Lord Millett has put forward that the presumption arises as a result of the lack of intention to benefit the recipient – the 'negative' formulation. Lord Millett's view states that the transferor must have not intended the

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[928] *Dyer v Dyer* (1788) 2 Cox Eq Cas 92 at 93

[929] Gardner S, *An Introduction,* (No.882) at 65; see also Rickett C and Grantham R, *Resulting Trusts,* (No.884) at 16

[930] A third formulation, the 'factual' formulation, has been proffered by Swadling W, *Explaining Resulting Trusts,* (2008) 124 LQR. However, this was resoundingly rejected by Mee J, *Presumed Resulting Trusts, Intention and Declaration,* (2014) CLJ 86 and so will not be considered by this thesis.

[931] *Westdeutsche,* (No.186) at 708

[932] *Standing v. Bowring* (1885) 31 Ch.D. 282 at 289

[933] *Westdeutsche,* (No.186) at 708

[934] Tucker L*, Lewin on Trusts,* (No.185) at 288; Rickett CEF and Grantham R, *Resulting Trusts* (No.884) at 18-19

[935] Mee J, *Presumed Resulting Trusts, Intention and Declaration,* (2014) CLJ 86

recipient to benefit from the transfer. This means there is no need for the presumption to conclude that the transferor intended to retain a beneficial interest. In setting out this formulation[936], his Lordship adopted Chambers'[937] thesis that there is an absence of intention for the recipient to benefit - "It is equity's response to the receipt of property by someone who was not intended to have the benefit of the that property."[938] Under this formulation, the imposition of the resulting trust therefore responds to, and prevents, the potential unjust enrichment of the recipient[939]. According to its advocates, adopting a negative formulation corresponds best with the conclusions reached by the courts and accounts for instances in which the transferor neither intended, nor were in a position to actively intend, the retention of beneficial interest[940].

Both formulations of the presumption, notwithstanding their respective appeal, can be criticised as failing to adequately describe what is occurring within the resulting trust. The 'positive' formulation can be questioned on the basis that it is ascribing intentions to the recipient of the property that do not exist[941]. This is because whilst it can, in the majority of cases, be correct to presume that the transferor of property will have intended on retaining a beneficial interest in the property, as it is in their clear interests to do so as a result of the value contained in the beneficial interest, the same cannot be said for the recipient[942]. Indeed, it is extremely unlikely, considering the non-altruistic nature of the majority of individuals, that they would intend to deprive themselves of the asset and its value[943]. Instead, it is far more likely that they would perceive the transfer as a gift or loan, and so intend to take the beneficial title to the property.

Equally as problematic, resulting trusts have been found to arise even where the transferor did not intend to retain a beneficial interest[944]. For example, in *Vandervell v IRC*[945], Mr Vandervell thought that he had disposed of the beneficial interest in the property when he

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[936] *Air Jamaica v Charlton* [1999] 1 WLR 1399; *Twinsectra v Yardley* [2000] WTLR 527
[937] Chambers R, *Resulting Trusts*, (No.923)
[938] Ibid, at 33
[939] Mee J, *Presumed,* (No.935) at 86
[940] Chambers R, *Resulting Trusts,* (No.923) at 21
[941] Thomas G, *The Law of Trusts*, (No.185) at 714; Virgo G, *The Principles* (No.899) at 213; Millett P, *Restitution,* (No.882) at 401
[942] Gardner S, *An Introduction,* (No.882) at 293
[943] Virgo G, *The Principles of Equity and Trusts,* 4th edn (Oxford: OUP, 2020) at 243
[944] *Vandervell v IRC* [1967] 2 AC 291; Hayton D, *Underhill and Hayton,* (No.883) at 435
[945] [1967] 2 AC 291

made a gift of 100,000 shares. Had he retained an interest in the shares, then he would have been liable for stamp duty. Despite the protestations of Mr Vandervell that there was no was intention to retain a beneficial interest, the House of Lords held the property was subject to a resulting trust. Similarly in *Re Vinogradoff*[946], the transferor could not have intended to retain a beneficial interest in the property as the transfer was between a grandmother and 7-year-old granddaughter – meaning that the granddaughter was too young to be a trustee. Thus, Lord Browne-Wilkinson's formulation fails to adequately deal with the parties involved in the transfer of property, and leaves a large number of factual matrices to fall outside the theoretical framework adopted.

Chambers' formulation, although it overcomes the issues of the recipients' intentions by stating that only the transferor's lack of intention to benefit is relevant[947], also fails to accord with reality. For all the faults associated with Lord Browne-Wilkinson's formulation, it is submitted that should the transferor be asked subsequently to the transfer occurring what their intentions were, they would respond that they had a right to the property because 'it is still mine' – that they would frame their intention *positively* and have intended to retain an interest in the property. It is submitted unlikely, as individuals normally identify property ownership positively, that the transferor would, on their own initiative, formulate their response along the terms of 'I did not want them to benefit from the property'. Thus, they would state 'it is mine' rather than 'it is not theirs'.

Mee also notes that the negative formulation of intention fails to adopt the language utilised by the courts[948]. He submits that Chambers is incorrect when he concludes that the courts are confused on the issue, and flipflop between inconsistent statements on nature of the presumption. Instead, he states that the courts' inconsistent language is as a consequence of them having to choose between two options: whether there is a retention of beneficial interest or a gift/loan[949]. In electing between these two options, they must use language in both a positive and negative formulation without necessarily being confused on the issue. As seen in *Lavelle v Lavelle*[950], where Lord Phillips MR used both

[946] [1935] WN 68
[947] Mee J, *Presumed,* (No.935) at 100
[948] Ibid, at 102
[949] Ibid, at 102-103
[950] [2004] 2 FCR 418

a negative and positive formulation in two consecutive paragraphs[951], his Lordship still concluded that the positive formulation was correct. Thus, the negative formulation fails to accord with the historical view set out by judiciary.

Given the fundamental issues facing the alternative formulations of the presumptions underpinning the resulting trust, it is submitted that an alternative formulation is required and should be adopted by this thesis. Consequently, the formulation adopted is that acknowledged by Virgo[952] and adopted by the House of Lords/Supreme Court in relation to the common intention constructive trust[953]: imputed intention. Instead of the courts attempting to determine what the party *actually intended* through an inference, imputing an intention involves the court determining what a party *would have intended* had they considered the matter[954]. In imputing an intention, the courts are assisted by not requiring any evidence of the transferor's actions or statements, other than that the property was transferred, to establish the existence of a resulting trust[955], although evidence will still be required to rebut the presumption.

In the words of Lord Neuberger, the difference between an inference and imputation can be described thus:

> "An inferred intention is one which is objectively deduced to be the subjective actual intention of the parties, in the light of their actions and statements. An imputed intention is one which is attributed to the parties, even though no such actual intention can be deduced from their actions and statements, and even though they had no such intention. Imputation involves concluding what the parties would have intended, whereas inference involves concluding what they did intend."[956]

[951] Ibid, at [13] and [14]
[952] Virgo G, *The Principles of Equity and Trusts,* 4th edn (Oxford: OUP, 2020) at 245; see also Rickett CEF and Grantham R, *Resulting Trusts,* (No.884) at 19
[953] *Stack v Dowden* [2007] UKHL 17; *Jones v Kernott* [2011] UKSC 53
[954] Pawlowski M, *Imputing a Common Intention in Single Ownership Cases,* (2015) 1 TL 3 at 4
[955] *Stack v Dowden* [2007] UKHL 17, per Lord Neuberger at 126
[956] Ibid, at 126

Hence, by imputing an intention, the courts are able to sidestep many of the issues outlined above with the traditional formulations, even if in practice, rather than theory, the difference may only be minor[957]. Firstly, the imputed intention would be that of the transferor and the transferor alone[958]. It would be that had the transferor considered where the beneficial interest was to go, it would remain with himself, and so the recipient's intentions are no longer relevant. Thus, a realistic presumption is used to establish the resulting trust, rather than the unrealistic intentions ascribed to recipients under the *Westdeutsche* formulation. In doing so, a greater level of predictability would also be provided, as the transferor's imputed intention will always be the same – the retention of the beneficial interest.

Secondly, the shortcomings associated with Chambers' negative formulation too are avoided. As noted above, Chambers' formulation can be criticised as attributing intentions to the transferor that are unlikely, and for failing to formulate the presumption in a positive manner. The imputed form of intention would do away with the need theorise the presumption in a negative form, and would instead be a positive intention to retain the beneficial interest – a formulation of intention that better accords with the actual thoughts of transferors and also fits within the long history of authorities that have categorised the intention positively.

Finally, imputation of intention would assist in explaining the imposition of the resulting trust where the transferor has failed to effectively dispose of the beneficial interest. As set out above, in *Vandervell v IRC,* Mr Vandervell intended to dispose of his beneficial interest so as not to be liable for stamp duty. Accordingly, there was sufficient evidence to rebut the presumption of resulting trust as his intentions were known. However, what was not known were his intentions once it was established that he had failed to effectively dispose of the property. By imputing the intention that he would have intended to retain the beneficial interest (as the value of the asset outweighed the amount due under stamp duty, it would have been illogical to presume Mr Vandervell would wish to compound

[957] *Jones v Kernott* [2011] UKSC 53 per at 34, 58. see also Piska N, *Intention, Fairness and the Presumption of Resulting Trust after Stack v Dowden*, [2008] 71(1) Modern Law Review 120 at 128

[958] This is in keeping with the common intention constructive cases where the relevant intention is that of the legal owner of the property.

his losses by giving up the asset), a justification for the resulting trust can be established that does not fall foul of contradictory evidence.

Thus, the imputation of intention would fulfil the resulting trust's role as a "default mechanism, whose function it is to fill in evidential lacunae as to the location of the beneficial interest…"[959] by "filling in the missing elements."[960] This is done because in the absence of any indication from the parties' own words or conduct as to their intentions regarding the quantum of their beneficial ownership, the only recourse left to the court was to undertake its own assessment of what the parties must have intended[961], subject to contrary evidence. As the only evidence may be the existence of the transfer, the standard imputed intention of a retention of a beneficial interest will apply to these situations.

Once the presumption has arisen, and an intention for the transferor to retain the beneficial interest is imputed, then provided the intention is not successfully rebutted[962], Equity responds by imposing a resulting trust by operation of law. Therefore, the presumptions do not themselves lead to the imposition of a resulting trust – it is merely a fact pattern to which Equity responds through the imposition of a resulting trust[963]. Even Swadling, who rejects the notion that the resulting trust presumptions are based upon intention, has accepted[964] that the presumptions have an extremely limited role, and do not themselves give rise to a resulting trust.

Notwithstanding the advantages of imputing an intention, neither it, nor any of the alternative formulations, can overcome one fundamental criticism: that presumptions never truly resemble the actual intentions of the transferor[965]. For obvious reasons, a presumption of intention, as it is not based upon evidence, as the evidence is unavailable, cannot represent the transferor's true intentions.

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[959] Rickett CEF and Grantham R, *Resulting Trusts,* (No.884) at 20
[960] Pawlowski M, *Imputing,* (No.954) at 4
[961] *Oxley v Hiscox* [2004] EWCA Civ 546
[962] See Chapter 6
[963] Mee J, (No.935); Tucker L, *Lewin on Trusts*, (No.185) at 288; Chambers R, *Resulting Trusts,* (No.923) at 33 and 38-39; Penner J, *Resulting Trusts and Unjust Enrichment: Three Controversies,* in Mitchell C, *Constructive and Resulting Trusts,* (Oxford, OUP, 2010) 237, at 255
[964] Swadling W, *A New Role for the Resulting Trust?,* (1996) 16 LS 110 at 115
[965] Thomas G, *The Law of Trusts*, (No.185) at 760

Gardner has criticised the adequacy of the presumptions, and suggests that they originally accorded with the intentions of Medieval landowners, who did not intend to transfer land as a gift but as a means of keeping it safe whilst they were crusading, and who also had the overarching intention of creating or retaining their dynastic estates. However, this no longer accords with the intentions of the general population[966]. It is claimed that in modern society the presumption that giving away property in the absence of consideration is indicative of there not being a gift is 'counter-facilitative' and 'wrong'[967]. This is particularly the case since the adoption of fairer inheritance practices, where females and younger sons can now expect to inherit in equal shares with the eldest male child.

This thesis submits that this argument is wrong, however[968]. For whilst it is true there has been some evolution in the priorities of owners of land that have seen a liberalising of intentions, the majority of individuals, particularly when transferring property to strangers, do not intend to freely give away their property. Instead, the default position of most people is to retain ownership of the property. Furthermore, even where people do in contemporary society give property away gratuitously, such as their personal data, they expect something in return, such access to a social media platform or search engine. People have not yet evolved into entirely altruistic beings. Finally, although Gardner is correct that there has been a change in how property is distributed upon death, the law has (to a limited extent) already responded to this through the presumption of advancement, and the presumption that transfer by fathers to children are gifts[969]. Hence, the existing presumptions, including the law of advancement, are correct and continue to reflect society's attitudes to property transfers.

It has also been suggested by Chambers that rather than rely on presumptions, the courts should infer the intentions of the transferor on a case by case basis from the available facts[970]. Problematically, however, in many cases, as is shown in Section 2, it is impossible to interpret or establish the intentions of the transferor from the little evidence

[966] Chin J, Rabinowitz A and Quinn A, *The Presumptions* (No.916) at 46
[967] Gardner S, *An Introduction,* (No.882) at 65-66
[968] Rickett C and Grantham R, *Resulting Trusts,* (No.884) at 17 - the presumption "remains eminently sensible today."
[969] *Re Roberts* [1946] Ch 1.
[970] Chambers R, I*s There a Presumption of Resulting Trust?* In Mitchell C, *Constructive and Resulting Trusts,* (Oxford, OUP, 2010) 267 at 270-271

available. Should the judiciary be empowered to arbitrarily infer the intentions of the transferor in each individual case with insufficient evidence, it would become impossible for the parties to presume where the beneficial interest in the property would rest, and litigation would become an extremely risky roll of the dice. By utilising the presumptions, even if they are imperfect, parties to the transfer are able to know who shall have the beneficial interest by default, and then make an assessment of whether there is sufficient evidence to rebut the presumption. This is especially necessary in commercial contexts, where the intentions of the parties are kept purposefully vague and unknown so as to obtain a competitive advantage over rivals and suppliers.

Section 2 - The Purchase Price and Gratuitous Transfers Resulting Trusts and Their Potential Use

Section 2 of this chapter analyses two of the three forms of resulting trust - the purchase price resulting trust and gratuitous transfer resulting trust - and how they can be utilised by the liquidator or potential creditor to increase return rates. Section 3 analyses the automatic resulting trust separately. In doing so, this section will also examine how imputing an intention to the transferor's actions, rather than implying an intention, simplifies the process of imposing a resulting trust. It will also identify how the resulting trust may be utilised by a liquidator to increase the size of an insolvent company's asset pool, and how third parties may use it to prevent themselves becoming unsecured creditors, thereby reducing the company's asset pool.

Section 2.1 - Purchase Price Resulting Trusts

Equity presumes that when one party makes a contribution towards the purchase price of property, the contributor of the moneys intends to retain a beneficial interest in the property. Thus, it is presumed that the provider does not intend the recipients to take the property beneficially, as they provided the moneys in the character of a purchaser as opposed to a lender[971]. In *Dyer v Dyer*[972] the Court of Chancery were explicit that if one

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[971] *Wray v Steele* (1814) 2 Ves and B 388; *Rochefoucauld v Boustead* [1897] 1 Ch 196.; see also Cullen E, *Stack v Dowden: an End to Uncertainty?,* (2008) Insolvency Intelligence 43 at 43

[972] *Dyer v Dyer* (1788) 2 Cox EQ Cas 92; *Ebrand v Dancer* (1880) 2 Cas in Ch 26; *Wheeler v Smith* (1860) 1 Giff 300.

party supplies some or all of the purchase moneys, which is then used to purchase property in the name of a third party, the provider of the purchase moneys obtains an equitable interest in proportion to their contribution. The principle set out in *Dyer v Dyer* was reaffirmed by the House of Lords in *Westdeutsche*[973].

Purchase price resulting trusts, unlike gratuitous transfer resulting trusts[974], apply to all forms of property[975], including land[976]. Within the scope of this thesis, as the provision of the purchase price will be in the form of liquid assets (i.e. money), rather than illiquid assets such as land or machinery, there will be no security interest over the purchase moneys. At most they will be subject to an unsecured loan, which does not grant the provider of the moneys an interest in the assets acquired with the loan moneys[977]. Should the insolvent company have provided the purchase moneys to property purchased in the name of a third party, then for the unsecured creditors, assets subject to the purchase price resulting trust will not be available to fixed charge holders or mortgagees[978], and so will be available to the liquidator for distribution. Equally, should the insolvent company have purchased property with purchase moneys from a third party, the assets would be subject to a purchase price resulting trust in favour of the third party. These assets would consequently not be available to the insolvent company's liquidator or unsecured creditors, but would prevent the third party from becoming an unsecured creditor.

Before analysing in detail how such trusts can be applicable to instances of insolvency, it is first necessary to set out the law pertaining to this form of trust and resolve a number of uncertainties in the authorities to adequately identify in what matrices it is applicable.

There are many examples from the authorities illustrating when a purchase price resulting trust will arise. This includes *Abrahams v Trustee in Bankruptcy of Abrahams*[979], which was concerned with the purchase of a winning lottery ticket. The wife had paid for both her own share and the share of her estranged husband when she purchased the winning

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[973] *Westdeutsche,* (No.186) at 708.
[974] See below in Section 2.2
[975] *Re Vandervell's Trusts (no2)* [1974] Ch 269
[976] *Pettitt v Pettitt* [1970] AC 777 at 794
[977] *Hoare v Hoare* (1982) 13 Fam Law 142
[978] Thomas G, *The Law of Trusts,* (No.185) at 752
[979] [2000] WTLR 593

ticket. It was held that because she was the sole provider of the purchase moneys, and had not loaned her estranged husband his contribution to the lottery ticket, the winnings were solely held on trust for Mrs Abrahams.

Other factual matrices in which the purchase price resulting trust has arisen include *Lane v Dighton*[980]. Here a husband was able to persuade the trustees of his marriage settlement to make half of the trust's assets available to himself, even though he was only entitled to the benefit of the assets for life. In acquiring the legal title to half of the assets, there was a breach of trust and the assets remained the property of the marriage settlement, and the husband held the assets on resulting trust. A similar occurrence happened in *Ryall v Ryall*[981], where an administrator received assets from an estate he was administering to purchase land in his own name. After he died, the testator's legatees claimed the land belonged to the estate, and it was held that as the estate had provided the purchase moneys, it was the beneficial owner. Finally, in *Foskett v McKeown*[982], the resulting trust was utilised to grant victims of an investment scam a beneficial interest in the pay out of a life insurance policy in which the premiums had been paid with the victims' assets.

From the examples immediately above, it is clear that the purchase price resulting trust has a wide application to any instances where property is purchased in the name of a third party with contributions to the purchase price from persons other than the purchaser – although it must be remembered the presumptions can be rebutted by providing evidence that a loan or gift was intended[983].

Obviously, should there be only one provider of the purchase moneys, the property will be the sole beneficial interest of the provider of the purchase moneys[984]. However, should there be two contributors in equal shares, unless a contrary intention can be proven, they will take as joint tenants[985], and if there is a tenancy in common, then the equitable interest will be in proportion to their contribution[986].

[980] (1762) Amb 409
[981] (1739) 1 Atk 59
[982] [2001] 1 AC 102
[983] *Rider v Kidder* (1805) 10 Ves 360; *Seldon v Davidson* [1968] 2 All ER 755, CA
[984] *Abrahams v Abrahams* [2000] WTLR 593.
[985] *Robinson v Preston* (1858) 4 K and J 505; *Edwards v Fashion* (1712) Prec Ch 332
[986] *Pettitt v Pettitt* [1970] AC 777; *Finch v Finch* (1975) 119 Sol Jo 793.

Should there be two or more contributors to the purchase price, then the point at which the respective shares are calculated is potentially problematic. Under a resulting trust, the interests of the contributors are fixed at the time the property was purchased[987]. This means that subsequent payments are irrelevant to calculating the beneficial interest, and a purely arithmetic process is undertaken - which may potentially both help and hinder the provider of the purchase moneys. From an optimistic perspective, the provider is protected because there is certainty over the percentage of beneficial ownership, and they will be able to benefit from any increase in the price of the assets in this respective share[988]. However, should the provider only make a small contribution, then unlike under a common intention constructive trust[989], there is no mechanism available to the courts to increase the size of the beneficial interest. Although not problematic in commercial contexts, as it is unlikely the provider could realistically intend to have a greater share of the beneficial interest than that which they have provided, within the family home this lack of flexibility has led to the abandonment of the resulting trust in favour of the more malleable common intention constructive trust[990]. Thus, an insolvent company, should it have a beneficial interest in property, would be unable to increase its ownership percentage in the asset, but would be guaranteed of its ownership share.

It is also necessary for the provider to have made a contribution to the direct acquisition of property[991]. This requirement is illustrated best in *Winkworth v Edward Barron,* where a residential property was purchased for £70,000 by a company under the sole control of a husband and his wife, who had the intention of purchasing it from the company at a later date. After selling their former matrimonial home for £8,600, they used the proceeds to pay down the company's overdraft. The company then sought funds (£70,000) from the claimant, and as part of the agreement for the funds, the husband and wife provided a letter stating that they only occupied the house on a bare licence from the company and had no proprietary interest in the property. The company later became insolvent and the

[987] Browne-Wilkinson N, *Constructive Trusts and Unjust Enrichment,* (1996) 10 Tru LI 98 at 100
[988] Glister J and Lee J, *Hanbury & Martin's Modern Equity,* 21st edn (London: Sweet & Maxwell, 2018) at 721
[989] *Stack v Dowden* [2007] 2 AC 432; *Jones v Kernott* [2011] UKSC 53
[990] Ibid, at 31
[991] *Winkworth v Edward Baron* [1986] 1 WLR 1512; *Drake v Whipp* [1996] 1 FLR 826 (cost of renovations), *Burns v Burns* [1984] Ch 317 (household expenses) and *Ivin v Blake* (1994) 67 P and CR 263 (working for low wage) were all held not to be sufficient for a direct contribution.

wife sought a resulting trust over the 'matrimonial' home due to the £8,600 paid to the company to reduce its overdraft, alleging that the reduction in the company's debts constituted a contribution to the purchase price.

It was held that no purchase price resulting trust had arisen as there had been no contribution to the acquisition of the property[992].

The consequence of *Edward Barron* is that any money being claimed as forming part of the purchase price of an asset must be provided with the identifiable intention of purchasing the eventual asset – if no intention is present, then the courts will conclude that the funds were provided for a more general purpose, not as a contribution to the purchase[993].

Another problematic example of establishing whether there was a relationship between the provision of funds and the subsequent purchase of property is *Prest v Petrodel*[994]. Here moneys were provided to Petrodel Resources Limited by Mr Prest. These were then used for the purposes of purchasing several residential properties. Moneys were also provided from Petrodel Resources Limited to a subsidiary known as Vermont, which too were used to purchase land. It was held that the properties purchased were held on purchase price resulting trust for Mr Prest as he was the 'provider' of the funds. Accepting for the moment that the purchase moneys were indeed from Mr Prest[995], it is argued that the moneys were not provided for the purpose of purchasing the properties, and that there is sufficient evidence to prove it[996].

It is submitted that although the moneys were eventually used to purchase the properties, they were not initially provided for this purpose, and instead more general uses were intended. Within the facts of the appeal[997], there is no evidence establishing a link between the provision of the moneys by Mr Prest and the subsequent purchase of the properties by

[992] Ibid, at 1515. The rest of the House of Lord concurred with Lord Templeman's judgment
[993] Stubbins M, *Petrodel and the Purchase Price Resulting Trust: Another Interpretation?,* (2017) 23 T&T 383 at 387. See also Thomas G, *The Law of Trusts*, (No.185) at 753
[994] [2013] UKSC 34. Stubbins M, *Petrodel,* (No.993)
[995] See below for doubt that this was the case
[996] Stubbins M, *Petrodel,* (No.993) at 387
[997] *Petrodel Resources Ltd v Prest* [2012] EWCA 1395

the companies. Equally as plausible, if not more given the conduct of Mr Prest, the funds were provided to give the company sufficient assets to establish itself and begin operations. This would be a general intention to give the company a financial history with assets, enabling it to better attract credit in the future. Such an interpretation is possible because when the properties were purchased, the companies were not yet trading.

It could be argued that an intention to provide general working capital is similar to an intention to purchase the properties outright, in that it is intended property will eventually be purchased. However, the intention put forward in this thesis can be differentiated as the end purchase would be uncertain — it may have been the properties that were purchased or any other. Indeed, it may have seen Petrodel purchasing an office block, stocks, gold, or any other valuable asset (even monogrammed headed paper). Alternatively, the company could also have used the moneys to pay utility bills or suppliers. Thus, the two can be distinguished.

It is therefore submitted that no link should have been established between the funds and the purchase, and that no resulting trust should have been found[998], because the link between the provision of the funds and the purchases cannot be proven. It is further asserted that *Petrodel* illustrates the issue and difficulty of establishing a connection between the provision of moneys and the purchase of property - particularly where the facts and circumstances are unclear. Hence, as seen from *Petrodel* and *Edward Barron,* should a claim be made for a purchase price resulting trust, the claimant may face the uphill challenge of establishing a factual link between the purchase moneys and the acquisition of the asset. It must also be noted that in requiring such a connection, the courts are implicitly adopting a positive form of presumption, rather than Chambers' negative formulation.

Another, wider, issue raised by *Petrodel* and *Winkworth* is how Equity treats the provision of funds to companies by shareholders, which are then used to purchase property. The correct conclusion to draw, as seen in *Winkworth,* is that the funds become the legal and

[998] See also Virgo G, *The Principles,* (No.899) at 222

beneficial property of company, with the shareholder retaining no interest unless explicit provision is made. This view is also adopted in *Stockholm Finance v Garden Holdings*[999]:

> "…a wholly-owned company cannot be seen by its shareholder either as a potential rival to him in claims of ownership of property, or as a potential recipient of bounty from him…What goes out of one economic pocket comes straight out the other."

Similarly, in *Nightingale Mayfair Ltd v Mehta*[1000], it was held:

> "…the proper and natural inference from the decision by an individual to purchase a property in the name of a company and to provide it with the funds to do so, especially where the company is controlled by the individual, is that the company should be the beneficial as well as the legal owner of the money and then the property."

Consequently, should the corporate form be used by its members as a 'one-man company', and be used as a conduit for the member's activities, any moneys put into the company that are used to purchase property, unless there is an express statement to contrary, become the sole property of the company, with the member retaining no interest in the moneys. Any property purchased by the company in these circumstances will remain the company's, and if the company becomes the provider of funds for a third party to purchase property, it is the company and not the member who will acquire the beneficial interest under a purchase price resulting trust.

These limitations are to some degree offset by the diverse forms a contribution to the purchase price can take. Indeed, there is no need for a direct payment to occur, and indirect contributions have been allowed. One example is *Springette v Defoe*[1001], where a house was purchased from the local council by cohabitees. One of the cohabitees, owing to their status as a sitting tenant, was entitled to a 41% discount to the purchase price. It was held that the discount amounted to a contribution to the purchase price. Similarly in

[999] [1995] NPC 162
[1000] [2000] WTLR 901
[1001] (1992) 24 HLR 552

Laskar v Laskar[1002], although one of the purchasers did not provide any direct financial support for the purchase of a house from the council, it was again held that the discount made available to the purchaser through being a sitting tenant was a contribution to the purchase price, and a resulting trust was found to have arisen giving them 33% of the property.

A similar conclusion has been reached in *Calverley v Green*[1003] in relation to circumstances where a party accepts liability to pay the purchase price. This usually occurs where a party takes on the obligation to pay a mortgage and adopts the position of a mortgagor. In *Calverley* itself, although the defendant had paid a third of the purchase price through a deposit and all of the mortgage instalments, the claimant was held to have contributed to the purchase price by entering into an undertaking to repay the mortgage. However, the court also emphasised that payment of the mortgage instalments alone would have been insufficient, as this was merely discharging a debt[1004], rather than taking on the obligation to repay[1005].

The Court also held that whilst the payment of the mortgage does not alter the quantum of their beneficial interests under the mortgage, the defendant may be entitled to demand payment of half the mortgage instalments before the claimant could enforce their beneficial share. Thus, although a resulting trust may be imposed should the obligation to repay a mortgage be incurred, it is unlikely to enable the mortgagor to claim a free share of the property. Resulting trusts arising in such contexts would therefore only be of use to parties claiming actual occupation, who require a beneficial interest in the property to defeat the claims of parties seeking possession. It also means that should a company undertake to pay the mortgage instalments of another party – such as a subsidiary – then this would not entitle them to a beneficial interest unless a contribution to the mortgage is made. If, however, the parent company were to contribute to any repairs or renovations of the property of a subsidiary that results in an increase in the value of the property, they

[1002] [2008] 2 AC 432
[1003] (1984) 155 CLR 242; *Curley v Parkes* [2004] EWCA Civ 1515
[1004] See also *Laskar v Laskar* [2008] 2 AC 432; *Barrett v Barrett* [2008] EWHC 1061 (Ch) at 6-7; *Cowcher v Cowcher* [1972] 1 WLR 425; *Gallarotti v Sebastianelli* [2012] EWCA 865
[1005] *Calverley v Green* (1984) 155 CLR 242 at 257

would be entitled to a proportionate share in the increase of the property's value via a resulting trust[1006].

The final issue to address is whether or not the resulting trust is still applicable to the domestic home. In recent judgments concerning the family home, it has emphatically been held that the common intention constructive trust should be utilised rather than the resulting trust[1007]. Despite this, in *Laskar v Laskar*[1008] Lord Neuberger noted that the resulting trust is still applicable "where the parties primarily purchased the property as an investment for rental income and capital appreciation, even where their relationship is a familial one." The resulting trust therefore applies in all circumstances other than the family home – and even applies to residential property purchased for the purposes of investment. Hence, where there is close connection between the parties, such as second wife and stepdaughter, the resulting trust will be applicable[1009]. Thus, such trusts still have a role in determining the ownership of residential property – meaning should commercial entities purchase residential property, a beneficial interest may be acquired through a resulting trust.

In conclusion, the purchase price resulting trust potentially enables a beneficial interest to be acquired in multiple ways. Provided that the moneys were provided for the purchase of purchasing the property then a resulting trust is possible where direct contributions were made, discounts to the purchase price are used in order to purchase the property, or a party accepts/takes on mortgage obligations.

Section 2.2 - Application of the Purchase Price Resulting Trust in Liquidation

As set out above, the primary application of the purchase price resulting trust has been the traditional provision of purchase moneys by party A to party B with the purchased property registered in the name of party B. Within this thesis, therefore, the most apparent application of this trust is where the company or third party has provided some or all of

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[1006] *Drake v Whipp* [1996] 1 FLR 826
[1007] *Stack v Dowden* [2007] 2 AC 432 at 31, 60
[1008] [2008] 2 AC 432 at 110. See also *Geary v Rankine* [2012] EWCA Civ 555; *Favor Easy Management v Wu* [2012] EWCA Civ 1464.; Pawlowski M, *Beneficial Ownership of the Family Home: Where Now for the Resulting Trust?,* (2017) 23(7) T&T 757 at 758
[1009] *Wodzicki v Wodzicki* [2017] EWCA Civ 95.

the purchase moneys to property. This would provide them with a beneficial share of the purchased property in proportion to their contribution.

An example of such an occurrence would be as follows: Company A provides Company B with £5 million to purchase an office block from which it will operate. Company B uses that £5 million to purchase that office block as agreed and begins operating from it. As the provider of the purchase moneys, Company A would be the full beneficial owner of the office block. Should Company A then become insolvent, and enter liquidation, as the beneficial property of the company, the office block forms part of the company's general assets (as no fixed charge or mortgage would be present), and so could be utilised by the liquidator for distribution within the statutory priority of distribution. Were Company A to accept liability for any mortgage over the office block and make payments towards the mortgage, then this would also give rise to a resulting trust in favour of Company A.

Equally, should Company A provide Company B with £5.67 to purchase a new notebook, then Company A would be the full beneficial owner of the notebook, and so should Company B enter liquidation, it would be available for distribution to Company A and prevent them from becoming unsecured creditors.

Although of general applicability, the purchase price resulting trust would be particularly effective in two factual matrices: the corporate group formed of a parent company and subsidiaries, and the 'one man' company.

Within the corporate group, the most probable operation would be where the parent company, with superior financial resources, provided funds to its subsidiary to purchase property. The same would apply should the reverse be true, and the subsidiary be in a superior financial position and provide funds to the parent company. In both scenarios, the provider of the funds would be able to acquire all or part of the purchased property for themselves.

A reported similar factual matrix is the well-known *DHN Food Distributors v Tower Hamlets LBC*[1010]. Despite this case being concerned with piercing the corporate veil, rather than the resulting trust, it is an indicative example of how corporate structures and ownership models are used in practice, and how the resulting trust would be applicable in these circumstances. The facts of *DHN* itself involved a parent company (DHN) and two subsidiaries, Bronze and DHN Food Transport. The business was owned by the parent company DHN. The warehouse from which it operated was owned by the Bronze subsidiary, and the delivery vehicles were owned by DHN Transport.

Supposing for the moment that DHN had provided the purchase moneys for the purchase of the assets by the subsidiaries[1011], DHN would have been the beneficial owner of the warehouse and delivery vehicles. Given that DHN had entered into liquidation, acquiring the beneficial ownership of these assets would have made them available to its liquidator. Furthermore, owing to the doctrine of separate legal personality[1012], the liquidators of the subsidiaries would not have access to the assets, so boosting the available assets for DHN's creditors.

The potential outcomes of such a resulting trust are not limited to increasing the transferor's assets. Indeed, the availability of such a resulting trust could potentially incentivise corporate groups to look to, and use, internal funding arrangement to purchase property, rather than external debt options. This would particularly be the case if the parent company were cash rich and did not wish the group to incur interest payments. However, should a trust be imposed within a corporate group, it would lead to a 'robbing Peter to pay Paul' scenario for the group creditors, with those of the contributing company benefiting, whilst those of the recipient losing out. Notwithstanding this apparent unfairness, it may have the effect of allowing parts of the corporate group to survive by providing them with a new source of assets with minimal risk.

The alternative context in which the purchase price resulting trust would be of application is within 'one man' companies, where the shareholders have utilised the corporate form

[1010] [1976] 1 WLR 852
[1011] In fact, the assets had been purchased in a complicated arrangement with the Palestine British Bank – see ibid, at 854-855h
[1012] *Salomon v Salomon* [1896] UKHL 1

as a front for their own personal activities. Should the company enter liquidation, and the company be the provider of the purchase moneys to the shareholder or other party, then it would be the beneficial owner of the property.

The application to this context is best seen in a re-examination of *Petrodel,* which makes it possible to conclude that rather than the properties being the beneficial property of Mr Prest, they should have been the beneficial property of Petrodel itself. The case also illustrates the difficulties that arise in establishing such trusts, with accurate record keeping not be a priority.

In his leading judgment, Lord Sumption concluded three properties were purchased with funds that were provided directly by Petrodel Resources itself, and not by Mr Prest. In the case of two of the flats[1013], which were purchased by the subsidiary company Vermont, the funds came directly from Petrodel after it had begun trading operations. In the case of the third property, it was also held to have been purchased with funds provided by Petrodel, but who had acquired the funds itself from Mr Prest as it had not yet begun its operations[1014]. Mr Prest was also found to have placed additional financial resources in Petrodel over an extended period of time.

It is submitted that although Mr Prest indirectly provided the funds to purchase these properties, the doctrine of separate legal personality enunciated in *Salomon v Salomon* should have resulted in those funds being found to be the property of Petrodel Resources rather than remaining the assets of Mr Prest. In recognising that Petrodel was not a mere conduit for the provision of the funds, and was in fact the true legal and beneficial owner of the funds with autonomy over their use, Mr Prest could not have been the provider of the purchase moneys. Notwithstanding that Mr Prest must have been the one to elect that Petrodel would provide the funds to purchase the properties, owing to the fact that he was acting in his position of director and not owner of the funds, the moneys were no longer his property, and so he could not have acted in the capacity of provider. For this to have occurred, Petrodel itself would have had to acknowledge or accept Mr Prest's retention of beneficial ownership over the funds, which did not occur.

[1013] *Prest v Prest* [2011] EWHC 2956 (Fam) per Moylan J at 85
[1014] Ibid, at 85.

This interpretation of the ownership of the funds in *Petrodel* has received support from the judiciary. As outlined above, in *Stockholm Finance*[1015] and *Mehta*[1016], it was concluded that where a member transfers property to the company, or provides the funds to purchase property, the natural inference is that the property or funds now belong to the company. Additionally, Chadwick J emphasised that "If land is purchased in the name of a company" it would be "perverse" to not think the company holds the beneficial interest[1017].

Thus, the courts have been clear – where there is a provision of funds in order to enable a company to purchase property, those funds and the assets purchased are the property of the company and not the member. It is additionally submitted that, as set out above, even if Mr Prest was the true provider of the purchase moneys, no relationship between the moneys and the asset purchased can be established. In the case of Petrodel, this means the properties should have been held on resulting trust for it. If it had subsequently entered liquidation, the valuable properties could then have been made available to the liquidator and the statutory priority of distribution.

This reinterpretation of *Petrodel* has, however, been rejected by Pawlowski[1018]. He contends that in *Petrodel* and similar cases of purchase price resulting trusts, the courts have been correct to impose a resulting trust in favour of original provider of the funds (nearly always a member of the company) as there has been sufficient evidence to indicate that they were the true providers of the funds. The evidence for such a conclusion is that the companies had yet to engage in commercial operations, and no rent was paid for occupation of the properties. As Mr Prest elected to provide no evidence to the court, and actively sought to obfuscate the courts' attempts to establish the true factual matrix, Pawlowski further contends the Supreme Court was correct to find against Mr Prest and that he was the provider of the funds.

[1015] [1995] NPC 162

[1016] [2000] WTLR 901

[1017] *Arab Monetary Fund v Hashim* (15th June 1994, unreported), Ch D per Chadwick J. It was followed in *Trade Credit Finance No(1) Ltd v Bilgin* [2004] EWHC 2732 (Comm); *United Overseas Bank ltd v Iwuanynwu* [2001] All ER (D) 40

[1018] Pawlowski M, *A Fair Result?*, (2017) 189 Trusts and Estates Law and Tax Journal 4

Dealing with the first element, the available evidence rather than the adverse inference, it is submitted that as outlined above, Pawlowski's analysis does not accord with the fact pattern of *Petrodel.* As concluded by Lord Sumption himself, the moneys were eventually provided by Petrodel Resources Limited, and not Mr Prest. Even though Mr Prest may have been the original source, it was Petrodel Resources, an autonomous and separately legal entity, that provided the crucial funds for the purchase of the properties. As set out above, the courts in *Stockholm Finance* and *Mehta* both held that moneys provided to a company by a member were both legally and beneficially the company's. Consequently, because it was an autonomous and independent entity that provided the funds, the actual intentions of Mr Prest were irrelevant unless the company had expressly agreed to limitations on the use of the moneys. The only true provider of the funds could therefore have been Petrodel Resources[1019].

Turning to the second element, the role of the adverse inferences, it is also contended that Pawlowski's assertions are subject to criticism. Pawlowski contends, relying on Lord Sumption's comments[1020], that a refusal by the defendant to provide evidence entitles the courts to draw an adverse inference against them. Whilst this is undoubtably correct, and the ability to do so was categorically set out by Lord Lowry[1021], Pawlowski takes this further and submits that adverse inferences themselves are sufficient evidence for dealing with the presumptions of resulting trust.

It is submitted that adverse inferences in themselves are insufficient to rebut the presumption of resulting trust though. Instead, it is proffered that direct evidence as to the parties' intentions is necessary. As concluded in Chapter 6, where a full analysis of the requirements is undertaken, it is only once direct evidence is adduced that the presumptions can be rebutted. Instead, the adverse inference is only applicable once there is direct evidence, which then allows the courts to interpret any ambiguities against the party. Given that in *Petrodel* was there no evidence – even ambiguous evidence - of an alternative intention, a rebuttal of the presumption was precluded.

[1019] See also Virgo G, *The Principles of Equity and Trusts,* 4th edn (Oxford: OUP, 2020) 236-237
[1020] *Prest v Petrodel,* (No.997)
[1021] *R v Inland Revenue Comrs, Ex p TC Coombs & Co* [1991] 2 AC 283 at 300; see also *Wisniewski v Central Manchester Health Authority* [1998] PIQR P324, at 340

Within the context of this thesis, this is applicable where a shareholder pumps his money into a 'one man' company and uses that company to purchase property. Given the analysis above, as the company would be the provider of the purchase moneys, it is they who would acquire a beneficial interest rather than the shareholder. This is in-keeping with the *dicta* of *Arab Monetary Fund* and *Mehta* and could potentially result in substantial assets being made available. Taking *Petrodel* as an example, had the conclusions of this chapter been applied, roughly £17 million would have been accredited to the company's asset pool.

The final point to consider in relation to this potential factual matrix is the need for a relationship between the provision of funds and the purchased asset, as required by *Edward Barron.* Given that the shareholder may not provide the funds with a single, identifiable asset in mind, even if it can be established that the shareholder was the true provider of the funds, it may not be possible to establish that the relationship between the property and the funds. This is similar to the analysis of *Petrodel* above.

Should a resulting trust be found in favour of the company, and that it is the beneficial owner of property it provided the purchase moneys for, such trusts could undo potential damage to the unsecured creditors of these companies and see the liquidator provided with assets that can be sold and the returns used for distribution to the unsecured creditors.

The analysis of the purchase price resulting trust undertaken in this section has so far worked upon the basis that company A has provided party X with funds to purchase property, or party X has provided company A with funds. In doing so, there has been the presumption that this has taken the form of cash. However, as set out above, there is no requirement for the provision of the purchase price to take such form, and instead contributions can take a variety of forms.

Application of this freedom to companies can be seen in the examples of *Springette v Defoe* and *Laskar v Laskar,* the 'council house discount' cases. For, should a company within the corporate group, or a 'one man' company, have access to a discount to purchase property (such as a negotiated contractual right or statutory option to purchase), and another company within the corporate group/the shareholder provide the remaining necessary funds to purchase the property, then the company entitled to the discount would

acquire a beneficial interest to the property in proportion to the discount's size. As with all other purchase price resulting trusts, this beneficial interest would be made available to liquidators upon the onset of liquidation.

Similarly, as seen in *Calverley v Green,* should a company assent to be bound by the obligations of a mortgage, then they too would be deemed to have contributed to the purchase price. Within a corporate group, this would occur should a parent company agree to guarantee/be a party to a subsidiary's mortgage to ensure confidence from the bank. Within a one-man company, it would be where the company guarantees the shareholder's mortgage. In both instances, by guaranteeing the mortgage a share of the beneficial interest would be available for distribution should the guarantor be liquidated. However, as also recognised, the company would not be entitled to claim their beneficial share unless they also made a contribution to the mortgage instalments. Although it may make abstract financial sense for the company to subsequently[1022] contribute to the mortgage payments if the property has greatly increased in value, owing to this thesis' analysis of companies in liquidation, this will not be a viable possibility as such companies would not have sufficient assets to contribute to the mortgage payments in the first place. As seen in Chapters 3 and 4, the majority of liquidations fail to provide the liquidator with sufficient resources to undertake even simple litigation. Thus, this form of purchase price resulting trust is unlikely to be of any benefit to unsecured creditors in practice.

Thus, the resulting trust can be used to place assets back into the hands of the provider of the purchase moneys, which can then be distribute to unsecured creditors or prevent third parties becoming unsecured creditors. This can either be through the company being the provider of the purchase moneys, or the company purchasing assets with moneys provided by a third party. Whilst it may be argued that companies are unlikely to not specify the nature of the transfer, as implicitly evidenced in this chapter and Chapter 6, transactions regularly occur without this clarification being provided. Thus, in either circumstance, should the asset be land or other high value item, then the potential value being returned to the transferor may be substantial.

Section 2.3 - Gratuitous Transfer Resulting Trusts

[1022] Meaning shortly before the company entered liquidation

Equity also presumes that where a transferor has transferred property gratuitously, and there is an absence of a contrary intention, there is no intention on the part of the transferor for the recipient to acquire a beneficial interest in the property[1023]. Instead, it is presumed that a bargain, rather than a gift, was created, and so the transferred property is held on trust for the transferor[1024]. As with the purchase price resulting trust, before analysing in detail how they can be applicable to instances of insolvency it is first necessary to set out the law pertaining to this form of trust and resolve a number of uncertainties in the authorities to adequately identify in what matrices it is applicable.

The application of the presumption in relation to the gratuitous transfer resulting trust has been illustrated in numerous examples, primarily involving transfers of personal property. The best known is *Re Vinogradoff*[1025], where a grandmother transferred £800 of War Loan Stock to a bank account set up in the joint names of herself and her infant granddaughter. Farwell J held that the granddaughter was a resulting trustee for her grandmother as there was no evidence of an intention for her to benefit - particularly as it was the grandmother alone who received the dividend payments. Similarly in *Thavorn*[1026], a woman opened a bank account in favour of her nephew containing £20,000[1027]. She also directed that she alone was to be allowed to operate the account, and so it was held that the moneys were held on resulting trust for herself as there clearly was no intention for the nephew to benefit.

The gratuitous transfer resulting trust not only protects transferors who have failed to adequately express their intentions over transfers of property, but also protects those who do not have the capacity to adequately transfer property. In *Goodfellow v Robertson*[1028] for example, property was transferred while the owner was of 'unsound mind'. It was held that the transferor, because of his lack of capacity, could not have intended to part with his property, and so the recipient held it on resulting trust.

[1023] Hayton D, *Underhill and Hayton,* (No.883) at 495; Tucker L, *Lewin on Trusts*, (No.185) at 356
[1024] Chin J, Rabinowitz A and Quinn A, *The Presumptions,* (No.916) at 43
[1025] [1935] WN 68. See also Re *Howes* (1905) 21 TLR 501; *Re Müller* [1953] NZLR 879
[1026] *Thavorn v Bank of Credit and Commerce International SA* [1985] 1 Lloyd's Rep 259
[1027] See also *Aroso v Coutts* [2002] 1 All ER (Comm) 241
[1028] (1871) 18 Gr 572

From the examples, it can be seen that the gratuitous transfer resulting trust plays an important role in English property law. Not only does it provide a mechanism by which the ownership of property can be determined in the absence of evidence indicating the intentions of the transferor, but it also assists in protecting vulnerable individuals. In the context of this thesis, it is unlikely that vulnerable individuals will be involved given its commercial focus. It will be applicable where there is a lack of evidence as to the parties' intentions concerning the transfer of property, however. As is illustrated below, the gratuitous transfer resulting trust is of assistance where there has been a transfer of property by a company and it is unclear what the intentions behind the transfer were. In such circumstances, it is possible for the company to recover the property and make it available to unsecured creditors.

Section 2.3 (a) - Gratuitous Transfers of Land

The clarity of the law relating to personal property is not reflected in the law relating to gratuitous transfers of land, with much confusion reining over its current position[1029].

The root of the confusion is s60(3) Law of Property Act 1925, which *prima facie* appears to abolish the presumption of a gratuitous transfer of land. The provision states that:

> "In a voluntary conveyance a resulting trust for the grantor shall not be implied merely by reason that the property is not expressed to be conveyed for the use or benefit of the grantee.'

A literal reading of s60(3) thus implies that should there be a gratuitous transfer of land by a transferor, no resulting trust will be presumed merely because consideration was absent. If this literal interpretation is correct, then the gratuitous transfer resulting trust would be applicable only to personal property, whilst land would require the presentation of additional evidence for a trust to be imposed[1030].

[1029] Stubbins M, *The Gratuitous,* (No.927), where this section draws its conclusions
[1030] Ibid.

The response from the judiciary in interpreting s60(3) has been muddled. Upon the issue first being raised, Russell LJ in *Hodgson v Marks*[1031] refused to conclude how s60(3) should be interpreted, commenting that there was a "debatable question whether on a voluntary transfer of land by A to stranger B there is a presumption of a resulting trust".[1032] In the subsequent appeal of *Tinsley v Milligan*[1033], although unwilling to provide a definitive interpretation, Lord Browne-Wilkinson concluded that conceivably a change had occurred: "…it is arguable, however, that the position has been altered by the 1925 property legislation." Despite not being a categorical statement on the issue, it does indicate that the courts are receptive to the notion that s60(3) has in fact reformed the law.

In *Lohia v Lohia*[1034] HH Nicholas Strauss QC built upon Lord Browne-Wilkinson's conclusion and held "that the purpose of section 60(3) was accordingly to do away with the presumption of a resulting trust in the cases of voluntary conveyance and to make it necessary for the person seeking to establish a resulting trust to prove it."[1035] He therefore concluded that "Accordingly, I hold that a voluntary conveyance does not give rise to a presumption of a resulting trust"[1036]. Despite the case being appealed[1037], the Court of Appeal refused to discuss the issue[1038].

The Court of Appeal did, however, examine *Lohia* in *obiter* in *Ali v Khan*[1039], with Sir Andrew Morritt VC commenting that *Lohia* "establishes that the presumption of a resulting trust on a voluntary conveyance of land has been abolished by s60(3) Law of Property Act 1925"[1040]. Whether it can confidently be concluded that the presumption has been abolished is up for debate, though, owing to the Court of Appeal's refusal to tackle the issue head on.

[1031] *Hodgson v Marks* [1971] 2 WLR 1263
[1032] Ibid, at 1269
[1033] [1994] 1 AC 340.
[1034] [2001] 3 ITLELR 101
[1035] Ibid, at 130
[1036] Ibid, at 130
[1037] *Lohia v Lohia* [2001] EWCA Civ 1691
[1038] See the judgments of Mummery LJ (ibid, at para 26) and Sir Christopher Slade (ibid, at para 34)
[1039] [2002] EWCA Civ 974
[1040] Ibid, at para 24.

The academic community have not been as hesitant though[1041]. Thomas and Hudson have categorically rejected the possibility of the presumption surviving[1042], and also put forward persuasive policy justifications for the presumption's abolition[1043]. They submit that due to the strict formalities that exist in regard to conveyances of land in contrast to the transfer of personal property, there is a higher probability the transferor will have analysed the consequences of the transfer[1044]. Consequently, there is no need for the law to provide a safety net for transferors in such circumstances.

Thus, although not definitive, it is likely that the presumption has been abolished[1045], and there is no resulting trust should land be gratuitously transferred unless additional evidence is adduced.

Section 2.3 (b) - Does Petrodel Alter the Equation?[1046]

In *Petrodel,* Lord Sumption held that three properties transferred to Petrodel for £1 were held on gratuitous transfer resulting trust for Mr Prest, the company's sole shareholder. The reasoning was that since Mr Prest had not provided an explanation for the transfers, there had been "nothing to rebut the ordinary presumption of equity that PRL was not intended to acquire a beneficial interest in them"[1047].

It is submitted that there a several fundamental issues with Lord Sumption's judgment and reasoning. The main issue is the existence of £1 consideration for the transfer of the three properties, which runs counter to the restriction that gratuitous transfer resulting trusts can only arise in response to transfers where there is an absence of consideration[1048]. As has been made clear, when considering the issue of consideration in relation to

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[1041] See: G Kodilyne and T Carmichael, *Commonwealth Caribbean Law of Trusts* (3rd edn, Routledge 2013) 84; Mee J, *Resulting Trusts and Voluntary Conveyances of Lan*d, [2012] Conv 307; Mee J, *Resulting Trusts and Voluntary Conveyances of Land: 1674-1925*, (2011) 32 JLH 215; Tucker L, *Lewin on Trusts*, (No.185) at 360.
[1042] G Thomas and A Hudson, *The Law of Trusts,* (No.185) at 75
[1043] See also Chambers R, *Constructive Trusts in Canada,* (2001) 15 Tru LI 214-32; Chambers R, *Resulting Trusts in Canada,* (2000) 38 Alberta LR 378
[1044] See also D Hayton, *Underhill and Hayton,* (No.883) at 486
[1045] Stubbins M, *The Gratuitous,* (No.927); Mee J, *Resulting Trusts and Voluntary Conveyances of Land*, (2012) 4 Conv. 307-326
[1046] Stubbins M, *The Gratuitous,* (No.927)
[1047] *Petrodel,* (No.997) at 49
[1048] Pawlowski M, *A Fair Result?*, (2017) 189 Trusts and Estates Law and Tax Journal 4 at 5

transfers of property, the courts are concerned only with the existence of consideration, and not its amount[1049]. Similarly, with the ancient use, the existence of *any* consideration was enough to prevent a resulting trust arising[1050]. Owing to the discrepancy between Lord Sumption's conclusions in the Supreme Court and the settled law, *prima facie* the doctrine of precedent would result in the law being reformed, and the existence of consideration would not prevent a gratuitous transfer resulting trust from arising – a clear contradiction.

It is proffered though that there has been no change to the established law. Firstly, there was no acknowledgment by Lord Sumption, or the Supreme Court as a whole, that they intended on altering the law[1051]. Instead, it is only possible to infer that reform has occurred from the inconsistencies with the settled law. Secondly, it is submitted that adopting Lord Sumption's amendment would be unworkable, as it is unknown what level of consideration is permissible. Is it only nominal consideration? Consideration well below the true market value? Lord Sumption's judgment simply does not provide any advice on where the appropriate level should be set, and so adopting any such reform would create unnecessary confusion within the gratuitous transfer resulting trust.

Finally, adopting any such reform would also negatively affect families in the domestic context, where family members gratuitously transfer property to assist one another or avoid the payment of death duties. On such occurrences, it is unlikely the intentions of the parties would be expressed, and that the intentions of the parties might change over time[1052]. In such circumstances, it is therefore justified for Equity to interfere with the imposition of a resulting trust. However, where consideration is present, there is usually a thought out or well-expressed domestic justification for the transfer. There is consequently a much weaker justification for Equity interfering with such transactions.

Equally problematic though is Lord Sumption's treatment of s60(3) Law of Property Act 1925, where in relation to the three 'gratuitous transfers', it was concluded that the

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[1049] *Sturlyn v Albany* (1587) Cro Eliz 756; see also *Thomas v Thomas* (1842) 2 QB 859.
[1050] Rivington H, *Snell's Principles of Equity* (19th edn, Sweet and Maxwell 1925) at 113.
[1051] Stubbins M, *The Gratuitous* (No.927) at 522. See also Virgo G, *The Principles of Equity and Trusts,* (No.899) at 222; D Hayton, *Underhill and Hayton,* (No.883) at 497; Mee J, *Voluntary Conveyances of Land: the Presumption of Resulting Trust Redux?,* (2018) CPL 184 at 187
[1052] Stubbins M, *The Gratuitous,* (No.927) at 522

'ordinary presumption of equity'[1053] applied – the presumption of a resulting trust upon the gratuitous transfer of land. As outlined above, in doing so, Lord Sumption's judgment runs counter to established law. As with the issue of what constitutes a gratuitous transfer, His Lordship does not explicitly refer to any reform, nor does he reference s60(3) at all. To therefore conclude that *Petrodel* overrules judgments of the High Court, Court of Appeal and the majority of the academic commentary without reference to the issues or the statutory language is problematic[1054].

Therefore, it is submitted that despite the appearance of reform to the gratuitous transfer resulting trust, it should be concluded that *Petrodel* has not altered the law.

Section 2.3 (c) - Mistaken Transfers

One final area in which the gratuitous transfer maybe applicable to the liquidation process is mistaken transfers. Controversially, in *Chase Manhattan Bank NA v Israel British Bank*[1055] Goulding J held that where the claimant had mistakenly paid the defendant the same amount of money twice - $2 million each time - the claimant retained equitable title over the mistakenly paid moneys. The judgment was controversial for two aspects; the first was the reasoning for their being an equitable interest in the mistaken property, and the second was the priority it afforded the claimant, given that the defendant had entered insolvency.

In coming to his conclusion, Goulding J held that where a person pays money under a factual mistake, they retain an equitable interest in the mistakenly transferred property, and the conscience of the recipient is bound by a fiduciary duty to respect the transferor's proprietary right[1056]. This was grounded on an interpretation of *Re Diplock*[1057] and *Re Berry*[1058]*,* the latter being an American authority. Considering *Re Berry* first, he held that notwithstanding it being American precedent, the principles stated were the same as those in the English legal system[1059]. *Re Berry* itself stated that "On no possible theory could

[1053] *Petrodel,* (No.997) at 49
[1054] Stubbins M, *The Gratuitous,* (No.927) at 523
[1055] [1981] Ch 105
[1056] Ibid, at 119
[1057] [1948] Ch 465
[1058] (1906) 147 Fed 208 at 210
[1059] *Chase Manhattan Bank v Israel-British Bank* [1981] Ch 105 at 118

the retention of the money by [the recipient] be justified; it was paid to them and received by them under mistaken…the money in dispute never belonged to [the recipient]"[1060]. Secondly, Goulding J concluded that *Re Diplock* had not imposed the requirement of an initial fiduciary relation for the recipient to be bound by the transferor's proprietary interest – "the payment into wrong hands itself gave rise to a fiduciary relationship."[1061]

Complicating matters, Goulding J did not elucidate under which equitable mechanism the property was to be returned to the claimant[1062] – meaning it is unknown whether the mistaken transfer was subject to a constructive trust or resulting trust.

Notwithstanding Goulding J's equivocation, attempts have subsequently been made to identify the relevant equitable mechanism. In *Westdeutsche*[1063], Lord Browne-Wilkinson implied that Goulding J had given effect to his judgment through a constructive trust[1064]. However, His Lordship also concluded that Goulding J was incorrect in imposing a constructive trust, as there was no existing equitable interest[1065]. In regard to a constructive trust, it was held that a mistaken transfer itself was insufficient grounds for binding the conscience of the recipient. Instead, knowledge of the mistake could bind the recipient's conscience and then give rise to a constructive trust once the mistake became known[1066]. Within the factual matrix of *Chase Manhattan,* the recipient became aware of the transaction two days after the event, and so before they were petitioned for winding up, but in many cases the recipient will not acquire the necessary knowledge before the onset of insolvency. Consequently, should Lord Browne-Wilkinson's formulation be adopted, it is unlikely that mistaken payments will be a useful mechanism for liquidators to acquire property from the recipient owing to their lack of knowledge.

Similarly, Lord Millett has extra-judicially concluded that *Chase Manhattan* was wrongly decided[1067]. He agreed that a mistaken payment in itself was insufficient to bind the

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[1060] *Re Berry* (1906) 147 Fed 208, per Judge Coxe at 210
[1061] *Chase Manhattan,* (No.1059) at 119
[1062] Ibid, at 119
[1063] *Westdeutsche,* (No.186) at 715
[1064] See Virgo G, *The Principle,* (No.899) at 258; Calnan R, *Proprietary Rights* (No.71) at 142
[1065] *Westdeutsche,* (No.186) at 714-715
[1066] Ibid, at 715. His Lordship did express support for Goulding J's conclusion, if not his reasoning. See also *Metall and Rohstoff v. Donaldson Inc.* [1990] 1 Q.B. 391 at 473-474
[1067] Millett P, (No.882) at 411-413

conscience of the recipient[1068]. However, His Lordship concluded that *Chase Manhattan* was incorrect because the recipient was not a fiduciary, and so there was no proprietary interest at all[1069]. Thus, according to Lord Millett, the imposition of a constructive trust is not possible in instances of a mistaken transfer.

Given the rejection and criticism of Goulding J's reasoning for the transferor retaining a beneficial interest in mistaken property, and the issues with utilising the constructive trust, it is submitted that an alternative interpretation is required[1070]. Calnan has recognised, although does not accept, that there is a need for the transferor to retain a proprietary interest in the property where there has been a mistaken transfer to ensure that policy concerns are given effect to[1071]. Similarly in *Papamichael,* it was commented that the general public would expect the moneys to remain the transferor's[1072].

It is therefore submitted that rather than founding mistaken payments upon a constructive trust analysis, it should be interpreted as being a gratuitous transfer resulting trust. Such a possibility was contemplated by Lord Goff in *Westdeutsche*. Speaking strictly in *obiter,* His Lordship, when considering if a mistaken transfer should give rise to a proprietary interest, commented that "It is true that the doctrine of mistake might be invoked where the mistake is fundamental in the orthodox sense of that word."[1073] In the context of His Lordship's judgement he was considering the availability of the resulting trust in cases of mistaken transfer – thereby meaning His Lordship was in favour of there being a resulting trust in such circumstances. He did, however, conclude that the resulting trust should not be available merely because the underlying contract had been held to be *ultra vires,* as it was clear that transferor intended (even if incorrectly) to part with the beneficial interest.

Though a reinterpretation is undoubtably necessary, it is important to clarify in which circumstances a gratuitous transfer resulting trust could be applicable. This is necessary

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[1068] Ibid, at 411
[1069] Ibid, at 412-413
[1070] Jaffey P, *Proprietary Claims to Recover Mistaken Payments or Unauthorised Payments* in Devonshire P and Havelock R, *The Impact of Equity and Restitution,* (Oxford: Hart, 2019) at 82
[1071] Calnan R, *Proprietary Rights,* (No.71) at 147
[1072] *Papamichael v National Westminster Bank* [2003] 1 Lloyd's Rep 341 at 372-3. See also Goodhart and Jones, *Infiltration of Equitable Doctrine* (1980) 43 MLR 489 at 494
[1073] *Westdeutsche,* (No.186) at 690

because, as set out above, such resulting trusts are only possible if there is a transfer of property in the absence of consideration, and if there is no intention to make a gift or loan.

As recognised by Lord Goff, the resulting trust will have no applicability where the underlying contract was merely *ultra vires,* as the transferor intended on transferring equitable title to the recipient[1074]. Equally, as Webb acknowledged, in many other cases of mistaken transfer, the transferor also actively intended the recipient to take the property outright - such as where they mistakenly believe a debt has not been discharged, where there was a mistake of identity, where there was a mistake as to which property is to be transferred, or that a debt is owed in the first place[1075]. In all of these instances the transferor, although incorrect in their assumptions, did intend to transfer beneficial ownership of the property or received consideration for the property, and so there is a rebuttal to the presumption of a resulting trust[1076].

Hence, where there is an active mistake of law (i.e. the debt is not owed) or fact (i.e. the debt is paid to the wrong individual or a fraud is committed), then the gratuitous transfer resulting trust will not be applicable, as there cannot be a resulting trust because of the intention on the part of the transferor to pass the beneficial interest in the property[1077].

However, it is submitted that in the case of accidental, 'genuine', mistaken payments - where the transfer is made without the intention to transfer equitable title – then it is possible to reinterpret the transaction as being a gratuitous transfer resulting trust[1078]. As noted by Lord Goff, these are instances where "the mistake is fundamental in the orthodox sense of the word."[1079]

[1074] See also His Lordship's previous comments in *Barclays Bank v W.J. Simms Sons & Cooke (Southern) Ltd* [1980] 2 WLR 218 at 232
[1075] Webb C, *Intention, Mistakes and Resulting Trusts* in Mitchell C, *Constructive and Resulting Trusts,* (Oxford, OUP, 2010) at 315*;* Salmons D, *The Availability of Proprietary Restitution in Cases of Mistaken Payments,* (2015) 72 CLJ 534 at 536
[1076] See *Kelly v Solari* (1841) 9 M and W 54 for an example matrix.
[1077] This interpretation is raised by Bridge M et al in *The Law of Personal Property,* 2nd edn (London: Sweet & Maxwell, 2018) at 310. They conclude however that the cases historically are concerned with apparent gifts rather than mistaken payments.
[1078] See *Re Goldcorp Exchange* [1994] 2 All ER 806 e
[1079] *Westdeutsche,* (No.186) at 690

In *Chase Manhattan* itself, a series of administrative mistakes led to the mistaken payment[1080]. The second payment occurred as a result of a clerical error by an employee of the bank, which caused fellow employees to wrongly (and passively) believe that instructions from another bank had been received. The employees then partially acted upon these instructions, and made negligent attempts to stop the payment which were only partially successful. Hence, owing to the origins of transfer being a clerical error, the transferring bank never formed the intention to part with the beneficial interest in the moneys at any stage of the transfer – especially given the attempts to prevent the transfer from occurring.

Given this lack of intention, it is proffered that a gratuitous transfer resulting trust should have arisen in *Chase Manhattan*. Firstly, there was a transfer of property in the absence of consideration as the recipient had never contracted for the second payment to be made. Consequently, the mistaken transfer was gratuitous, and a presumption of a resulting trust should be imputed due to the transfer being of personal property and not land. This is also compatible with the theoretical foundations of the gratuitous transfer resulting trust – that the overwhelming number of individuals would not transfer property to a third party gratuitously without retaining a beneficial interest, even more so if the transfer had only occurred in genuine error. It is further proffered that given the transfer was founded up upon a clerical error and the subsequent attempts by Chase Manhattan to stop the transfer from occurring, there was insufficient evidence to rebut the imputed intention and argue that bank intended to part with the beneficial interest. Thereby, the moneys should have been held on a gratuitous transfer resulting trust for the transferor.

A fundamentally similar occurrence happened in *Williams v Williams*[1081]*,* although with a very different fact pattern. In *Williams* a father purchased an estate and, without his knowledge, the conveyance was in his son's name. The purchase was with the father's moneys, and he also collected the rents from the estate. The conveyancing solicitor had erroneously concluded that as previous transactions had been in the son's name, this transaction should also be in the son's. It was held that as it was clear the father intended to retain the beneficial interest in the property, the son held it on trust for the father. Thus, where there is a true mistaken transfer that prevents the transferor from forming the

[1080] [1981] Ch 105 at 114.
[1081] (1863) 32 Beav 370

intention that the recipient should receive the beneficial interest, that property will be subject to a trust[1082].

In his extra-judicial writings, Lord Millett obliquely questions the reinterpretation of *Chase Manhattan* set out above. His Lordship, in commenting on *Chase Manhattan,* concluded that "…The plaintiff had intentionally though mistakenly parted with all beneficial interest in the money…The fact that the transferor intended to part with the beneficial interest was inconsistent with the existence of a resulting trust."[1083] Notwithstanding that Lord Millett's second conclusion, that the existence of an intention to part with the beneficial interest precludes the existence of a resulting trust, is correct, it is submitted that his initial observation as to the intentions of the transferor in the case were mistaken. As outlined above, on the facts the transferring bank did not intend to part with the beneficial interest, and in fact tried, if incompetently, to row back on the transaction. Given this, it is submitted that his Lordship was mistaken in ruling out the possibility of a resulting trust in these circumstances.

Finally, in addition to being theoretically sound[1084], one further advantage to this reinterpretation is, unlike with Lord Browne-Wilkinson's constructive trust analysis, there is no need for the recipient to have knowledge of the mistake, as their knowledge and intentions are irrelevant under a resulting trust. Indeed, by imputing an intention to the transferor, the resulting trust would arise as the result of an objective reading of the facts, only not arising should there be sufficient evidence to rebut the presumption. In the alternative formulations of mistaken payments, the recipient's knowledge is fundamental, and troublesome to prove[1085]. The impact of removing the requirement for the defendant to have knowledge of the transfer is illustrated in *Chase Manhattan* – under Lord Browne-Wilkinson's formulation the transferor would initially have had no priority owing to the two days it took for the recipient to realise the mistake had been made, whilst under the

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[1082] See also *Bainbridge & Anor v Bainbridge* [2016] EWHC 898 (Ch)
[1083] Millett P, *Restitution and Constructive Trusts,* (No.882)
[1084] Support for such as interpretation comes from G Thomas and A Hudson, *The Law of Trusts*, (No.185) at 543. See also *Leuty v Hillas* (1858) 2 De GF and J; *Craddock Brothers v Hunt* [1923] 2 Ch 136, CA; *Blacklocks v JB Developments (Godalming)* Ltd [1982] Ch 183; Salmons D, *The Availability of Proprietary Restitution in Cases of Mistaken Payments,* (2015) 72 CLJ 534 at 555; *Seldon v Davidson* [1968] 1 W.L.R. 1083
[1085] Salmons D, *The Availability of Proprietary Restitution in Cases of Mistaken Payments,* (2015) 72 CLJ 534

reinterpretation the transferor would have had priority the moment the transfer occurred as the recipient's knowledge was irrelevant. Consequently, the reinterpretation protects those transferors when there is a delay in becoming aware of the mistake. Finally, given the limited nature of the resulting trust, and its limitation to genuine, accidental mistakes, there is no issue of the mechanism being utilised to an excessive extent[1086], as is the concern should any unjust enrichment analysis be utilised.

Section 2.4 - Application of the Gratuitous Transfer Resulting Trust in Liquidation

Given the above discussion of the gratuitous transfer resulting trust, it is clear that, within context of liquidation, such trusts are of greatest applicability to instances where an insolvent company has transferred personal property to another company gratuitously. In such circumstances this would include both transfers with external parties but also the corporate group, whereby property is transferred gratuitously between members of the group. Should such transfers occur, then obviously the transferor would able to recover the property, and either prevent the property from entering the insolvency asset pool or return the property to the company's asset pool and make it available for distribution.

One hypothetical matrix might be the creation by a corporate group of a new company to undertake a new business opportunity. In such a matrix, to take advantage of the opportunity, and as a consequence of the group's existing subsidiaries having excess resources, the property is transferred from these subsidiaries to the new company gratuitously. In this situation such an occurrence might be rationalised on the basis that because they are effectively one economic unit[1087], it makes little business sense to transfer moneys around the group – especially if the newly formed subsidiary has insufficient assets to purchase the property or is not in a position to acquire credit to make the purchase. Should the recipient company become insolvent, then owing to the gratuitous nature of the transaction, and the lack of intention to transfer legal title to the recipient company, the pre-existing subsidiaries could enforce their resulting trust and take possession of the asset. Again, this can be rationalised on the basis that the

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[1086] A. Burrows, *The Relationship between Unjust Enrichment and Property* in S. Degeling and J. Edelman (eds.), *Unjust Enrichment in Commercial Law* (Sydney 2008) at 333-34; P. Birks, *Unjust Enrichment,* (Oxford: OUP 2005); P. Birks, *An Introduction to the Law of Restitution*, revised ed. (Oxford: OUP 1989)

[1087] Such has been seen previously in *DHN Foods v Tower Hamlets LBC* [1976] 1 WLR 852

transferring company could be said to have not intended to the transfer beneficial title as a means of hedging its bets – the transfer would therefore be an unofficial 'loan' of the asset. This too would be beneficial should the transferring subsidiary, as opposed to the recipient, enter insolvency, as the subsidiary's liquidator could also enforce the resulting trust and distribute the assets among the unsecured creditors.

Although the above matrix could operate 'accidentally' – i.e. without the corporate group actually intending the to create such relationship – it may also be used by a corporate group 'intentionally'. In transferring property gratuitously, it could be used as a way of increasing the balance sheet of one of the subsidiaries and acquiring confidence in its financial position from lenders - thereby making it possible to acquire credit. Furthermore, because trusts are not required to be registered[1088], as the resulting trust is an operation of law and so is impossible to be registered[1089], it could operate as a quasi-security interest, ensuring the corporate group/transferring companies do not have to act as traditional creditors. An obvious downside of such a scheme would be the misrepresentation of the subsidiary's financial position to creditors, and such concerns are thoroughly addressed in Chapter 6.

Notwithstanding the above applying to personal property, as concluded previously in this section, the presumption of a gratuitous transfer resulting trust does not apply to land. Hence, should companies attempt such schemes as outlined immediately above with real property, there would be no presumption that the transferring company would retain a beneficial interest. Albeit that the transferor could adduce evidence of an intention to retain a beneficial interest, doing so could prove problematic and unavailable[1090].

Finally, it is submitted that in instances of mistaken transfer, where there was never an intention to benefit the recipient, a resulting trust can be imposed. This is where the transferor did not think that there was an obligation to pay - either legal or factual - and did not intend for the beneficial ownership to move to the recipient. In such circumstances, as opposed to mistakes as to identify or legal obligation, there is a genuine mistaken payment and no intention to benefit was ever formed. Such instances may

[1088] See Chapter 6 Section 4
[1089] See Chapter 6 Section 4
[1090] *Marr v Collie* [2017] UKPC 17

include human error, or computer error. Should the company have mistakenly transferred the assets then these would be recoverable by the liquidator and be distributable to unsecured creditors, whereas should the company be the recipient of mistaken funds, they would be segregated from the asset pool and prevent the third-party transferor from becoming a creditor.

Section 3 – The Automatic and Quistclose Trusts

Section 3.1 - The Automatic Resulting Trust

In contrast to the 'presumed' resulting trust analysed in Section 2 of this chapter, Megarry J in *Re Vandervell (No2)*[1091] held that there is a second type of trust not based upon the presumed intentions of the parties: the 'automatic resulting trust'. In his Lordship's view, this arises 'automatically' whenever there has been a failed attempt at disposing of property, and operates to restore the beneficial interest in the property to its original owner unless some alternative provision has been made. The function of such trusts is to prevent there being a 'gap' in the equitable title[1092], and ensure that there is a recognised beneficial owner to the property. This is important as, otherwise, the property ends up going to the Crown *bona vacantia*[1093], and all parties are denied the benefit of it.

Historically, automatic resulting trusts appeared to run counter to those of the presumed resulting trust. As noted above in Section 1, Megarry J's classification of there being two distinct categories, the 'automatic' and 'presumed' resulting trusts. It was concluded there was no difference between the two classes identified by Megarry J[1094], as both are founded upon intention. It was therefore incorrect to identify them as being distinct from one another.

[1091] [1974] Ch 269
[1092] Thomas G, *The Law of Trusts,* (No.185) at 734; Tucker L, *Lewin on Trusts*, (No.185) at 315; Mee J, *The Past, Present and Future of the Resulting Trusts,* (2017) 70 Current Legal Problems 189
[1093] *Re West Sussex Constabulary Widows, Children and Benevolent (1930) Fund Trusts* [1971] Ch 1
[1094] Browne-Wilkinson N, *Constructive Trusts and Unjust Enrichment,* (1996) 10 Tru LI 98 at 100

Notwithstanding the issues surrounding the distinction, there is some merit in suggesting that the two categories operate differently. As noted by Underhill and Hayton, unlike presumed resulting trusts, where there is usually some vague but unexpressed idea as to what should occur to the beneficial ownership of the property, under an automatic resulting trust there is normally no consideration of where the ownership should lay[1095]. Given this, it is unlikely that the presumption will be rebutted, and so in practice (if not theory) the resulting trust will operate 'automatically' without the transferor having played an active or passive. Hence the distinction relates to the trust's operation, rather than its theoretical foundations.

Given the competing arguments, the preferred view taken by this thesis is that there is no theoretical difference between the presumed and automatic resulting trust, and instead there is merely one form of trust founded upon the imputed intentions of the transferor[1096]. This is because, as acknowledged by Lord Browne-Wilkinson, both forms of resulting trust arise as a result of the presumed intentions of the transferor, and although the 'automatic' resulting trust may operate as such in practice, it does not operate such in theory. Alternatively, the distinction is valuable for assisting in explaining how the different forms of resulting trust operate rather than their theoretical bases, and thus is merely a descriptive tool.

It is further submitted that the automatic resulting trust accords with the theoretical position taken in this thesis. As outlined above, this thesis' proffers that Equity imputes an intention that the transferor of property intended to retain[1097] a beneficial interest in property if it is transferred gratuitously or if they contributed to the purchase price. It is submitted that the automatic resulting trust accords with this interpretation because of the matrices it is applicable to. The automatic resulting arises where there has been a failure of trust or the trust has surplus assets after its purpose has been achieved. Should the settlor have failed to provide a gift-over for the property, then Equity is confronted with a situation where there is no evidence as to how the settlor intended to deal with the trust

[1095] Hayton D, *Underhill and Hayton,* (No.883) at 448; Mee J, *'Automatic' Resulting Trusts: Retention, Restitution or Reposing Trust?,* in Mitchell C *Constructive and Resulting Trusts,* (Hart: Oxford, 2010) at 232

[1096] Hayton D, *Underhill and Hayton,* (No.883) at 449

[1097] Mee J, *'Automatic' Resulting Trusts: Retention, Restitution or Reposing Trust?,* in Mitchell C *Constructive and Resulting Trusts,* (Hart: Oxford, 2010) at 207.

assets. In such circumstances, Equity must take the initiative and impute what the settlor's most likely intention would have been if they had set their minds to the issue – that they would have intended to retain beneficial ownership of the property[1098]. By retaining the beneficial interest, the settlor is then free to either create another trust or utilise the property for this own benefit. Hence, the automatic resulting trust involves the imputation of an intention that the settlor intended to retain a beneficial interest, and provides an objective means of determining the beneficial ownership of property.

Section 3.2 – Application of the Automatic Resulting Trust in Liquidation

The primary matrix in which the automatic resulting trust arises is upon the failure of an express trust, such as where the company is the settlor of a trust. An express trust may fail because of a non-existent beneficiary[1099], a failure to meet the 'three certainties'[1100], or some other subsequent failure[1101]. Should the trust fail[1102], the property would result back to the company, who would then enjoy beneficial ownership over the property. Obviously, this would apply to any instances in which a company sought to, but failed to, create an express trust. However, this may in particularly be of use should the company have attempted to engage in tax efficiency schemes[1103] that are later declared void[1104]. This may be because the transactions have no commercial or business purpose other than to avoid tax[1105]. Although there is insufficient scope within this thesis to analyse such schemes[1106], this form of corporate behaviour has become infamous through multiple headlines concerning multinational companies[1107]. Should an express trust be utilised in such schemes[1108], and that scheme subsequently fail, then the assets would be returned to

[1098] Ibid, at 235. See also Thomas G, *The Law of Trusts,* (No.185) at 734
[1099] *Omojole v HSBC Bank Plc* [2012] EWHC 3102 (HC)
[1100] *Knight v Knight* (1840) 49 ER 58
[1101] *Re Ames' Settlement* [1946] Ch 217
[1102] Such as in *Tinker v Tinker* [1970] P 136
[1103] *IRC v Duke of Westminster* [1936] AC 1 per Lord Tomlin. See also Thomas G, *The Law of Trusts,* (No.185) at 38-40
[1104] *Rudkin v Dolman* (1876) 35 LT 791; *Re Boyes* (1884) 25 Ch D 531; *Re Pugh's WT* [1967] 3 All ER 337.
[1105] *McNiven (HM Inspector of Taxes) v Westmoreland Investments* [2003] 1 AC 311; *Countess Fitzwilliam v IRC* [1992] STC 185
[1106] Which is likely - for full analysis see Loutzenhiser G, *Tiley's Revenue Law,* 8th edn (Oxford: Hart, 2016) at 624-642 and 767-787
[1107] It includes both the use of discretionary trusts with a number of 'straw' beneficiaries and extra-jurisdictional trusts in well known 'tax havens'.
[1108] See Loutzenhiser G, *Tiley's Revenue Law,* 8th edn (Oxford: Hart, 2016)

the company should no gift over be provided. In doing so, the resulting trust would be giving effect to commercial logical as companies very rarely intend to part with property without receiving something in return in order to protect the interests of their members. This is especially true should a tax efficiency scheme have failed. A prime example of such an intention to retain the beneficial interest in property after a failed attempt to minimise tax liabilities, and the effects of such a resulting trust, is *Re Vandervell,* where after an attempted tax efficiency scheme was declared void the property resulted back to Mr Vandervell[1109].

Furthermore, should the company set up a trust for distressed individuals, and that fund no longer be required, it too will result to the settlor company[1110]. Such instances, although not directly involving companies, include *Re Gillingham Bus Disaster Fund*[1111], where the contributions were unnecessary owing to insurance payments, and *Re Abbott*[1112], where the death of the beneficiaries (two elderly women) meant the donated funds were no longer needed. Within a corporate context, it is unlikely that companies would regularly engage in such philanthropic activities. However, they may engage in such activities if it is part of the overall company image (such as the Ronald McDonald House Charities[1113]) or if they are involved in an unfortunate event (Primark with the Raza Plaza disaster)[1114]. Should these schemes fail or become unnecessary, then the surplus would be held on resulting trust for the company and could become a company asset. This would then form part of the asset pool and be available to the liquidator for distribution to the unsecured creditors.

[1109] Pearce R and Barr W in *Pearce & Stevens' Trusts and Equitable Obligation,* 7th edn (Oxford: OUP, 2018) at 153 submit that it is likely Mr Vandervell would have denied any beneficial interest in the property owing to the tax bill that became due. However, it is submitted that although there may be negative tax implications, reacquiring the asset would outweigh any such negative tax effects.
[1110] *Abbott Fund Trusts, Re Smith v Abbott* [1900] 2 Ch 236; *Re Ames' Settlement* [1946] Ch 217; *Re Cochrane* [1955] Ch 309
[1111] [1958] Ch 300
[1112] *Abbott Fund Trusts, Re Smith v Abbott* [1900] 2 Ch 236
[1113] See https://www.rmhc.org.uk
[1114] Here Primark agreed to provide emergency aid and compensation to the victims of the collapsed factory: Butler S, *Primark to Pay £6m more to Victims of Rana Plaza Factory in Bangladesh,* 16th Match 2014, https://www.theguardian.com/world/2014/mar/16/primark-payout-victims-rana-plaza-bangladesh

Consequently, should an insolvent company have created, or have attempted to create, an express trust that that fails or completes its purpose with a surplus of assets, then these assets will be available for the liquidator to acquire and then make them available for distribution. Owing to the probability that such express trusts will have been created by deed or trust document, rather than orally, the liquidator will usually have knowledge of the trust from the company's records. Despite this, proving that the trust has failed may prove problematic, with the potential beneficiaries seeking argue the trust is still valid. Consequently, this may involve costly litigation to establish the trust's failure[1115]. Although such issues largely lay outside the scope of this thesis, the degree of clarity surrounding this area of law, if not the factual matrices, may make it easier for liquidators to establish a potential claim – if not enforce it.

Section 3.3 - Quistclose Trust

The *Quistclose* trust has sparked, and continues to spark, heated debate concerning the possibility of lenders retaining a beneficial interest in property. Such trusts arise whenever property has been transferred for a specific purpose that subsequently fails and there was an intention that the property should therefore be held on trust for the provider of the asset. Usually, but not always, this arises in the context of banks lending funds to struggling businesses in the hope that the emergency funding will enable the company to trade its way out of trouble[1116]. This mechanism is now regularly used as a means of protecting lenders when there has been insufficient time to draw up more detailed and comprehensive arrangements[1117] - i.e. when the loan takes the form of emergency finance. By finding a proprietary interest over the assets in favour of the provider, they acquire priority should the company be unable to turn around its fortunes. This granting of lenders priority over the moneys has meant that the *Quistclose* trust has become a controversial mechanism as the provider's priority to the company's assets regularly comes at the expense of the unsecured creditors, who no longer have access to the moneys[1118].

[1115] This is considered in more depth in Chapter 6
[1116] For example, see the seminal case of *Barclays Bank v Quistclose Investments* [1970] AC 567
[1117] McKendrick E, *Commerce* in Swadling W, *The Quistclose Trust: Critical Essay,* (Oxford: Hart, 2004) at 145
[1118] McCormack G, *Reservation of Title,* (London: Sweet & Maxwell, 1990) at 29

The policy debate surrounding the *Quistclose* trust, analysed fully in Chapter 6, has primarily focused on the issue of fraud and misrepresentation of the company's financial position to potential investors. At one end of the spectrum, Goodhart and Jones[1119] have commented that the existence of such trusts is acceptable because the unsecured creditor could not have been relying on the company to use such assets to discharge their debts. This is as a consequence of *Quistclose* moneys usually being provided only as emergency funding towards the end of the life of a company, and shortly before the company eventually enters an insolvency regime. As such, existing creditors would have provided the credit before these assets were made available to the company, and so they could not have contemplated having access to these assets. In effect, the loan moneys were never available to the unsecured creditors, and so it is not unjust to grant priority to the lender. Indeed, they go so far as to claim that *Quistclose* trusts are 'just and commendable'.

At the other end, Moffatt[1120] retorts that this may not always prove to be true. He submits that whilst parties who provided credit prior to the specific loan being granted may not be defrauded, this does not prevent the company from trying to create a false image of commercial solidity with the loan moneys. The company could then, either intentionally or unintentionally, use this false image to acquire further credit that will not be, and could never have been, repaid. Hence, the *Quistclose* trust may be used as an instrument of fraud, and fall foul of public policy concerns.

From this brief outline of the debate surrounding the *Quistclose* trust, it is apparent that such trusts straddle this thesis' analysis of the resulting trust. This is because such trusts can either increase an insolvent company's asset pool by returning assets to the company if it took on the position of lender, or it can decrease the size of the company's asset pool by segregating assets for lenders if it took on the position of borrower. It has also shown that such trusts are highly controversial, and these policy concerns are addressed fully in Chapter 6. This section will therefore briefly set out the historical background to the *Quistclose* trust, then seek to determine its theoretical foundations, before the next section identifies how and when such trusts might be applicable to instances of insolvency.

[1119] *Infiltration of Equitable Doctrine* (1980) 43 MLR 489 at 494
[1120] Moffatt G, *Trusts Law*, (No.899) at 804. See *Re Northern Development (Holdings) Ltd,* 6th October, unreported as an example provided.

Section 3.3 (a) - Historical Foundations of the Quistclose Trust

What would eventually be termed the *Quistclose* trust can be traced back to *Hassall v Smither*[1121], where it was held that if moneys were made available for a particular purpose, they must be used for that expressed purpose or they will be held on trust for the provider of the moneys. Similarly, in the subsequent case of *Toovey v Milne*[1122], it was held that if there is an advance of moneys and the expressed purpose of the loan fails, it must be repaid to the lender, and no proprietary interest in the loan moneys passes to the borrower. This principle was subsequently applied[1123] to the misapplication of funds intended to purchase a business[1124] and the return of investors' moneys upon the non-completion of a railway[1125].

Hence, from this brief outline of the *Quistclose* trust's history, it is apparent that it forms an integral part of English law, and has become a key component of modern property and commercial law. This is best illustrated in the seminal case of *Barclays Bank v Quistclose Investments Ltd*[1126]. Rolls had previously declared a dividend, and so Quistclose Investments agreed to loan it £209,719 on the written condition that it would be used for the purpose of paying the dividend and would also be placed in a separate account. Prior to paying the dividend, however, Rolls entered liquidation. Barclays then informed Rolls that as the loan moneys were placed in an account Rolls had with them, it was exercising its right to combine the accounts to pay down pre-existing debts. However, Quistclose claimed that the loan moneys were held on trust for itself. As set out fully below, it was held that the parties had a mutual intention that the moneys should not become part of Rolls' assets, and that if the dividend could not be paid, the moneys should be returned to Quistclose.

However, in the historical cases running from *Hassall* to *Wilson,* although the courts were clear that a trust would be imposed, they did not identify which form of trust was being

[1121] (1806) 12 Ves 119
[1122] (1819) 2 B & Ald 683
[1123] McCormack G, *Proprietary Claims and Insolvency*, (No.188) at 64. See also *Re Rogers* (1891) 8 Morr 243
[1124] *Gilbert v Gonard* (1884) 54 LJ Ch 439
[1125] *National Bolivian Navigation Co. V Wilson* (1880) 5 App Cas 176
[1126] [1970] A.C 567

imposed, nor the policy reasons for doing so. Whilst *Quistclose* did attempt to provide a theoretical foundation[1127], as acknowledged immediately below, this has come in for heavy criticism, and cannot adequately explain the imposition of lender priority. Furthermore, the authoritative reasoning for the *Quistclose* trust has drastically changed from being along express trust foundations to resulting trust foundations, with the resulting trust analysis still receiving criticism. Hence, it is necessary to try and provide some modicum of clarity to the *Quistclose* trust's theoretical foundations to ensure it falls within this thesis' analysis of the resulting trust. The thesis concludes that of the three rival interpretations, the *Quistclose* trust is a form of automatic resulting trust arising upon the default exercise of a power.

Section 3.3 (b) - The Possible Interpretations

1. *Express Trust Analysis*

The first detailed interpretation of the theoretical foundation of the *Quistclose* trust was provided by Lord Wilberforce in *Quistclose.* His Lordship stated that such trusts are founded upon express trust lines, and involve two trusts: a primary trust over the account in which the loan moneys are placed upon receipt, and a secondary trust to return the moneys to the lender[1128]. To justify such a conclusion, Lord Wilberforce relied heavily on *Toovey v Milne*[1129] and *Re Rogers*[1130]. However, neither of these judgments, as with the other historical cases, set out the theoretical foundations of the trusts imposed, and Lord Wilberforce did not seek to identify the reasoning adopted in these cases. Hence, His Lordship adopted an express trust foundation.

Utilising the express trust is, however, problematic. As concluded below, identifying who is the beneficiary of the trust is not always possible. In many cases, rather than there being an identifiable human or legal beneficiary, there is an abstract purpose. These include

[1127] Although only one reasoned judgment was provided by the House of Lords, that of Lord Wilberforce.
[1128] *Barclays Bank v Quistclose Investments* [1970] A.C. 567 at 580
[1129] (1819) 2 B&A 683
[1130] *Re Roger, ex parte Holland and Hannen* (1891) 8 Morr 243 – this extended the application of the *Quistclose* trust to instances of money having been provided to pay an individuals' creditors before entering bankruptcy.

Moore v Barthrop[1131] (the reduction of an overdraft), *Re Vautin*[1132] (the discharge of debts) and *Re EVTR*[1133] (the purchase of audio equipment). In *Twinsectra v Yardley*[1134] for instance, the loan was provided not for a beneficiary, and instead was provided solely to be 'applied in the acquisition of property'. As expounded in *Morice v Bishop of Durham*[1135]*,* all express trusts must have a human or legal beneficiary, and cannot be for abstract purposes unless they fall within one of the three exceptions set out in *Re Endacott*[1136]. In *Twinsectra,* Lord Millett therefore held that solely relying on the purpose the moneys were provided for would have conflicted with the beneficiary principle, and there was a need to also identify a human beneficiary[1137]. Hence, should the loan at the centre of a *Quistclose* case be made for an abstract purpose – which is a distinct possibility – it would run counter to the beneficiary principle.

The existence of *Quistclose* trusts for purposes also precludes the analysis adopted in *Re Northern Development (Holdings)*[1138] that the intended recipients of the loan moneys could be interpreted as being the beneficiaries[1139]. In doing so, the trust is no longer for an abstract purpose, and instead becomes one for human beneficiaries. Adopting such an interpretation is not free of issues, however[1140]. Firstly, even though there may eventually be identifiable parties who benefit from the trust, it is difficult to argue that the trust is truly in their favour when it is unequivocal that it was created to carry out a purpose rather than benefit those individuals. Secondly, it can be difficult to identify a beneficiary/group of beneficiaries either because they are no clearly identified, or because they cannot be known at the creation of the trust (such as if the moneys are to be used to pay future suppliers). In *Re Northern Developments*[1141] for example, the loan moneys were intended

[1131] (1822) 1 B&C 5
[1132] [1900] 2 QB 325
[1133] [1987] BCLC 646
[1134] [2002] UKHL 12
[1135] (1804) 9 Ves 399
[1136] [1960] Ch 232, which held they are limited to trusts for the upkeep of particular animals, graves and monuments and the saying of private masses. None of these apply to instances of *Quistclose* trusts
[1137] [2002] UKHL 12 at 79 and 89
[1138] (Unreported) 6th October 1978
[1139] Such an interpretation relies upon *Re Denley* [1969] 1 Ch 373, thereby avoiding the issues associated with the beneficiary principle.
[1140] See Swadling W, *Orthodoxy* in Swadling W, *The Quistclose Trust: Critical Essay,* (Oxford: Hart, 2004) at 29
[1141] (Unreported) 6th October 1978

to pay a subsidiary's unsecured creditors – both those who existed at the time of the transfer and those who became creditors subsequently. Given that the subsequent creditors could not be identified at the time of the trust being created, certainty of object could not have existed at the creation of the trust.

Furthermore, should the express trustee refuse to carry out the purpose, as the context has changed and the need for the money is no longer there (i.e. the rescue of the company is now impossible), then the beneficiaries would be free to overrule them and utilise the rule in *Saunders v Vautier*[1142] to bring the trust to an end. This would enable the intended recipients to compel the borrower to transfer the moneys and allow them to be distributed amongst themselves. Both the lender and borrower would be powerless to prevent such an occurrence. As is apparent, should this occur, the moneys could not be returned to the lender, and would instead fulfil the purpose of being transferred to the third parties[1143].

From this, it is apparent that adopting an express trust basis as the theoretical foundations of the *Quistclose* trust is problematic and subject to a number of fundamental flaws.

2. *Constructive Trust Analysis*

An alternative formulation of the *Quistclose* trust was put forward in *Carreras Rothmans Ltd v Freeman Mathews Treasure Ltd*[1144]. Although not explicit in his categorisation of the *Quistclose* trust, Peter Gibson J appears to justify it along constructive trust grounds by referring to the role of the borrower's conscience in the imposition of such trusts, and Equity binding their conscience to prevent them acquiring the beneficial interest to the loan moneys – the fundamental elements of the constructive trust. Specifically, his Honour stated that:

> "equity fastens on the conscience of the person who receives from another property transferred for a specific purpose only...so that the person will not

[1142] (1841) 4 Beav 115
[1143] Virgo G, *The Principles,* (No.899) at 243
[1144] [1985] Ch 207

be permitted to treat the property as his own or to use it for other than the stated purpose."[1145]

Hence, under such a formulation, the *Quistclose* trust would arise as a consequence of the borrower being unable to retain the moneys beneficially because, to do so, would be unconscionable owing to the limitations imposed as to the use of loan amounts. This obviously contrasts with the express trust, where the *Quistclose* trust is imposed as a consequence of the parties' express intentions.

Academic adoption of such a position is seen from Smolyansky[1146], who insists that the *Quistclose* trust can be rationalised along constructive trust lines. This is necessary, according to Smolyansky, because of the flaws in adopting the alternative rationales. These flaws can be overcome, firstly, because as the constructive trust is imposed irrespective of the parties' intentions[1147], there is no need for the lender or the borrower to have expressly indicated that the moneys were to be held on trust, and there is no need to "do violence to the proper manner by which the law ought to construe the intention of the parties in a commercial context"[1148] – which is necessary to impose a resulting trust in such matrices. Moreover, it is submitted that owing to the constructive trust's flexibility, with the categories of such trusts never being closed, it would be possible to easily extend the constructive trust to such circumstances. Finally, it is argued by Smolyansky that it is justified to impose a constructive trust in these circumstances as it would be unconscionable to allow the insolvent company's unsecured creditors access to the loan moneys when they themselves did not contribute towards them and, had the emergency finance been successful, would have benefited without providing any consideration.

Notwithstanding the attractiveness and simplicity of these submissions, categorising the *Quistclose* trust along the lines of the constructive trust is questionable. First and foremost, despite the extended opportunity the higher courts have had in adopting such a framework, no such adoption has taken place. Indeed, in *Twinsectra* the House of Lords demurred the opportunity to adopt a constructive trust foundation. Furthermore, in Lord

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[1145] Ibid, at 222
[1146] Smolyansky M, *Reigning in the Quistclose Trust: A Response to Twinsectra v Yardley,* (2010) 16(7) Trusts and Trustees 558 at 567-568
[1147] *Muschinski v Dodds* (1984) 160 CLR 583 at 615
[1148] Smolyansky M, (No.1146) at 567

Millett's rejection of Smolyansky's submissions, it was noted that Smolyansky was mistaken as to the possible unconscionable conduct of the unsecured creditors[1149]. This was because the unsecured creditors had no rights over the loan moneys. Instead, whilst they may have had an indirect interest as a result of any liquidation dividend paid by the liquidator, the beneficial interest in the moneys rested either in the lender or insolvency practitioner (on behalf of the now insolvency borrower). Consequently, the unconscionability of the unsecured creditors receiving the loan moneys is not a relevant consideration[1150], and so the *Quistclose* trust cannot be rationalised along constructive trust lines as there is no unconscionability.

3. Resulting Trust Analysis

The final interpretation, and the most authoritative theoretical foundation, is that of a resulting trust. Notwithstanding *Twinsectra's* role in the adoption of a resulting trust analysis, such an interpretation was first put forward by Lord Millett (Peter Millett QC as he was then) in a highly influential extra-judicial article[1151]. His Lordship proffered that Lord Wilberforce's formulation of the *Quistclose* trust was incorrect, and that rather than being an unorthodox dual-trust mechanism, such trusts were in fact orthodox applications of trust principles to commercial activities[1152].

In putting forward this 'orthodox' interpretation, Lord Millett argued that the beneficial interest rests with the lender throughout the arrangement, and does not pass to either the final recipient or the borrower. With legal title passing to the borrower and the beneficial interest remaining with the lender, the lender retains control over the borrower by subjecting the borrower to a restriction – revocable at any time – to apply the loan moneys for the stated purpose[1153]. Only the lender would acquire this right, and the final recipients of the moneys would have no right to enforce the obligation[1154].

[1149] Millett P, *The Quistclose Trust – A Reply,* (2011) 17 (1) Trusts and Trustees 7 at 15-16
[1150] See also Hudson E, *A Normative Approach to the Quistclose Trust,* (2017) 80(5) MLR 775 at 796-7
[1151] Millett P, *The Quistclose Trust: Who Can Enforce It?,* (1985) 101 LQR 269.
[1152] Ibid, at 283
[1153] Ibid, at 284
[1154] Ibid, at 285

Hence, the moneys are held on trust for the lender until they are applied for the stated purpose, and should the purpose become impossible to carry out, the lender would therefore be entitled to demand the return of the loan moneys. This was justified, using *Toovey v Milne* and *Carreras Rothmans* as examples, on the basis that it is very difficult to prove that the lender would have intended to benefit the final recipient. Such trusts were therefore described as 'illusory trusts'[1155], owing to the fact the apparent beneficiaries, contrary to appearances, do not in fact receive the beneficial interest to the property. Notwithstanding its 'illusory' nature, should the lender express some alternative intention, such that the final recipient was to benefit, then it is possible for there to be a trust for the benefit of the third party[1156], and the 'illusion' disappear. In proposing such a formulation, although not using the specific language, Lord Millett was clearly advocating the adoption of the resulting trust.

Building upon his extra-judicial publication, His Lordship in *Twinsectra*[1157] authoritatively[1158] adopted his previous submissions and, discarding the classification of 'illusory' trusts, openly theorised the *Quistclose* trust as an orthodox resulting trust. In doing so, His Lordship also in *obiter* endorsed Chambers' negative formulation of the resulting trust[1159], if not his interpretation of the *Quistclose* trust[1160]. Notwithstanding Lord Millett advocating an alternative formulation of the role of presumptions within the resulting trust to that adopted by this thesis[1161], as set out below, there is no practical impact upon the use of the *Quistclose* trust irrespective of which formulation is adopted[1162]. Moreover, as explored immediately below, the imputed formulation adopted by this thesis is more than capable of explaining and justifying the imposition of a resulting trust in *Quistclose* circumstances.

[1155] Ibid, at 288
[1156] Ibid, at 285
[1157] *Twinsectra v Yardley* [2002] AC 164
[1158] Although Lord Millett gave a minority judgment, his fellow Law Lords concurred with his analysis of the *Quistclose* trust
[1159] *Twinsectra v Yardley* [2002] AC 164 at 184
[1160] Ibid, at 190-191. See also Hayton D, *Underhill and Hayton,* (No.883) at 461
[1161] Penner J, *Lord Millett's Analysis* in Swadling W, *The Quistclose Trust: Critical Essay,* (Oxford: Hart, 2004) at 52
[1162] Parmar D, *The Uncertainty Surrounding the Quistclose Trust – Part One,* (2012) ICR 137 at 138

In setting out his interpretation for the *Quistclose* trust, Lord Millett summarised his view as the following:

> "I would reject all the alternative analyses, which I find unconvincing…and hold the *Quistclose* trust to be an entirely orthodox example of the kind of default trust known as a resulting trust. The lender pays the money to the borrower by way of loan, but he does not part with the entire beneficial interest in the money, and in so far as he does not it is held on a resulting trust for the lender from the outset….[the borrower] has no beneficial interest in the money, which remains throughout in the lender subject only to the borrower's power or duty to apply the money in accordance with the lender's instructions. When the purpose fails, the money is returnable to the lender, not under some new trust in his favour which only comes into being on the failure of the purpose, but because the resulting trust in his favour is no longer subject to any power on the part of the borrower to make use of the money."[1163]

Consequently, it was concluded that the beneficial interest in the loan moneys remained with the lender through a resulting trust up and until they were used for their intended purpose. Should the purpose become impossible to carry out, the moneys would be returned to the lender under the resulting trust. In coming to this conclusion, the *Quistclose* trust was described as being akin to a retention of title clause – the beneficial interest remains with the provider until the necessary action (either the carrying out of the intended purpose or payment for goods) is carried out[1164].

Lord Millett also expanded upon the restrictions imposed upon the borrower[1165]. It was held that upon the moneys being made available, the lender acquires an equitable right[1166] to compel the borrower to carry out the intended propose or prevent the misapplication of the loan moneys. According to Tucker, the borrower therefore receives a power to

[1163] *Twinsectra v Yardley* [2002] AC 164 at 193
[1164] Ibid, at 187
[1165] Ibid, at 184
[1166] Smith L, *Understanding the Power* in Swadling W, *The Quistclose Trust: Critical Essay,* (Oxford: Hart, 2004) at 67 makes it clear that although Lord Millett refers to a duty, the borrower only receives a power

carry out the purpose if desired, but if it is concluded that this is no longer expedient, they are prevented from utilising the moneys for any other purpose[1167]. In imposing such an obligation, the borrower is thereby prevented from acquiring a beneficial interest as they do not acquire free use of the moneys.

The primary benefit of adopting the resulting trust is the resolution of the need for an identifiable human beneficiary. As outlined above, the adoption of an express trust framework is problematic given that many *Quistclose* trusts are made for an abstract purpose, and so do not have an identifiable beneficiary. Utilising the resulting trust, however, negates this issue by ensuring that there is always an identifiable beneficiary in the form of the lender retaining the beneficial interest throughout the transaction[1168].

Three further issues are also resolved by adopting the resulting trust. Firstly, by retaining a beneficial interest in clearly demarcated assets (the loan moneys in segregated bank accounts), it is easy to identify the relevant property and so certainty of subject matter does not become an issue[1169]. Secondly, by adopting the resulting trust, rather than engaging in convoluted and imaginative interpretations of the factual matrices, Lord Millett's concern with respecting legal orthodoxy is achieved and the *Quistclose* trust merely becomes "an application of ordinary principles of property law."[1170] Finally, by ensuring that the lender retains the beneficial interest throughout, rather than acquiring an interest at a later date, they are assured of having priority over other creditors[1171].

Subsequently to *Twinsectra,* Lord Millett's formulation has received support and further clarification. In *Challinor v Juliet Bellis*[1172]*,* Briggs LJ wholeheartedly adopted Lord Millett's resulting formulation, noting that the difficulties associated with Lord

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[1167] Tucker L, *Lewin on Trusts,* (No.185) at 339
[1168] Clarke R, *The Quistclose Trust: A Welcome Facilitator of Corporate Rescue,* (2017) 26 Nottingham LJ 130 at 134
[1169] Loi K, *Quistclose Trusts and Romalpa Clauses: Substance and Nemo Dat in Corporate Insolvency*, (2012) LQR 412 at 419
[1170] Hackney, *Understanding Equity and Trusts,* (London: Fontana Press, 1987) at 148-153
[1171] Penner J, *Lord Millett's Analysis* in Swadling W, *The Quistclose Trust: Critical Essay,* (Oxford: Hart, 2004) at 43; see also Chapter 6 Section 4
[1172] [2015] EWCA Civ 59 at paras 58-60

Wilberforce's interpretation were 'authoritatively resolved' by *Twinsectra*[1173] and that "*Quistclose* trusts are a species of resulting trust…"[1174].

However, in seeking to provide additional exposition, Briggs LJ appears to advocate the need for elements that are anathema to the resulting trust. Indeed, he states that "There must be an intention to create a trust on the part of the transferor…It means the transferor must have intended to enter into arrangements which, viewed objectively, have the effects in law of creating a trust…"[1175] As set out in Section 1, this is problematic as within the resulting trust there is no need for an 'intention to create a trust', and instead an intention is ascribed to the transferor of property so long as certain predetermined acts have occurred. In fact, *prima facie,* such a requirement would correspond best with an express trust formulation, as such trusts do require the settlor to formulate the intention to create a trust[1176]. Moreover, Briggs LJ stated that "they [resulting trusts] are not presumed to exist unless a contrary intention be proved"[1177]. Again, this too is anathema to a resulting trust analysis owing to the fact there is no need for an express intention for a resulting trust to arise, as the intention to retain the beneficial interest is either inferred or imputed. In point of fact, contrary intentions are only necessary should there be evidence that the transferor intended that the recipient should receive the beneficial interest of the property and so rebut the presumption of a resulting trust[1178].

Notwithstanding Briggs LJ's incompatible statements, it is apparent that he viewed the *Quistclose* trust as being a compliant and orthodox resulting trust. His Lordship, in contradiction of his previous references, recognised that no such intention was necessary, and that the *Quistclose* trust arises as a result of the lender's actions and the intention subsequently imputed; "A person creates a trust by his words or conduct, not by his innermost thoughts."[1179] Quite how these contradictory statements can, or should, be reconciled is unclear. However, from Briggs LJ's overall statements it is apparent that he adopted Lord Millett's resulting trust formulation and the use of orthodox resulting trusts.

[1173] Ibid, at para 55
[1174] Ibid, at para 56
[1175] Ibid, at para 57
[1176] See *Knight v Knight* (1840) 49 ER 58
[1177] Ibid, at 58
[1178] See Chapter 6 Section 1
[1179] *Challinor v Juliet Bellis* [2015] EWCA Civ 59 at para 59

Further, and non-contradictory, adoption can be seen in *Raymond Bieber v Teathers*[1180], where Patten LJ endorsed Lord Millett's judgment[1181] by concluding that the beneficial interest in the assets remains with the lender, and *Templeton Insurance v Pennington Solicitors*[1182], where Lewison LJ repeated his support and adopted the resulting trust - "The terms of the trust were the classic *Quistclose* type of trust, namely, a resulting trust…subject to a power…"[1183]. What has therefore become clear is that the resulting trust has been accepted by the judiciary as the foundation of the *Quistclose* trust.

The resulting trust formulation has not been free of reproof, however, with Thomas and Hudson[1184] arguing that it fails to explain certain cases of *Quistclose* trust. They proffer that where the loan contract clearly states that the moneys are to be placed into a separate bank account, an express trust, rather than a resulting trust, would arise. In segregating the assets, there is now an express statement as to intention, and so the imputed intention of the resulting trust is rebutted.

Whilst this argument does superficially carry some weight, there are a number of objections to it. Firstly, even if the loan agreement does contain a segregation clause, this is unlikely to be sufficient to prove an intention to create a trust, as whilst it indicates an intention to place some form of control over the loan moneys and restrict their usage, it is does not indicate an intention to separate the beneficial and legal interests in the moneys. In contrast with *Paul v Constance*[1185], where Mr Constance repeatedly stated that the 'money is as much yours as mine' without understanding the full legal effects of his statements, but demonstrated a clear (if misplaced) intention to a grant beneficial interest in the property, a mere segregation clause does not indicate that any party other than the lender will be able to treat the moneys as their own. Instead, it merely indicates that the borrower is restricted in what the money can be used for. Furthermore, as illustrated below, it is possible for a *Quistclose* trust to arise even if there is no express

[1180] [2012] EWCA Civ 1466
[1181] Ibid, at 15
[1182] [2006] EWHC 685. See also *Cooper v PRG Powerhouse LTD* [2008] EWHC 498; *Kingate Global Fund v Knightsbridge (USD)* (2010) 12 ITELR 850 (Bermuda CA); *Re EVTR* [1987] BCLC 646 at 650
[1183] *Templeton Insurance v Pennington Solicitors* [2006] EWHC 685
[1184] Thomas G, *The Law of Trusts,* (No.185) at 750
[1185] [1976] 1 WLR 527

segregation clause, meaning that such clauses cannot be central to the establishment of such trusts.

Thomas and Hudson moreover submit that should Lord Millett's formulation be adopted, there could be no trust in *Quistclose* circumstances[1186]. They argue Lord Millett's use of the words 'the money remains with the lender' requires both the legal and equitable title to remain with the lender – thereby preventing the necessary division of legal and beneficial title and turning the borrower merely into a bailee of the lender. They instead argue that the beneficial interest in the property should rest with the lender, and the borrower instead acquire a right to be vested automatically with the absolute interest in the money so as to enable them to give effect to the identified purpose. In doing so, the lender retains the equitable interest in the property barring the elements needed by the borrower to give effect to the intended purpose. Although such a reinterpretation does provide an explanation for the location of the beneficial interest in the property, arguably it is too convoluted and based upon an incorrect reading of Lord Millett's comments.

It is submitted that rather than requiring both the legal and beneficial title to remain with the lender, Lord Millett's comments require only the beneficial title to remain in order to protect the lender, and the statement that the 'money remains with the lender' was making the untechnical or real world reference to the fact that the lender retained control over the money rather than a purely legal statement that both legal and beneficial title rested with the borrower. This interpretation is possible owing to the purpose of the *Quistclose* trust – it is utilised to return the loan moneys to the lender, and only a beneficial interest is necessary to provide the lender with priority. Once this realisation is acknowledged, Thomas and Hudson's elaborate reinterpretation becomes unnecessary.

The suitability of utilising presumptions to establish the existence of a *Quistclose* trust has been criticised by both Chambers[1187] and Emily Hudson[1188]. Taking Chambers' criticism first, he argues that the presumptions underlying the resulting trust apply only to apparent gifts, and that the presence of consideration (i.e. interest payments) for the

[1186] Thomas G, *The Law of Trusts,* (No.185) at 1379
[1187] Chambers R, *Restriction on the Use of Money* in Swadling W, *The Quistclose Trust: Critical Essay,* (Oxford: Hart, 2004) at 84
[1188] Hudson E, *A Normative* (No.1150)

loan would rebut the presumptions, and the borrower would take the full beneficial interest subject to the restrictions imposed by the lender. He also submits that the existence of a restriction on the loan's use reveals the lender's intention. It is submitted that whilst Chambers' analysis is correct if consideration has already been paid, it is not so if consideration has *yet* to be paid until some later date, and instead there is merely a gratuitous transfer. Hence, until the purpose is given effect to the 'loan' element of the arrangement is not operative. In instances of failed loans for a specific purpose, it is extremely likely (unless the parties have agreed upon an upfront payment for making the loan available, which is remote given the emergency nature of the loan) that no consideration/interest payment has been paid to the lender. Consequently, the purpose of the transfer has failed, and the presumption of resulting trust is not rebutted because there has yet to be any consideration – merely the intention to provide consideration that has failed. Moreover, it is submitted that the existence of the restriction is insufficient to rebut the presumption of resulting trust. It is proffered that whilst it may assist in not rebutting the presumption, it is not enough to discard the resulting trust entirely as it is evidence of control and use of the moneys, rather than where the beneficial interest of the moneys should lie – for this to occur, the loan contract would have to provide evidence of the borrower/eventual recipient receiving the beneficial interest such as a statement recognising either party as being the true owner of the property.

Emily Hudson also questions the use of presumptions, and argues that Lord Millett's formulation now requires lenders to provide evidence of their actual intentions, rather than merely rely upon the presumptions of resulting trust[1189]. It is therefore proffered that in needing to do so, and because there is regularly evidence of an intention, there is an express rather than resulting trust[1190]. Hudson's submissions can be questioned on two points, however. Firstly, there is no need within a *Quistclose* trust for the parties to have expressly stated their intention to retain a beneficial interest in the loan moneys, and so sole reliance on expressed intentions to justify such trusts is not a viable possibility. Secondly, it is submitted that this misstates the role of resulting trust presumptions. As set out in Section 1.1, the presumptions arise where there is a lack of evidence regarding the transferor's intentions – where there is no express statement. In instances of

[1189] Ibid, at 782
[1190] Ibid, at 783. See also Bridge M, *The Law of Personal Property,* 2nd edn (London: Sweet & Maxwell, 2018) at 301

Quistclose trusts there is usually no such statement, and instead at most there is a segregation clause, meaning there is insufficient evidence to properly establish the intentions of the transferor or create an express trust[1191]. Even if there is a segregation clause or restrictive obligations over the potential uses of the moneys, it is submitted that they are still insufficient to form a declaration of express trust, as they merely seek to limit the use of the moneys, rather than impose trustee obligations. Instead, the existence of this evidence merely fails to rebut the presumption, rather than actually bring about the creation of an express trust, or, if sufficiently strong, replaces the use of the presumption with actual evidence that the beneficial interest is to be retained[1192].

The final contention with the *Twinsectra* formulation is the form of resulting trust that was adopted. Despite the detail provided by Lord Millett in his judgment, it was not stated which form of the resulting trust had been adopted beyond the notion that it abided by orthodox principles.

As set out above, there are three forms of resulting trust. Classification as a purchase price resulting trust is not possible owing to the fact that the loan moneys are (until used for their intended purpose) in their same form, and have not been used to purchase any substitute property. It is submitted that if consideration has yet to be paid, it is possible for there to be a gratuitous transfer resulting trust as the loan moneys will not take the form of real property. The problem is if the borrower has provided consideration prior to, or on the event of, the loan moneys being transferred. Whilst this is again unlikely owing to the emergency finance nature of *Quistclose* trusts, such a possibility cannot be ruled out in other contexts, and so the gratuitous transfer formulation would only be applicable to some, and not all, *Quistclose* trusts.

Having dispensed with the alternatives, the final possibility is the automatic resulting trust. As set out in the previous section, such trusts arise upon the ineffective disposition of property – either where there is a surplus after the terms of an express trust have been carried out or an attempted express trust has failed. Given that *Quistclose* trusts arise upon

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[1191] Penner J, *Lord Millett's Analysis* in Swadling W, *The Quistclose Trust: Critical Essay,* (Oxford: Hart, 2004) at 62; Tucker L, *Lewin on Trusts,* (No.185) at 337

[1192] See *Pettit v Pettit* [1970] AC 777 at 823; *Hodgson v Marks* [1971] 1 Ch 892; see also Chambers R, *Resulting Trusts,* (No.923) at 32

the intended purpose of the loan failing, it is clear that such trusts fall within the remit of the automatic resulting trust, and that Equity imputes the intention that the lender intended the property to return to him upon this failure.

Whilst this formulation is attractive in its simplicity, Virgo has however found two primary issues with this analysis[1193]. He submits that Lord Millett's analysis is defective with the orthodox law in two aspects: firstly, there is no initial express trust or attempt at creating an express trust, and secondly that there was no failure of purpose in the majority of instances in which a *Quistclose* trust has been identified. To sidestep these issues, it is proffered that *Quistclose* and *Twinsectra* should be reinterpreted as instances as where the creation of a private purpose trust was attempted and failed owing to being void due to the beneficiary principle[1194]. As a consequence, it is concluded that an orthodox automatic resulting trust arises to return the property to the lender.

There is much to commend about Virgo's simple interpretation. However, the notion that previous cases can be reinterpreted as attempts to intentionally create void purpose trusts must be rejected on the basis that it is apparent from even a cursory reading of the facts that this was not attempted. It is apparent, for example, from the actions of the parties in *Quistclose* itself that no express trust was attempted or contemplated. Instead, Tucker submits that rather than rely on a void express trust, the automatic resulting trust arises as a consequence of a non-exercised power[1195]. This is because in default of the power being exercised owing to the change in circumstances, an automatic resulting trust arises to return the loan moneys to the lender – much like upon the failure of an express trust. It is submitted that utilising the simple defaulted exercise of the power, rather than a fictitious reinterpretation of there being an attempted private purpose trust, is both more in keeping with legal orthodoxy and more factually sound. Virgo himself attempts to address the shortcomings of his interpretation by admitting that it may prove problematic to identify the necessary intention to create an express trust[1196]. Given that the power is indistinguishable from the loan agreement, no such evidential problem exists in Tucker's formulation. Finally, given that there only need to be a default in use of the power, rather

[1193] Virgo G, *The Principles* (No.899) at 245
[1194] Ibid, at 246
[1195] Tucker L, *Lewin on Trusts,* (No.185) at 338
[1196] Virgo G, *The Principles* (No.899) at 248

than a failure of purpose, Virgo's second objection becomes irrelevant. Hence, it is submitted that whilst *Quistclose* trusts are orthodox automatic resulting trusts, they arise in default of exercise of a power rather than an attempt to create a private purpose trust.

Thus, the *Quistclose* trust, for the purposes of this chapter, and despite the continued controversy, will be seen as an automatic resulting trust, applying orthodox principles.

Section 3.5 - The Requirements

Having ascertained the theoretical foundations of the *Quistclose* trust, it is now necessary to identify the relevant requirements of these trusts in order to determine how they impact upon the actual, and potential, unsecured creditors of insolvent companies and lenders. As already noted, certainty of object and subject matter will be relevant considerations[1197], but for the most part are not contentious issues given the clearly demarcated nature of the loan moneys (or their substitutes[1198]) and the lender being the continuous beneficiary.

The fundamental requirements of a *Quistclose* trust are that there is a provision of assets, for a specific purpose, with sufficiently certain terms that allow the court to determine whether or not that purpose has been carried out, and that the recipient of the loan moneys is not to receive beneficial title to the moneys and must instead keep them separate. It is important to acknowledge, however, that whilst the majority of cases involve a loan, this is not a requirement[1199]. Instead, there must merely be the provision of assets to one party by another. Historically, these requirements were succinctly set out in *Henry v Hammond*[1200]:

> "It is clear that if the terms upon which the person receives the money are that he is bound to keep it separate...and to [treat it] as a separate fund to the person entitled to it, then he is a trustee of that money and must hand it over to the person who is his cestui que trust. If on the other hand he is

[1197] Loi K, *Quistclose Trusts,* (No.892) at 419
[1198] See *Re Golcorp Exchange* [1994] UKPC 3*; Hunter v Moss* [1994] 1 WLR 452 for discussions of the certainty of subject matter
[1199] *Cooper v PRG Power* [2008] EWHC 498
[1200] [1913] 2 KB 515 at 521

not bound to keep the money separate, but is entitled to mix it with his own money and deal with it as he pleases...he is not a trustee of the money, but merely a debtor."

Whilst they have been restated more contemporaneously in *Bieber v Teathers*[1201] and *Bellis v Challinor*[1202], the only crucial change has been an emphasis on the need for there to be a clear and distinct purpose. From these statements of the criteria it appears that there are two elements that require further elaboration to determine their precise meaning; the need for the moneys to be segregated and the need for a specific purpose.

Section 3.5(a) - Need for Segregation

From the authorities it appears that whilst there is no need for the moneys to actually have been segregated, there must be a term in the transfer that prevents them from becoming part of the borrower's general assets. As stated in *Bieber,* there must be a "mutual intention of payer and recipient…that the funds transferred should not be part of the general assets of the recipient…"[1203]

Examples of what will constitute the requisite intention to segregate include *Re Nanwa Gold Mines*[1204], where money had been advanced on the promise that it would be kept in a separate account. Here the company, Nanwa Gold, had attempted to acquire subscriptions to the issue of new shares on the promise that the moneys would be held in a separate account and returned should the company be unable to raise enough funds to continue operations. It was held that as the moneys were intended to be, and actually were, segregated, they were not available to the company's insolvency practitioners.

This clear and sufficient intention can be contrasted with *Moseley v Cressey's Co*[1205], which Harman J did so in *Re Nanwa.* Here the company invited investors to purchase shares by means of a prospectus that stated that should the sale not proceed, the moneys would be returned. It was held that, unlike in *Re Nanwa* where there was an undertaking

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[1201] [2012] EWCA Civ 1466 at 14 and 15
[1202] [2015] EWCA Civ 59 at 56
[1203] *Bieber v Teathers* [2012] EWCA Civ 1466 at 14
[1204] [1955] 1 WLR 1080
[1205] (1865) LR 1 EQ 405

to segregate the assets into a separate account, a mere promise to return (and not segregate) the investors' moneys was insufficient to create a *Quistclose* trust as the company had obtained an unrestricted access to the moneys legal and beneficial title. Similarly in *Gabriel v Little Ors*[1206]*,* the requisite intention was found lacking in a loan to develop property. Although the loan was made available for the express purpose of property development, no restrictions as to the loan moneys' use or segregation from the borrower's general assets was included[1207]. Hence, the money was as the free disposal of the of the borrower and not subject to any trust.

Hence, it is incontrovertible that the moneys must be subject to a term that they are to be segregated and not form part of the borrower's general assets. It is furthermore apparent that whilst such a term is necessary, it does not need to be carried out and the moneys actually be segregated. In none of the referred to authorities is it stated that the borrower *must* carry out the segregation – merely that it must have been the parties' intention that this *would* occur as an enforceable restriction over the moneys was created[1208]. In *Bellis v Challinor* it was stated, for example, the requirement is merely that the "property is transferred on terms that do not leave it at the free disposal of the transferee"[1209] – not that segregation actually occur[1210]. This is important as if the lender fails to do so – which given the frantic and confusing circumstances in which the *Quistclose* trust is utilised is foreseeable – the lender will still be protected and granted priority. Instead, a failure to segregate will merely require the location of the loan moneys or their substitute through the rules of tracing.

Section 3.5(b) - Need for a specific purpose

Directly linked with the need for segregation is the requirement that there must be a specific purpose to the loan. This has been seen in *Quistclose* itself (the payment of a declared dividend), *Twinsectra* (the purchase of land) and *Carreras Rothmans* (the

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[1206] [2013] EWCA Civ 1513. See also *Guardian Ocean Cargoes Ltd v Banco de Brasil* [1994] 2 Lloyd's Rep 152 per Savile LJ at 159-160 and *Tuthill v Equine FX Ltd* [2013] EWHC 1207 QBD
[1207] Ibid, at 43
[1208] Chambers R, *Resulting Trusts,* (No.923) at 150
[1209] [2015] EWCA Civ 59 at 63
[1210] Tucker L, *Lewin on Trusts*, (No.185) at 334; see also Parmar D, *The Uncertainty Surrounding the Quistclose Trust – Part One,* (2012) ICR 137 at 140

discharge of the debts of a supplier). In all of these cases identifying the purpose of the loan was not problematic as the available evidence – primarily the loan contract – made it explicitly clear what the purpose was, and so an in-depth enquiry into locating the purpose was unnecessary.

Notwithstanding the requirement that there be a 'specific' or 'particular' purpose[1211], the courts have not adopted a restrictive approach in identifying the requisite purpose[1212]. Indeed, the courts appear willing to engage in the process of finding a specific purpose and infer an intention to the parties from facts if necessary, rather than rely upon their express statements[1213]. As noted by Briggs LJ, the court must construe the words in the loan agreement and the parties' conduct (including a third party) to determine whether the loan was for a specific purpose[1214], rather than merely rely on the wording in the loan contract itself.

This willingness, although recently affirmed in *Bellis,* has been central since the *Quistclose* trust's inception. In *Toovey v Milne*[1215]*,* Abbot CJ rejected the need for clear evidence to be provided to indicate that a specific purpose was present. His Lordship instead allowed the court to infer from the facts that "…the fair inference from the facts proved was that this money was advanced for a specific purpose…."

An example of the courts utilising this ability to infer a specific purpose from the facts can be seen in *Edwards v Glyn*[1216]. Here a bank that was expected to be subject to a run was provided £3,000 in return for a guarantee. The guarantee stated that the moneys were to be returned if the bank was unable to withstand the run. When the run could not be withstood the guarantor repaid the moneys on the basis that the loan was for the purpose of preventing the run on the bank – something that had clearly not been achieved.

[1211] *Bieber v Teathers* [2012] EWCA Civ 1466 at 14
[1212] Zhuang W, *Resulting Trusts as a Response to Unjust Enrichment,* (2014) 26 SAcLJ 649 at 653
[1213] See Clarke R, *The Quistclose Trust: A Welcome Facilitator of Corporate Rescue,* (2017) 26 Nottingham LJ 130 at 136; Beglan W and Belcher A, *Jumping the Queue*, (1997) JBL 1 at 5
[1214] *Bellis v Challinor* [2015] EWCA Civ 59 at [59]-[61]
[1215] (1819) 2 B&A 683 at 684
[1216] (1859) 2 E&E 29

Furthermore, the courts have not limited themselves to identifying a purpose, but also reinterpreting and redefining existing purposes. This can be seen in Lord Millett's interpretation of *Quistclose* itself[1217]. *Prima facie* the purpose of the loan central to *Quistclose* was to pay the declared dividend. However, to justify his argument that the purpose of the loan had failed, it was instead proffered that rather than merely being for the purpose of paying the dividend (which could still have been paid), the loan was to preserve Rolls Razor as a going concern. Given that this was no longer possible owing to the company's liquidation, it was apparent that the purpose had failed. In redefining and reinterpreting the nature of the specific purpose, it shows that the courts are willing to use their discretion to find a *Quistclose* trust and thereby provide lenders with the trust's protections.

The final step the courts have taken in assisting the locating of a specific purpose is relaxing the degree of precision any stated purpose is expressed in. In *Twinsectra,* for example, the purpose was expressed and broadly stated as being the 'acquisition of property'. Whilst Carnwath J found this too imprecise at first instance, Lord Millett found it to be sufficiently certain as the court could still "determine whether it is still capable of being carried out or whether the money has been misapplied…"[1218] Hence, from the courts' willingness to infer, reinterpret and allow for very broadly stated purposes greatly extends the possibilities for lenders acquiring the protections afforded by the *Quistclose* trust – particularly if the loan agreement is ambiguously drafted.

However, there are clear limits to the degree that a specific purpose can be inferred – namely that there is a lack of any evidence. In *Holiday Promotions (Europe) Ltd*[1219]*,* no *Quistclose* trust was found owing to the lack of a specific purpose. Here the customer had paid to the company a refundable deposit of £150 in the hopes of winning a free holiday. It was held that only a contractual, and not proprietary, relationship existed between the two parties for two reasons: firstly the moneys were not segregated and were placed in a general account, and secondly the moneys were not intended to be used for any specific purpose – they were to be used by the company for its general purposes. Therefore, the

[1217] Millett P, *The Quistclose Trust: Who Can Enforce It?,* (1985) 101 LQR 271 at 275/76
[1218] *Twinsectra v Yardley* [2002] 2 All ER 377 at 101
[1219] [1996] 2 BCC 618

court was unable to ascribe a specific purpose to the moneys, and the lender failed to gain the protections provided by the *Quistclose* trust because of a clear lack of evidence.

Similarly, allowing the recipient free rein with the use of the moneys will prevent a purpose being inferred. In *Neste Oy v Lloyd's Bank Plc*[1220], a shipowner employed a company to run its port services. In enable it to do, it sometimes provided it with the necessary funds. The payments were titled ‘advances’, but were paid in advance and in arrears. Moreover, the moneys did not have to be used specifically for the purposes of providing the port services – they could be applied to any business the company engaged in – and there was also no separate bank account in which they were to be held. Consequently, no *Quistclose* trust was found.

Neste and *Holiday Promotions* therefore illustrate that whilst the courts have a large degree of discretion to find a specific purpose, there is a limit, and if the facts provide no evidence of there being one purpose, no *Quistclose* trust can be present. Given the lengths the courts have gone to locate a purpose, it is probable that this is unlikely to present too much of an issue in the majority of *Quistclose* claims, and it is only in the most the extreme cases that no purpose will be identified[1221].

Section 3.6 - The Potential uses of the Quistclose Trust in Liquidation

As acknowledged in Section 3.5, the *Quistclose* trust potentially has a direct and significant impact upon unsecured creditors should liquidation occur. It was noted that such trusts can increase the payable liquidation dividend by returning assets to the now insolvent company (if the company took on the position of a lender) or they can prevent providers of credit becoming creditors. Hence, this section will now outline in detail precisely how the *Quistclose* trust achieves these outcomes and whether they are beneficial of negative for unsecured creditors.

Section 3.6 (a) – Traditional Quistclose Trusts

[1220] [1983] 2 Lloyd's Rep 658
[1221] Hayton D, *Underhill and Hayton,* (No.883) at 462

Given the discussion set out immediately above, and the seminal nature of *Barclays Bank v Quistclose,* the obvious and simplest utilisation of such trusts for the benefit of unsecured creditors is if the now insolvent company provided a loan to another party for a specific purpose that has failed – that the insolvent company was a creditor and is now owed repayment of the loan moneys. Such a *Quistclose* trust would be an entirely orthodox use of the mechanism, and would fall squarely in the previous fact patterns such as *Quistclose* itself, *Hassall* and *Toovey v Milne.*

Regardless of such a fact pattern's orthodox and theoretical possibility, the prospect of this occurring in the real world is very limited. Owing to the emergency finance nature of the overwhelming number of *Quistclose* trusts, the majority of companies, if they are facing the imminent prospect of insolvency, would not realistically be in a position to make such loans available. It is submitted that there would only be two noticeable exceptions to this practical limitation. First, should the insolvent company be a bank who is made insolvent without any forewarning[1222]. In such circumstances, the bank would have been operating its usual business model and so made the emergency finance available to the third party. The insolvency would not have been predicted and lending would not be restricted. The second once again concerns corporate groups. Should a parent make a loan available to its subsidiary, or the subsidiary make a loan available to its parent, primarily for the purpose of rescuing the company or for the purchase of new equipment, then the provider of the moneys would be able to reclaim them. As opposed to unconnected companies, there is a greater probability that the closer relationship will cause lenders to take more risks and so make the moneys available. This is particularly so if the failure of one company threatened the entire group.

An example of such loans being made available is *Carreras Rothmans Ltd.* Although not involving a direct parent/subsidiary relationship (instead it was client and supplier), the case did share many of the same features outlined above. The client (Carreras) made emergency financing available to its advertising agency (Freeman Mathews) to ensure its continued operation and already negotiated discounts. Specifically, the loan moneys were made available to enable Freeman Mathews to pay third parties and so were placed in a

[1222] Such as happened at the height of the finance crisis in 2008 when major banks such as Northern Rock and Royal Bank of Scotland.

separate account. Prior to actually paying the third parties, Freeman Mathews entered liquidation. Carreras paid the third parties directly to discharge the outstanding debts and then sought to recover the loan amounts provided. It was held that the loan moneys were held on trust as the specific purpose had failed and segregation was intended. Despite there being a few differences between *Carreras* and the fact pattern outlined above, the case does illustrate the potential – and willingness – for companies with a close relationship to minimise the risks of emergency finance by retaining the beneficial interest to the moneys until the successful carrying out of the purpose. Moreover, it also illustrates the potential for unsecured creditors to leverage immediate discharging of debts in return for not pursuing any claim to the loan moneys themselves.

As is also illustrated in *Carreras,* the more likely outcome is that *Quistclose* trusts in the context of emergency finance will be used to reduce the insolvent company's asset pool and cause harm to the unsecured creditors. As occurred in *Quistclose, Re Northern Development* and *Carreras,* a company in financial distress acquired emergency funding and upon that funding no longer being required, parties other than the now insolvency company had a beneficial interest in the property. Consequently, the unsecured creditors had no access to the moneys, and so could not be made available to the unsecured creditors. Although Chapter 6 submits that this priority for the lender can be justified on the basis that the property was always theirs and it would be unjust to allow third parties access to loan moneys that were provided for a failed specific purpose, it is undeniable that by granting the lender priority the unsecured creditors lose out by having fewer assets available to discharge their debts. Furthermore, as recognised by McKendrick[1223], the *Quistclose* trust is infrequently utilised by the traditional lenders of secured credit – major financial institutions – and so if it is utilised, it is likely that smaller, much weaker lenders will benefit – those who would otherwise have become unsecured creditors.

Notwithstanding these issues, as acknowledged above, it is possible to grant the intended eventual third-party recipient of the moneys a beneficial interest in the loan moneys. Thereby, rather than the lender acquiring priority, creditors - such as in *Re Northern Developments* – would have access to the moneys directly.

[1223] McKendrick E, *Commerce* in Swadling W, *The Quistclose Trust: Critical Essay,* (Oxford: Hart, 2004) at 150

In *Re Margaretta Ltd*[1224], Michael Crystal QC held that third parties could acquire a beneficial interest of the loan moneys in two circumstances[1225]:

1) Where the obvious intention would be frustrated if the donor retained a power of revocation of the trust;
2) Where the existence of the trust arrangements is communicated to the intended payee and the latter gains a beneficial interest in the money either because of the creation of an estoppel in his favour or because communication perfects an assignment for the donor's equitable interest to him.

Of these two scenarios, the second is more likely given the difficulty associated with the courts identifying the intention that the third party was to have the beneficial interest in the loan moneys without written evidence. This is borne out in the reported cases, which focus on type 2 claims. In *Re Margaretta* itself, moneys were set aside in a solicitor's account so that VAT obligations on the sale of land in London could be paid. The money was then misappropriated, and the company entered insolvency. It was held that the solicitor had not received the beneficial interest in the moneys and was under a fiduciary obligation not to apply the moneys for any purpose other than paying the VAT, and because the Treasury had been informed of the fund and the intention to use the moneys for that singular purpose, they now held the beneficial interest in the moneys. Hence the Treasury, an unsecured creditor of Margaretta, was able to prevent itself incurring a loss by obtaining the beneficial interest as a consequence of the communication and falling within category two. Similarly in *Re Northern Developments,* unsecured creditors were able to acquire a beneficial interest in loan moneys when they were paid into an account for the for the express purpose of "providing moneys for Kelly's unsecured creditors over the ensuing weeks", and such an action was communicated to them.

As acknowledged above, there is strong judicial support for unsecured creditors obtaining a beneficial interest in loan moneys if the intention to do so is communicated to them, thereby increasing such an outcome's predictability. Lord Millett, extra-judicially, has

[1224] [2005] EWHC 582 (Ch)
[1225] Ibid, at 24

stated “If A's intention was to benefit C, or his object would be frustrated if he were to retain a power of revocation, the transaction will create an irrevocable trust in favour of C, enforceable by C but not by A. The beneficial interest in the trust property will be in C.”[1226]

Hence, should it be communicated to a third party that they are to benefit from the loan moneys that have been provided for a specific purpose and been segregated, it is the third party (and likely unsecured creditor) rather than the lender who will have the beneficial interest to the loan moneys. In turn, this will allow them to at least partially escape the negative impact of the borrower entering insolvency and allow for the discharge of the debt owed. As stated above, relying upon ground 1 (the obvious intention) is likely to fail owing to the lack of evidence, however, should there be written evidence (ground 2) that is sufficiently precise, the third party will acquire the beneficial interest. However, given the potential size of the loan amounts, although there may be sufficient evidence, the lender is likely to change the existence of the evidence, giving rise to large prospective legal fees.

As the creditors obtain a right to the money by the lender communicating the transfer of the interest to them, they have a coexisting interest, which is ‘one in favour of the lender and another in favour of the creditors’[1227].

Section 3.6(b) - Priority of Employees

The *Quistclose* trust can also arise between employee and employer in two specific circumstances: either the employee has provided funds to the employer to be used for a specific purpose, or should the employer have taken out an insurance policy for the benefit of the employees. In both scenarios, as the moneys are held on trust for the employees, they acquire priority and the funds do not form part of the company’s asset pool – thereby preventing their distribution to other creditors.

[1226] Millett PJ, *The Quistclose Trust: Who Can Enforce It?* (1985) 101 LQR 269 at 290. See also ibid, at 278

[1227] Chambers R, *Resulting Trusts,* (No.923) at 82; See also Moffatt G, *Trusts Law*, 5th edn (Cambridge: CUP, 2009) at 814:

In *Cooper v PRG Powerhouse*[1228], an employee purchased a car in order for him to perform his duties, however the company paid all the sums due on it. Eventually the employee left his job but wished to keep the car, and for this to occur, the employee was required to pay the remaining amount due on the car to the company, who would then complete the purchase of the car. In between the employee transferring the funds and the company completing the purchase, the employer entered insolvency. It was held that as the moneys had been provided for a particular purpose (the purchase of the car) and there was an intention for the moneys to have been kept separate from the company's general assets, the moneys were held on trust – granting the employee priority over other creditors of the company.

Cooper has been criticised on two bases, however: there was no loan, and there was no express direction by the employee that the moneys should be segregated. In answering the second issue first, although there was no express direction, it was unequivocal that the moneys were to be used for a single purpose (the purchase of the car) and were not to form part of the company's asset pool. Secondly, in neither *Quistclose* nor *Twinsectra* was it held that a loan was necessary – instead it was merely stated that moneys must be provided for a specific purpose. Whether that be a loan or some other purpose, it is irrelevant. Therefore, *Cooper* is an orthodox application of *Quistclose* principles and opens up the possibilities for granting employees priority in the event of their employer entering liquidation by preventing them from becoming unsecured creditors. This prevention of them becoming unsecured creditors is important as transferring moneys to the company for a specific purpose – unlike unpaid wages[1229] – does not allow employees to take on the position of preferential creditors. Thus, the *Quistclose* trust can be used as a mechanism to provide employees with similar protections to those granted under the Insolvency Act and expand their applicability.

Secondly, employees can use the *Quistclose* trust should their employer enter insolvency and an insurance policy taken out for their benefit pays out. If there is a payment, those moneys do not become part of the employer's asset pool. In *Re Independent Air Travel*[1230], an airline pilot was involved in a fatal airline crash. As part of their employment contract,

[1228] [2008] EWHC 498
[1229] Sch 6 para 9 Insolvency Act 1986
[1230] [1961] 1 Lloyds Rep 604

an insurance policy was taken out by in their name which paid out upon their death. The moneys were paid to the company. Upon the company entering liquidation before transferring the moneys, it was held they were held on trust for the pilot's executor on the grounds that although there was no express words, it was clear that the moneys were to be used for the sole purpose of providing for the pilot's family. In doing so, the moneys did not form part of the company's asset pool and so were not available to the liquidator.

The advantage of employees utilising the *Quistclose* trust in these two scenarios is, as noted, that they acquire priority over the company's other creditors and avoid the status of unsecured creditor. Although this decreases the size of the company's asset pool, given the relatively small sums involved however (£34,239 and £4,000 respectively), and that the moneys should never have formed part of the asset pool, the impact on these unsecured creditors is likely to minimal and fully justified.

Section 3.6(c) - Misapplication of Client Funds by Agents

One of the growing uses of the *Quistclose* trust has been for the reclamation of misappropriated assets by agents. In a string of judgments beginning with *Twinsectra,* but also including *Templeton Insurance*[1231] and *Global Marine*[1232], it has been held that if funds are transferred to a solicitor with an express purpose, then should they be misappropriated, they will be subject to a trust and traceable. The misappropriation is not limited to theft but also includes misapplication of the moneys for other purposes[1233].

The use of *Quistclose* trusts in these circumstances has become more commonplace as a result of the nature of modern commercial activity. With companies having to rely on intermediaries to conduct business, the opportunity for misapplication or misappropriation has also increased, requiring new forms of protection for clients. In utilising the *Quistclose* trust, it allows the client to retain a beneficial interest over the moneys and enforce this interest against either the agent or third-party recipients. Should the client have become insolvent, the liquidator too would be able to enforce the beneficial

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[1231] *Templeton Insurance v Pennington Solicitors* [2007] WTLR 1103

[1232] *Global Marine Drillships v Landmark Solicitors* [2011] EWHC 2685

[1233] See *Templeton Insurance v Pennington Solicitors* [2007] WTLR 1103 and *Global Marine Drillships v Landmark Solicitors* [2011] EWHC 2685

interest, reclaim the property, and increase the size of the asset pool for the benefit of the unsecured creditors. Given that these arrangements, unlike with traditional *Quistclose* trusts, do not involve a loan, it is much more likely that now insolvent companies would be involved in their use – particularly if the purpose of the transfer has been frustrated by the onset of insolvency. Hence, such trusts could provide a means of reclaiming assets for distribution to unsecured creditors.

Section 3.6(d) - Purchase of Equipment

The final potential utilisation of the *Quistclose* trust is where moneys have been made available with purpose of the purchasing equipment, where should the purchase of equipment not go through, the moneys are held on trust for the provider. As is also stated below, if the purchase actually occurs, it is possible to interpret that a purchase price resulting trust arises. This further trust is beneficial should the purchase occur shortly before a company enters insolvency, as the asset can then be claimed by the provider and sold to recoup some, or all, of the moneys provided.

The best example[1234] of the use of the *Quistclose* trust in this manner is *Re EVTR*[1235]. It involved a company (EVTR) that was in financial difficulties and required additional funds. The owner persuaded his friend, Mr Barber, to provide financial assistance, and it was agreed that he would procure equipment worth £60,000 to enable new business to be taken on. This sum was paid to the company's solicitors who placed it in the client account, and an order was placed for the new equipment. It was agreed that the new equipment would be delivered in 7 months, and in the meantime temporary equipment would be leased. The £60,000 was then transferred to the manufacturer to enable them to proceed with the purchase and acquisition of the temporary equipment, which was then put to this use. However, before the equipment could be delivered, EVTR was placed into receivership and the majority of the £60,000 was repaid to the receiver for not completing the purchase of the equipment.

[1234] Clayton N, *Resulting Trusts and Failure of Purpose,* (1987) 2(3) JIBL 189
[1235] [1987] BCLC 646

It was held that the returned moneys were on trust for Mr Barber as they had been provided for a specific purpose (the purchase of new equipment) and had been segregated from the company's other assets in the solicitors' client account[1236]. This is an orthodox use of the *Quistclose* trust, and can be taken advantage of by the corporate group or individuals closely associated with the recipient company. The most likely use is in the corporate group though, where one company within the group makes moneys available for the purchase of property that subsequently does not occur and the recipient enters insolvency, or where two companies work closely together and moneys are made available. A hypothetical example of the latter might include outsourcing companies such a Kier and its contractors, whereby the larger company (Kier) makes funds available to the smaller company (the contractor) to enable it to purchase equipment to carry out its functions. Hence, should the insolvent company be the provider then the liquidator will be able to recover the moneys from the recipient (provided the purchase has not occurred), but should the insolvent company be the recipient the moneys will not form part of the company's asset pool and instead the provider will escape taking on the position of an unsecured creditor. Should the latter occur then the insolvent company's unsecured creditors would suffer as the moneys would not be available to the liquidator.

The need for the purchase not to have occurred though could prove problematic should the recipient enter insolvency shortly after the purchase. Should this occur, as the purpose of purchasing the equipment has occurred, no *Quistclose* trust would be possible. Instead, it is submitted that provided the provision of the money was gratuitous, then a purchase price resulting trust would become operative. This is based on the arguments of Section 2 – that where property is purchased by one party with assets provided by another, and there is a clear link between the provision of the moneys and the property purchased, the provider acquires all or part of the beneficial interest in the acquired property.

One fundamental issue in establishing a purchase price resulting trust is the argument that rather than being gratuitous, the provision of the moneys was intended to be a loan. In *EVTR*[1237]*,* however, it is clear that the provision of the moneys was not intended to be a loan. Originally, Mr Barber intended to provide EVTR with the moneys unconditionally,

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[1236] Ibid, at 650
[1237] Ibid, at 647

and only did not do so on advice from his accountant. Instead it was agreed that he would purchase the shares in the holding company and assist EVTR under the agreement to purchase the holding company's shares. Hence, from the original intention to provide the moneys with no restrictions, and the subsequent intention for Mr Barber to then procure the equipment for the company, it is clear firstly that no loan was intended, and secondly that he intended to retain the beneficial interest in the moneys and its substitute property. Put bluntly, Mr Barber was providing a comprehensive rescue *package* rather than mere rescue *finance*. The presumption of a resulting trust would not, therefore, have been rebutted if in the case of EVTR the purchase actually occurred, and Mr Barber would have retained a beneficial interest in the equipment should EVTR have entered insolvency.

Another hypothetical example is helpful in illustrating how the purchase price resulting trust might arise. Company A makes £5 million available to Company B to purchase office space. Although made available, and the purpose for the moneys being made available are clear, it is not explicit on what basis the money is being made available, only that the beneficial title is not to be taken by Company B, and is to only be used for the office space. At this point a standard *Quistclose* trust exists if the company enters insolvency[1238], as it is clear there is the provision of moneys for a specific purpose and the beneficial interest is to remain with the provider.

Should the transaction go through, and because of changes in the economy (such as a worldwide pandemic) Company B struggles and enters into insolvency, no *Quistclose* would exist as the purpose has been fulfilled. However, owing to the fact that the transaction was ambiguous and not expressed to be a loan, the office would be subject to a purchase price resulting trust and thereby not form part of Company B's asset pool. Given the ambiguous nature of the arrangement, and the extremely unlikely scenario that a company would freely give away its assets, it is justified to impute the intention that Company A would retain a beneficial interest in the moneys. Obviously, should the transaction have been clearly categorised as a loan, then such an interpretation becomes impossible.

[1238] See *EVTR* [1987] BCLC 646 at 651

Consequently, providers of moneys for the purchase of equipment would benefit doubly if they do not express the transaction as being a loan. Firstly, prior to the purchase they are protected by a *Quistclose* trust should the recipient enter insolvency. Secondly, should the purchase occur, then they are protected by a purchase price resulting trust. In either circumstance, the provider has priority of the assets and does not take on the position of unsecured creditor – a useful security device for providers of finance.

Section 4: Conclusion

This chapter has shown that the resulting trust is capable of increasing the size of a company's asset pool by making the company a beneficiary of assets held on trust by recipients, and thereby increase the assets that can be made available to unsecured creditors of a company that has entered liquidation. It has also shown that it can prevent assets from forming part of the company's asset pool, with the company taking on the position of trustee. Should this latter matrix occur, then the party entitled to the property will be prevented from becoming an unsecured creditor of the company, and consequently the asset cannot be made available for distribution to the company's actual unsecured creditors[1239]. Irrespective of whether the resulting trust increases the size of the asset pool or prevents a party becoming a creditor, it is capable of assisting affected by a company's insolvency.

Dealing with the different forms of trust individually, the purchase price resulting trust is able to assist should the now insolvent company have contributed to all or some of the purchase price of property. This is the case even should the moneys have initially been made available to a 'one company' by its shareholder, and the company then makes the purchase moneys available. As also concluded, the company would be the beneficiary of a purchase price resulting trust should it agree to take on mortgage obligations and make contributions. This would provide the company with a rateable share of the purchased asset. Furthermore, as also seen, should a company purchase property with moneys directly provided from a third party for the purpose of purchasing that property, then the property would be held on trust for the third-party provider.

[1239] Whilst this would negate the need for party to engage in the liquidation regimes, such trusts are inherently linked to the issue of insolvency.

One key advantage of utilising the purchase price resulting trust is that, as illustrated above, such trusts are well established in law with clear requirements – although complicated fact patterns such as in *Petrodel* may have evidential issues. This legal clarity thereby provides liquidators with a large degree of predictability in regard to likely outcomes, provided that the presumption of resulting trust is not rebutted[1240]. One potential evidential complication is the need for a direct link between the purchase and the provided moneys. However, given that in the majority of cases this is unlikely to be an issue owing to there being a clear connection between the provision of funds and the eventual property purchased, it is unlikely to create impactful levels of uncertainty.

Similarly, the gratuitous transfer resulting trust is also able to assist unsecured creditors should the now insolvent company have transferred personal property in the absence of the consideration – including where the transfer was a genuine mistake. However, should the gratuitous transfer be of land, it is submitted that no resulting trust will arise, and the recipient will retain the property. Whilst there has been no guidance from the senior courts as to the correct interpretation of s60(3) Law of Property Act 1925, should the analysis of this thesis not be accepted by the Court of Appeal or Supreme Court, then any company would retain a beneficial interest in the property and the land would now form part of the asset pool. As with the purchase price resulting, whilst there are areas of uncertainty within the gratuitous transfer resulting trust, they do not unduly hinder the utilisation of such trusts. Consequently, the possibility of unsecured creditors benefiting from the liquidator reacquiring the assets is unaffected, and the liquidator can pursue litigation with fair level of certainty.

The most predictable of all the forms of resulting trust, the automatic resulting trust, is of use should the company have sought to create a beneficial fund for distressed individuals that failed or is no longer of any use, or should the company have taken part in a tax 'efficiency' scheme that is later declared void. Unlike with the gratuitous transfer and purchase price forms of trust, the is very little in the way of theoretical uncertainty with the automatic resulting trust, and so liquidators can be fairly confident of the applicable law in commencing claims for such trusts.

[1240] Chapter 6 Section 1

Finally, this chapter has shown that the *Quistclose* trust is of assistance should the company have provided moneys for a specific purpose on the understanding they are to be segregated, or the company receives moneys in the same context, and that purpose is not carried out, then the recipient will be prevented from acquiring the beneficial interest in the property. As noted above, however, the prospect of the insolvent company being the provider of the moneys, and therefore being in a position to recover them, is extremely unlikely[1241], and so the majority of *Quistclose* trusts will be used to prevent the loan moneys forming part of the company's asset pool will primarily be used to prevent the transferor becoming an unsecured creditor themselves. Such trusts are not limited to these matrices, and is also of use should the lender have expressed that a third party is to have the beneficial interest over the moneys, where employees have provided moneys to their employers for a specific purpose, where there has been a misapplication of moneys by an agent, and if moneys have been provided for the purpose of acquiring equipment. As with mistaken payments, although there is a vociferous debate surrounding the correct theoretical foundation of the *Quistclose* trust, this does not impact upon the legal requirements, and so once again the resulting trust could provide the liquidator or potential creditors with a predictable and useful mechanism to improve their positions.

[1241] Unless the provider of the moneys is a parent company

Chapter 6: The Efficacy of Utilising the Resulting Trust in Liquidation

This chapter builds directly on the analysis conducted in Chapter 5, which analysed the underpinnings of the resulting trust and concluded that they arise as a consequence of an imputed intention that a transferor of property does not give away the beneficial interest in the property unless there is consideration, a gift or loan. It also established that, within the context of liquidation, the resulting trust can be used in a number of scenarios to increase the size of a company's asset pool by 'returning' property to the company. This 'returned' property can then be made available to unsecured creditors by the liquidator through a liquidation dividend. However, it also concluded that the resulting trust is capable of removing assets from the company's asset pool, 'returning' property to the original, third party transferor, and thereby preventing these parties becoming unsecured creditors at all.

Given this potential usage of the resulting trust, this chapter will assess how feasible it is to actually utilise such trusts and conclude as to their overall effect. This is necessary as although it was proven in Chapter 5 that it may be theoretically possible for resulting trusts to be used by liquidators or third parties, practical considerations may make enforcing the resulting trust, and commencing the necessary litigation, unsustainable and treacherous[1242]. Should this be the case, it would prevent the resulting trust from being a potential mechanism of assisting these parties.

As identified in Chapter 5, in order for the resulting trust to offer greater levels of assistance than those provided by the anti-deprivation and personal liability provisions of the Insolvency Act 1986, it must meet three criteria: 1) Be capable of increasing the size of the company's asset pool to return assets to the unsecured creditors, or prevent parties from becoming unsecured creditors; 2) Possess clear and easy to identify provisions that offer the liquidator or third party the possibility of predicting the likely outcome of

[1242] See McCormack G, *Proprietary Claims and Insolvency,* (No.188); Finch V and Milman D, *Corporate Insolvency Law,* (No.6)*;* Swadling W, *The Quistclose Trust: Critical Essays,* (Oxford: Hart, 2004)

litigation; and 3) Be attractive to third party litigation financiers, owing to the lack of financial resources available to commence litigation.

This chapter will consequently conclude as to whether the resulting trust is able meet these three criteria. Chapter 5 proved that, theoretically at least, the resulting trust is able to increase the size of the company's asset pool[1243], thereby partially meeting Criteria 1, and does possess relatively clear and identifiable provisions that can provide a high level of predictability, again partially meeting Criteria 2[1244]. In Section 3 of this chapter it is concluded that the resulting trust does, in certain instances, fulfil all the criteria and is able to provide effective assistance.

As noted, whilst the resulting trust is theoretically able to increase the size of the asset pool, there are a number of factors that possibly hinder these theoretical outcomes. These factors include the ability to rebut the presumptions of resulting trust[1245], the lack of an available asset to be returned[1246], the limited nature of resulting trustee liability[1247], and finally the lack of funds required to commence litigation. This chapter therefore analyses whether these issues undermine the use of the resulting trust as a means of unsecured creditor protection.

This chapter takes the following structure. Section 1 analyses how the resulting trust can be rebutted and the level of evidence necessary to rebut the imputed intention ascribed to the transferor. This will establish the grounds on which the presumptions can be rebutted, and the quality of evidence needed to successfully rebut the imputation. Section 2 analyses the practical limitations in commencing litigation. These include the rules of tracing, the extent of resulting trustee liability, the costs of enforcing a claim of resulting trust, and whether a resulting trust over an insolvent company's assets constitutes a preference. Section 3 then concludes on the effectiveness of the resulting trust and whether is it a viable mechanism to be used in the context of insolvency. Section 4 finishes

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[1243] Or prevent parties becoming creditors
[1244] Chapter 5 only partially meets Criteria 2 as Chapter 6 must analyse whether the other practical factors are equally clear
[1245] *Fawkes v Pascoe* (1875) LR 10 Ch App 343; Fung E, *The Scope of the Rule in Shephard v Cartwright,* (2006) LQR 651
[1246] See *Re Diplock* [1951] AC 251 for example
[1247] Chambers R, *Resulting Trusts,* (No.923)

the analysis by looking at the policy arguments that arise from the utilisation of the resulting trust and whether its use is fair on other parties who are affected by the restriction of access to the assets.

Section 1: Rebutting the Imputed Intentions of the Transferor and the Imposition of a Resulting Trust

As recognised in the introduction to this chapter, notwithstanding the analysis that the resulting trust can be utilised by liquidators and third parties in a wide ranging and novel set of matrices, sustaining a claim is impossible should the recipient be able to rebut the presumption of resulting trust and show that the transferor did not intend to retain a beneficial interest in the transferred asset[1248]. As seen in Sections 2 and 3.3 of Chapter 5, evidence that the transferor had alternative intentions to those imputed by the presumptions will prevent a resulting trust arising and the property remaining with the recipient.

Section 1.1: The Doctrine of Advancement

Before analysing when and how the presumptions can be rebutted, it is necessary to briefly acknowledge that owing to the context of this thesis – the use of resulting trusts in corporate liquidation – the doctrine of advancement will not apply. This doctrine states that where certain relationships exist – such as father and child[1249] and husband and wife[1250] - the presumption that the transferor retains a beneficial interest in the property is reversed, and instead it is presumed a gift was intended. This reversal of the presumption does not apply to transfers from mothers to children[1251] or to transfers between wives and husbands[1252] however. Although the doctrine has been abolished by s199 Equality Act 2010, this section has yet to become active law, and so the reversal currently survives and is applicable. However, given that this thesis is concerned solely with the use of the resulting trust in a *corporate* context – meaning involving at least one

[1248] *Westdeutsche*, (No.186) at 708*;* Rickett C and Grantham R, *Resulting Trust,* (No.884) 15 at 17
[1249] *Bennet v Bennet* (1879) 10 ChD 474; *McGrath v Wallis* [1995] 2 FLR 114
[1250] *Tinker v Tinker* [1970] P 136
[1251] Thomas G, *The Law of Trusts,* (No.185) at 756
[1252] *Abrahams v Abrahams* [2000] WTLR 593

company as either transferor or recipient – none of the specific, domestic relationships of advancement are applicable, and so the doctrine has no application to this thesis' analysis.

Section 1.2: Rebutting Through a Gift or a Loan

Beyond the doctrine of advancement, there are two ways of rebutting the presumptions of resulting trust: either by establishing that the transfer was a gift, or establishing that the transfer was a loan. Both methods of rebuttal are well established with a substantial body of precedent. Examples of establishing there was a gift include *Fawkes v Pascoe*[1253]*, Re Young*[1254]*,* and also *Aroso v Coutts*[1255]*,* where the transfer of moneys clearly stated the beneficial interest was to be shared. Similarly, with establishing that there was a loan there is also a large body of authority, including *Re Sharpe (a Bankrupt)*[1256] and *Vajpeyi v Yijaf*[1257]*,* where the provision of £10,000 to purchase a house was interpreted as being a loan. Consequently, the exceptions are well documented and delineated.

The courts have moreover set limits on the evidence that can be relied upon in rebutting the presumption. In *Shephard v Cartwright*[1258] a restriction was placed upon subsequent acts being adduced as evidence of an intention by the transferor. It was held, citing with approval a passage from *Snell's Equity,* that only evidence of the "acts and declarations of the parties before or at the time of the purchase, or so immediately after it as to constitute a part of the transaction, are admissible in evidence either for or against the party who did the act or made the declaration…"[1259]. Hence, whilst the recipient can adduce evidence of subsequent actions against the transferor, the transferor is barred from doing so[1260].

This restriction has been heavily criticised, not only for the apparent unfairness towards the transferor, but also because it fails to draw an important distinction. As noted by

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[1253] (1875) LR 10 Ch App 343
[1254] (1885) 28 Ch D 705*;* see also *Standing v Bowring* (1885) 31 Ch D 282.
[1255] [2002] 1 All ER (Comm) 241
[1256] [1980] 1 WLR*;* See also *Aveling v Knipe* (1815) 19 Ves 441; *Hussey v Palmer* [1972] 3 All ER 744 (although only in Cairns' LJ dissenting judgment)
[1257] [2003] EWHC 2339
[1258] [1955] AC 431
[1259] Ibid, at 445-446, which Viscount Simonds quoting *Snell's Equity* (24th edn) at 153
[1260] See *Crabb v Crabb* (1834) 1 Myl. & K. 511 at 519

Fung[1261], *Shephard v Cartwright* does not distinguish between acts that evidence post-transfer intention, and those that illustrate the intention of the transferor at the time of the transfer – those that have no relevance to the imposition of a resulting trust and those that evidence the actual intention[1262]. Instead, they argue that subsequent evidence establishing the transferor's intentions at the time of the transfer – rather than evidence that merely establishes subsequent intention - should be made admissible. However, despite the self-evident logic in reforming the rule, the Privy Council in *Antoni v Antoni*[1263] applied the rule, making reform of the restriction seem uncertain unless the issue comes before the Supreme Court.

Consequently, it is uncertain whether the evidential restriction applies. If it does, then it is potentially problematic for claimants intending on bringing litigation as any evidence of subsequent conduct can only be used against the transferor, and not in their favour. Should the company or third party have subsequently acted as if there was meant to be a gift or loan it could be used against them, whilst any subsequent conduct indicating that there was no loan or gift could not be used in the transferor's favour. However, this is applicable only if there is subsequent, adverse evidence, which is not guaranteed, and in the majority of commercial cases is likely to be irrelevant as the transferor's intention will be sufficiently established at the time of the transaction. Any subsequent actions would likely go towards illustrating later intentions rather than those at the time of the transfer. Should the rule not be applicable, which it is submitted it should not, then clearly no such issues would arise. Hence, the evidential restriction is unlikely to cause a major headache to the majority of liquidators or third parties bringing resulting trust claims, nor prevent the initiation of litigation.

Despite the clarity of when the presumptions can be rebutted, and the slightly murkier limits of relying on subsequent conduct, the quality of evidence needed to prove that there was a gift or a loan remains ambiguous. This is because there has been no conclusive statement as to exactly what evidence, or what quality of evidence, is required to rebut the presumptions. In *Finch v Finch*[1264], Lord Eldon suggested that the presumptions could

[1261] Fung E, *The Scope of the Rule in Shephard v Cartwright,* (2006) LQR 651 at 653
[1262] See A W.L., *Transferor's Intention, Trustees' Undertaking and the Scope of Fiduciary Liability,* (2018) 32(1) TLI 50; *M v M* [2013] EWHC 2534 (Fam), per King J
[1263] [2007] UKPC 10
[1264] (1808) 15 Ves JR 43

be rebutted if there was 'sufficient evidence'. However, despite acknowledging the possibility, no assistance was provided to determine what was meant by 'sufficient evidence'.

Similarly in *Fowkes v Pascoe*[1265], Mellish LJ held that the evidence required to rebut the presumptions "must, beyond all question, be of very different weight in different cases." As with Lord Eldon's statement, this does not clarify the standard of evidence required, and instead clouds the issue further by stating that each case must be dealt on its own terms – meaning that it is impossible to predict what evidence would or would not be able to rebut the presumption in any given case. Lord Browne-Wilkinson in *Westdeutsche*[1266] did provide some assistance by stating that "If the settlor has expressly, or by necessary implication, abandoned any beneficial interest in the trust property, there is in my view no resulting trust." Thereby, if there is an express statement or sufficiently clear conduct that the transferor no longer intended to retain a beneficial interest the presumption will be rebutted. However, no guidance was yet again provided about the conduct that was necessary to rebut the presumption. Hence, beyond clarification that express statements will rebut the presumptions, little judicial guidance from the higher courts has been provided on the quality of evidence required to rebut the presumptions.

Despite the dearth of judicial guidance, Rickett and Grantham have proffered that there is a minimum threshold must be met[1267]. They argue that 'sufficient evidence' should be interpreted as being evidence of the transferor's 'actual intention'[1268]. They clarify this further by stating that the presumption of resulting trust "will give way to *clear* evidence of a different intention"[1269] (emphasis added) and that this clear "evidence establishes that A intended to make an outright gift to B…"[1270] Accordingly, evidence merely casting doubt on the transferor's intention is insufficient. Instead, evidence must be adduced that proves the transferor did intend a gift or loan to be made – that there must be *actual evidence,* rather than merely aspersions. This has been reinforced by Fung[1271], who notes

[1265] (1875) LR 10 Ch App 343 at 352
[1266] *Westdeutsche,* (No.186) at 708
[1267] Rickett C and Grantham R, *Resulting Trusts,* (No.884)
[1268] Ibid, at 17
[1269] Ibid, at 17
[1270] Ibid, at 18
[1271] Fung E, *The Scope of the Rule in Shephard v Cartwright,* (2006) LQR 651

that "This presumption of resulting trust can be rebutted either by direct evidence that A intended to benefit B…"[1272] Thus, there is a minimum bar that evidence must meet to rebut the presumptions, and that is actual evidence of intention.

Notwithstanding this clarification, it has also been proffered that no minimum standard has been set for the level of evidence needed to be rebut the presumptions. In *McGrath v Wallis*[1273], Norse LJ took the opposite view and concluded that the presumptions could be rebutted with evidence that was 'markedly more than slight'. Similarly, Chambers has argued that the presumptions can be rebutted with 'the slimmest of evidence'[1274], relying on Mummery LJ's comments in *Lohia v Lohia*[1275].

However, it is submitted that the adoption of such a reduced standard would be deeply flawed. Firstly, Chambers' reliance on *Lohia* as proof that very little evidence is necessary is challengeable. Upon a cursory reading of Mummery LJ's judgment it becomes apparent that whilst in that particular case there was limited available evidence, there was still some substantial evidence that was *enough* to rebut the presumption, and that a "reasonable court could have made" the conclusion that the presumption had been rebutted in those circumstances. Hence, the trial judge was not relying on 'the slimmest of evidence'. Secondly, if the lower standard of evidence were to be adopted, the resulting trust would be plagued by issues of uncertainty. Should the 'slight' evidence or 'slimmest of evidence' be adopted as the evidential standard, it would become impossible for practitioners to advise clients on the likelihood that a resulting trust claim would be successful, and would furthermore make the establishment of the resulting trust next to impossible achieve. This is because should any recipient could successfully adduce tangential information, the presumptions would be become irrelevant and unusable. Thus, it is submitted that for the resulting trust to be a viable mechanism for protecting property rights, a higher standard of evidence – evidence of actual intention – is necessary.

[1272] Ibid, at 651
[1273] [1995] 2 FLR 114 at 122
[1274] Chambers R, *Is There a Presumption of Resulting Trust?* in Mitchell C, *Constructive and Resulting Trusts,* (Oxford, OUP, 2010) at 267
[1275] [2001] EWCA Civ 1691 at 20-21

The effect of adopting this higher evidential standard can be seen clearest in relation to *Petrodel*[1276]*,* although this case involved the unique situation of the transferor trying to counter claims that they remained the beneficial owner of the transferred property. As noted in Chapter 5, the Supreme Court held that there was a series of resulting trusts, despite there being evidence to the contrary, as a consequence of Mr Prest refusing to cooperate with the litigation and the Court therefore drawing an adverse inference to his conduct. However, it is submitted that the Supreme Court's reliance on this adverse inference should have been insufficient evidence. Indeed, there was much evidence – equally, if not more, persuasive than the adverse inference - to rebut the claim that Mr Prest had retained a beneficial interest. This is particularly the case as the properties were purchased by Mr Prest's companies and the remaining properties were transferred for consideration – both acts that strongly indicate that there was no intention to retain a beneficial interest. In effect, Mr Prest was found to be the beneficial owner of the properties, at the expense of the companies Petrodel and Vermont, on nothing more than the lack of available evidence – a finding that severely weakened the latter's financial position with no justification. By comparison, in *Aroso* and *Re Sharpe,* the presumptions were rebutted on the basis of actual evidence of the transferor's intentions – thereby it being fully justified to remove the transferor's beneficial interest. It is therefore submitted that to ensure a justifiable outcome, reliance upon an adverse inference/slight evidence is insufficient, and actual evidence should be adduced.

In setting this standard of evidence, practitioners are able to adequately advise clients on the likely outcome and the strength of any resulting trust claim. In the context of liquidation this will be beneficial to liquidators and third parties, and encourage resulting trust claims, as the probability of success (provided they themselves can provide sufficient evidence to establish a resulting trust claim) can be determined at the outset, and 'safe' litigation likely to result in the return of property commenced and 'risky' litigation that is unlikely to lead to the return of property and merely incur costly legal fees be avoided. Thereby, the liquidator or third party are potentially protected by the return of property from successful litigation or by not having the limited funds in the asset pool wasted on unviable litigation.

[1276] *Prest,* (No.997) at 47

Section 2: Practical Limitations of Utilising the Resulting Trust

Should the beneficiary of the resulting trust – in the context of this thesis the liquidator or a third party – be able to prove that they fall within one of the categories of resulting trust, and the recipient is unable rebut the presumption of resulting trust, then they face a number of factors they must consider before litigation is commenced. These factors, although not directly related to each other, all converge to potentially make pursuing litigation, despite being possible and likely to succeed, undesirable. It is therefore necessary to analyse how likely these factors are to inhibit the willingness to commence litigation. The relevant factors include: a) the ability to trace and its limitations; b) the potential liability of resulting trustees should there have been a dissipation or misappropriation of trust assets; c) the potential costs of litigation; and d) the possibility of the resulting trust being a preference. This section will therefore analyse their potential impact.

Section 2.1: The Ability to Trace

Tracing is a fundamental mechanism in the enforcement of proprietary rights[1277]. Tracing is not limited to enforcing the beneficial interest against the original property – the beneficial owner is also free to enforce their interest over all substitute property that has been obtained with the proceeds of the original asset. Although fundamental to enforcing proprietary rights, it is important to note that it is not a method of determining them[1278] - meaning it is neither a claim nor remedy in itself. Instead, it is merely a mechanism for identifying what has happened to the property and which persons now have possession of the property or its substitutions[1279]. Put another way, it is a means of 'following' the property into the possession of persons other than the original trustee, or 'tracing' into substitute property[1280].

[1277] Oakley A, *Proprietary Claims,* (No.905) at 404
[1278] Millett P, *Restitution,* (No.882) at 403
[1279] *Foskett v McKeown* [2001] AC 102 at 128
[1280] Ibid, at 127; Stevens, *Vindicating the Proprietary Nature of Tracing,* [2001] Conv 94; Grantham and Rickett, *Tracing and Property Rights: The Categorical Truth,* [2000] 63 MLR 905; Walker Sir R, *Tracing After Foskett v McKeown,* [2000] RLR 573

In order to utilise the tracing mechanism, it is necessary to prove that there is firstly a proprietary base[1281], and secondly identifiable property[1282]. Given that the resulting trust is a mechanism for transferors of property to retain rights over property, and there is nearly always identifiable property in some form, tracing potentially plays an important role in resulting trust litigation. The need to be able to trace is imperative in cases of resulting trust owing to the potential that the resulting trustee will be unaware of the trust until the commencement of litigation, and so may dissipate the assets believing that they are both legally and beneficially theirs. This is exacerbated further by the limited liability of resulting trustees[1283], who are unlikely to be personally liable for any shortfall in trust assets that occurred before they became aware of their fiduciary position – thereby making the reclamation of dissipated trust assets through tracing the only feasible method of limiting transferor losses.

Notwithstanding the potentially important role tracing may play in any resulting trust claim brought by a liquidator or third party, as seen in Chapter 5, many resulting trusts consist of clearly identifiable property that is easy to locate - such as land or substantial personal property. In these circumstances, the rules of tracing are unlikely to be relevant, but there remains the possibility of dissipation. However, in instances of *Quistclose* trusts and mistaken payment claims, where the moneys are more easily dissipated due to them being in easily accessible bank accounts, the need to be able to trace is likely to be much greater. Therefore, this section will analyse and establish when resulting trust assets can be traced, and whether there is a substantial impediment for liquidators to commence litigation.

Where resulting trust assets have been used to purchase tangible property, there are very few limitations placed upon the beneficiary's ability to trace. The beneficiary is firstly able to trace through clean substitutions. In *Taylor v Plumer*[1284] for example, a stockbroker misappropriated client funds intended for an investment and instead purchased bullion and American stocks. The client was able to trace into the purchased bullion and stocks. Furthermore, the beneficiary is also able to trace into a mixed bulk –

[1281] The retention of proprietary rights over an asset in the possession of another: *Re Diplock* [1948] Ch 465; *Westdeutsche,* (No.186)
[1282] *Yugraneft v Abramovich* [2008] EWHC 2613 (QBD)
[1283] See below in Section 2(b)
[1284] (1815) 3 M&S 562

where two parties' property has been mixed together. In *Indian Oil Copn v Greenstone*[1285], this involved the mixing of two parties' crude oil, and both parties could trace rateably into the combined mixture. This has, moreover, been extended to include where a new but similar item is created[1286]. However, it is not possible should a completely new item, that has no relationship to the previous item, be created from the mixture[1287]. Hence, on a basic level, should the tangible trust assets be disbursed by the trustee, and new ones purchased as their replacement, or new but similar assets be created, the new assets will replace the disbursed ones and be made available to the claimant without issue. Although there is a limitation should a completely new asset be created, this is unlikely to overly impact the reclamation of resulting trust property in a negative manner owing to the form of asset that regularly constitutes the basis of a resulting trust – money and land, which are difficult to transform in to unrelated and brand new property. The final positive is that, should the property increase in value, then the beneficiary is permitted to keep the increase in value in the property[1288] – potentially providing a windfall for unsecured creditors should the asset be claimed.

In addition to being able to successfully trace into tangible property, it is also possible for the liquidator to trace moneys through the banking system and into bank accounts[1289]. Thus, should resulting trust moneys be mixed with the trustee's or third parties' personal assets, it is possible to trace into this mixture of moneys. Within the context of this thesis, this is again most likely to be applicable in instances of mistaken transfers and *Quistclose* trusts owing to the assets taking the form of easily transferable moneys[1290]. However, should tangible assets subject to a purchase price or gratuitous transfer resulting trust be sold and their proceeds then transferred, it would also be necessary to trace through the banking system. As set out below, the rules of tracing go a long way to protecting resulting trust beneficiaries by permitting recovery in all but a few contexts.

[1285] [1988] QB 345

[1286] *Glencore International AG v Metro Trading International Inc (No2)* [2001] 1 Lloyd's Rep 284

[1287] *Borden v Scottish Timber Products* [1981] Ch 25

[1288] *Re Tilley's WT* [1967] Ch 1197; See also *Jones v De Marchant* [1916] 28 DLR 561 where it was held that if property is mixed that cannot be separated, the original owner will be entitled to the entire bulk

[1289] *Foskett,* (No.1279)

[1290] *Chase Manhattan,* (No.1059); *Re Goldcorp Exchange Ltd* [1994] 2 All ER 806; *Bainbridge v Bainbridge* [2016] EWHC 898 (Ch)

The ability for a beneficiary to trace money into a 'mixed fund' is well documented. Whilst it is not possible for the beneficiary to claim the entirety of the fund, they are able to trace into the fund and any subsequently purchased property rateable to their contribution. In *Foskett v McKeown*[1291]*,* the trustee misappropriated assets from his beneficiaries to pay some of the premiums on his life insurance policy. After the trustee's suicide, it was held that as the beneficiaries had contributed to 40% of the paid premiums, they were entitled to trace into the proceeds of the policy and recover £400,000 – covering some of the losses sustained by the trustee's breach of duty.

However, what becomes more difficult is when the trustee and trust moneys are mixed and some of the money is dissipated rather than used to purchase new assets – even though the tracing rules do operate harshly again the trustee. Should the trustee make a distribution from the mixed fund, there is a presumption that he spends his own moneys first, rather than the beneficiary's[1292]. In the words of Lord Walker[1293]*,* trustee money "sinks to the bottom [of the bank account] in the sense that…it is treated as withdrawing its own money from a mixed funds before it touches trust money". However, should the application of this presumption be unfair – such as where the trustee makes initial payments to purchase valuable assets and later payments are merely dissipated – then the presumption can be reversed, and it be found that trust money was spent first and not dissipated[1294]. Under the latter reversal of the presumption in *Re Oatway,* it is presumed that the assets have been purchased with trust moneys, meaning that they can be traced into.

This ability of 'cherry picking'[1295], and the impact for liquidators and third parties pursuing a resulting trust claim, is clear – should the mixing of trust and trustee property occur, and an asset be purchased, then the beneficiary will have access to the asset which can then form part of the company's asset pool and be distributed to the unsecured creditors. The flexibility of the presumptions means that Equity and the rules of tracing

[1291] [2001] 1 AC 102
[1292] *Re Hallett* (1880) 13 Ch D 696
[1293] *Re Lehman Brothers International (Europe* [2012] 3 All ER 1 at 65
[1294] *Re Oatway* [1903] 2 Ch 356
[1295] *Dyson Technology Ltd v Curtis* [2010] EWHC 3289 (Ch) at 20; Nair A, *Claims to Traceable Proceeds: Law, Equity and the Control of Assets,* (Oxford: OUP, 2018) at 20

do all in their power to ensure that the beneficiary does not lose out – and if the property has increased in value, even make a profit[1296].

Less generous are the rules regarding mixtures of trust moneys and other innocent volunteers. This would occur should resulting trust assets be mixed not with trustee moneys but with moneys from other trusts. Given the equal position of the two parties, it is not possible to utilise the harsh rules associated with mixtures of trust and trustee moneys. Instead, there are three possible outcomes[1297]: 1) recovery of identifiable assets by the beneficiary who provided the funds[1298]; 2) *pari passu* allocation of the remaining funds amongst the innocent parties; and 3) the rule in *Clayton's Case*[1299] may be applicable, whereby moneys first paid into the account are presumed to have been the first paid out. However, the last possibility is rarely used due to its apparent unfairness to those whose money was misappropriated first[1300], and so has become an exception rather than its historical position as the rule[1301].

Owing to the limitations of this thesis it is not possible to analyse the correctness of any of the three approaches or which is the most justifiable[1302]. However, the effect that any of the options would result in is clear should the liquidator or third party bring a resulting trust claim. Should there be identifiable assets that were purchased with trust moneys then obviously the most desirable outcome would be recovery of that asset at the expense of the other innocent volunteers. However, the likelihood of there being sufficient evidence to prove a link between the trust moneys and any purchased asset, due to the mixture of innocent volunteer moneys, is unlikely[1303], and so this is not a foreseeable outcome. Instead, the most likely outcome is rateable distribution of the remaining assets with the other the innocent volunteers. This outcome, as seen in Chapter 1 with *pari passu* in the context of liquidation, would likely result in substantial losses for the beneficiary.

[1296] *Turner v Jacob* [2006] EWHC 1317 (Ch)
[1297] *Madoff Securities International v Raven* [2011] EWHC 3102 (Comm)
[1298] *Russell-Cooke v Prentis* [2003] 2 All ER 478 – where the trust moneys were linked to specific mortgage loans
[1299] (1816) 1 Mer 572
[1300] *Barlow Clowes International v Vaughan* [1992] 4 All ER 22 at 46; *Re Walter J. Schmidt & Co* (1925) 298 F. 314 at 316
[1301] *Russell-Cooke v Prentis* [2003] 2 All ER 478, per Lindsay J at 55
[1302] Nair A, *Claims to Traceable Proceeds,* (No.1295)
[1303] See *Re Diplock* [1948] Ch 465 for an example of the limited applicability of *Russell-Cooke v Prentis*

However, the small crumb of comfort is that they would at least recover something. Furthermore, should *Clayton's Case* apply (as unlikely as that is), there is the possibility that should the resulting trust moneys be the first paid in, then nothing would be recovered. Should they be paid in later, then there is a greater chance of recovering assets. Although it is not possible to predict with certainty the applicable rule to a mixture of trust and innocent volunteer moneys, the most likely outcome is that *pari passu* distribution will occur. Therefore, should the liquidator be faced with a resulting trust claim involving such a circumstance, there is a likelihood that limited trust assets will be recoverable – potentially making it desirable and feasible for the liquidator to commence litigation.

Moreover, there are a few further, but minor, limitations to the right to trace that potentially affect the feasibility of commencing litigation to enforce a resulting trust. The first is the rules concerning the 'lowest intermediate balance'. This states that where there is a mixture of trust and trustee moneys in a bank account, and the account as a whole is dissipated below the level of the trust's contribution, then any subsequent payments into the account, unless expressly intended to replenish the trust assets, cannot be traced into[1304]. Similarly, should the account be overdrawn, and trust moneys be paid in subsequently, then the beneficiary is prevented from tracing into those moneys as they have been used to discharge an unsecured debt[1305] and 'thereupon ceased to exist'[1306]. Should either of these events occur, then the beneficiary will be precluded from tracing. Although this is a possibility for all forms of resulting trust, this is particularly likely with mistaken transfers and *Quistclose* trusts when the moneys have been placed in an active, general account[1307] that has a fluctuating credit balance and even enters an overdraft. If the recipient is a bank – such as in *Chase Manhattan* itself – or other financially resource rich party, then the prospect of accounts going overdrawn is remote due to the lack of need for such unsecured credit. However, should either event occur, then despite having a valid claim, the liquidator or third party would be unable to reacquire the assets.

[1304] *Roscoe v Winder* [1915] 1 Ch 62; *Bishopsgate Investment Management v Homan* [1995] 1 All ER 347
[1305] *James Roscoe (Bolton) v Winder* [1915] 1 Ch 62
[1306] *Re Goldcorp* [1995] 1 AC 74 at 105; *Moriarty v Atkinson* [2008] EWCA Civ 104
[1307] In the latter case in breach of the terms of the loan

These limitations are potentially offset should the trustee use the moneys to discharge secured debts[1308]. In this event the beneficiary is free to subrogate themselves into the into the position of the secured creditor and recover any amount of trust assets used to discharge the debt[1309]. In effect, the beneficiary becomes the secured creditor. Hence, should a secured asset be discharge with trust assets, there is the possibility for the liquidator to recover the amounts dissipated – however, the limitation to secured assets potentially restricts the applicability of this rule as the majority of debt is unsecured, and also restricts the feasibility of relying on reclamation of assets.

The penultimate considerations in regard to tracing is the possibility of dissipation and the recipient being a *bona fide* purchaser for value. Dissipation is the use of trust moneys to pay for things that do not result in the acquisition of an asset[1310], whilst the *bona fide* purchaser for value is anyone who purchases assets for their market value without notice that of the breach of trust[1311]. Moreover, should the recipient be in a position that would render it inequitable to trace[1312], the beneficiary would be barred from tracing[1313]. Fortunately, given the commercial context of this thesis, it is unlikely that assets will be distributed to parties from whom it would be inequitable to trace[1314] – meaning it is unlikely to affect liquidators or third parties. It is, though, much more foreseeable that assets may be transferred to a *bona fide* purchaser for value because of the distance involved in two companies, or company and consumer, contracting for the sale of an asset. Notwithstanding the limited effect of it being inequitable to trace, should dissipation occur or there be a *bona fide* purchaser for value - all foreseeable occurrences - then as with the other restrictions to tracing, the unsecured creditors would lose out.

To summarise on the relationship between tracing and the enforcement of resulting trusts, it is apparent that tracing is potentially a very useful feature of utilising the resulting trust.

[1308] Pawlowski M, *Overdrawn Accounts and Backward Tracing,* (2017) 188 Trusts and Estates Law and Tax Journal at 12-13

[1309] *Boscawen v Bajwa* [1995] 4 All ER 769; *Banque Financiere de la Cite v Parc (Battersea)* [1999] 1 A.C 221

[1310] *Re Diplock* [1948] Ch 465, at 521; Oakley A, *Proprietary Claims and Their Priority in Insolvency,* (1995) 54 CLJ 377 at 420

[1311] *Sinclair Investments v Versailles Trade Finance* [2011] 4 All ER 335; Oakley A, *Proprietary Claims*, (No.905)

[1312] Such as if the recipient is a hospital or school

[1313] *Re Diplock* [1948] Ch 465; *Lipkin Gorman Ltd v Karpnale* [1991] 2 AC 548

[1314] Such as charities, hospitals or schools

As seen above, the rules of tracing generally work in the liquidator or third party's favour should the original property be substituted, with the rules for tangible property and the mixing of trust and trustee moneys all providing a means for the liquidator to recover the asset in the majority of situations. Although there are restrictions concerning mixtures of volunteer assets and dissipation, these are unlikely to overly hinder the commencement of litigation in the majority of cases. The primary issue of dissipation cannot effectively be addressed and is a real possibility, but the restriction on the lowest intermediate balance is likely only to affect a minority of *Quistclose* and mistaken transfer claims. Further, should one of the other restrictions apply, then the claimant will be able to establish this early on in the litigation process and minimise the dissipation of their meagre resources by perusing pointless litigation. As was also seen in the analysis, the two primary forms of trust affected by the restrictions to tracing are mistaken transfers and *Quistclose* trusts – meaning the majority of resulting trusts are not unduly affected as the asset is either in its original form or is an identifiable substitute. This is in contrast with the remedies available under the Insolvency Act 1986 set out in Chapter 5. These limit the liquidator to pursuing personal actions that fail in a practical sense should the defendant have insufficient resources to give effect to any judgments given in favour of the liquidator. Hence, the resulting trust's ability to pursue identifiable assets in the majority of claims provides a useful tool for liquidators in increasing the company's asset pool and third parties from avoiding becoming unsecured creditors – one that is not available under the traditional creditor protection mechanisms of the Insolvency Act 1986.

Section 2.2: Resulting Trustee Liability

Closely related to the ability to trace is the personal liability of the resulting trustee for breaches of trust. Should the rules of tracing prohibit the reclamation of trust property, then bringing a personal claim against the resulting trustee may provide a mechanism for addressing any shortfall in the trust assets. The liquidator or third party would consequently have two means of recovering dissipated trust assets and minimising unsecured creditor losses. Despite this potential, the position of resulting trustees has remained unclear, and their potential liability is up for debate. Therefore, this section will analyse and seek to clarify the position and liability of resulting trustees, and consequently their potential to make restitution for lost trust assets.

Trustees, irrespective of the form of trust that arises, are subject to stringent obligations owing to their position as fiduciaries[1315]. These duties regularly include the duty of loyalty to the trust and the beneficiaries[1316]; burdensome investment obligations[1317]; and a general duty to carry out their duties with reasonable care and skill[1318]. Moreover, should the trustee be working in a professional capacity, then the standard of care demanded rises in line with their level of professionalism[1319]. The duties owed by trustees were placed into three broad categories in *AIB Group (UK) v Redler*[1320], which are: 1) the custodial duties to preserve trust assets; 2) the management and stewardship duties to manage the trust assets with proper care; and 3) a duty of undivided loyalty to the trust and trustees.

The need to impose such duties on a trustee arises from the inherit potential for them to abuse their fiduciary position of trust and confidence and misappropriate trust assets[1321]. Given the control trustees have over the assets, and the plausibly limited supervision of them by the beneficiaries[1322], the potential for them to act in their own interests is high. Prototypical examples of this possibility are *Lipkin Gorman v Karpnale*[1323] and *Bishopsgate Investment Management v Maxwell (No2)*[1324], where in the latter case directors of a company misappropriated pension fund assets to support companies within the group. Within the context of this thesis, and again with *Quistclose* and mistaken transfer trusts in particular[1325], there is the possibility that dissipation of trust assets may occur, although without the same level of malicious intent.

Considering the duties specific to the three forms of trust, the duties of the express trustee are clear, well documented in the legislation and case law[1326], and can also be determined on an individual basis by reference to the trust deed. The position of the resulting trustee

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[1315] *Bristol and West Building Society v Mothew* [1998] Ch 1 at 18; *Pitt v Holt* [2013] UKSC 26
[1316] *Boardman v Phipps* [1967] 2 AC 46; *Re Duke of Norfolk's Settlement Trusts* [1982] Ch 61
[1317] Ss 3 and 4 Trustee Act 2000
[1318] Ibid, at S1
[1319] Ibid, at S(1)(b)
[1320] [2014] UKSC 58
[1321] Pearce R, Barr W, *Pearce and Stevens' Trusts and Equitable Obligations,* 7th edn (Oxford: OUP, 2018), at 617
[1322] Particularly if they are young children
[1323] [1987] 1 WLR 987
[1324] [1994] 1 All ER 261
[1325] This is as a consequence of both forms of trust primarily being made up of moneys in an active bank account
[1326] Trustee Act 2000

is more ambiguous and uncertain, however. This is primarily because they do not operate in the same manner as express trustees owing to their differing responsibilities – the resulting trustee is primarily there to merely hold property for the beneficiary and return it, rather than actively manage the property[1327]. In the context of this thesis, should the duties be onerous on resulting trustees, meaning it is more likely that liability will be imposed, then there is a greater likelihood that should dissipation of trust assets occur, the trustee will be required to make up the shortfall. On the other hand, if the duties are reasonably lenient, then such a possibility becomes much more remote. Consequently, establishing whether the resulting trustee duties are lenient or onerous may have an important impact should there be a shortfall in the trust assets.

As noted immediately above, the majority of resulting trusts merely require the trustee to first hold, and then return, the property to the transferor[1328]. Given this limited set of obligations, the extent of their duties has been, and still is, rarely considered in the authorities as they are perceived as merely being bare trustees[1329]. This lack of consideration is problematic because as noted in the section on tracing, should there be a delay between the transfer of the property and the recognition of there being a trust, there is a distinct possibility that the assets may be misappropriated and dissipated.

In some of the early authorities the courts were willing to find that resulting trustees had breached their duties and were liable to compensate the trust[1330]. However, in *Westdeutsche*[1331] there was an unwillingness to find a resulting trust because of their Lordships' disagreement with the imposition of obligations and liability on the defendants[1332], who otherwise would have incurred substantial financial implications. This in keeping with Lord Browne-Wilkinson's previous conclusions in *Lord Napier and Ettrick v Hunter*[1333]*,* where his Lordship held that the imposition of liability on a resulting trustee was undesirable in that instance. In refusing to establish a resulting trust in order to side step the imposition of liability, it is implicit from the House of Lords' judgments

[1327] *Stafford v Kekatos (No3)* [2008] NSWSC 1093 at 93
[1328] Chambers R, *Resulting Trusts,* (No.923) at 198-199
[1329] *Essery v Cowland* (1884) 26 Ch D 191
[1330] *Matusewich v Matusewich* (1978) 4 Fam LR 258 (W.A.)
[1331] [1996] 2 WLR 802 at 961, 974, 986
[1332] The potential impact of liability was one among several justifications for rejecting a resulting trust being present
[1333] [1993] AC 713 at 752

that the resulting trustee has the same obligations and level of liability as an express trustee[1334], but that imposing the same level of liability is undesirable in instances of resulting trust. Whilst this is potentially understandable owing to the limited responsibilities of the resulting trust, it is problematic from a policy perspective. This is because it means that transferors face the possibility of not being able to recover assets that rightfully belong to them due to no fault of their own and the courts' unwillingness to address the issue.

Happily, a way out of this prospect has been put forward by Lord Millett. In *Lonrho v Fayed (No2)*[1335]*,* it was commented that constructive trustees are not always subjected to the same obligations as express trustees, and so have reduced levels of liability. In *Target Holdings v Redferns*[1336]*,* Lord Browne-Wilkinson, in contrast with his earlier judgments*,* also intimated that the differing forms of trustee would not be subject to uniform levels of liability[1337], with the detailed duties of an express trustee not necessarily applying to the other forms of trustee. As the resulting trustee is much closer in function to the constructive trustee than the express trustee, there is now doubt as to whether it is correct to imply that resulting trustees share the same liability as express trustees. It is submitted that this proximity to the constructive trustee, rather than the express trust, and Lord Browne-Wilkinson's *obiter* comments, mean that the resulting trustee cannot be seen as having the same liability as the express trustee. Thus, there is no longer any justification for not imposing the resulting trust merely to minimise potential trustee liability.

Moreover, in the majority of resulting trusts[1338], they arise in the absence of a pre-existing fiduciary relationship, and without the now resulting trustee having any knowledge of their new position and responsibilities. Examples of such an occurrence are common in the authorities, and include *Sinclair v Broughman*[1339] and *Chase Manhattan*[1340]. Chambers has concluded that as a consequence of this lack of knowledge, the resulting trustees' obligations in these situations are restricted to protecting the transferor's interest

[1334] Chambers R, *Resulting Trusts,* (No.923) at 198
[1335] [1992] 1 WLR 1 at 11
[1336] [1995] 3 All ER 785
[1337] Ibid, at 795
[1338] Those including gratuitous transfer and *Quistclose* trusts.
[1339] [1914] AC 398
[1340] [1981] Ch 105

in the property[1341]. Thereby, as commented above, they are merely bare trustees with minimal levels of obligations. Indeed, they will not be personally liable for any dissipation of trust assets until their conscience has been affected by knowledge of the trust[1342]. However, in certain circumstances[1343], there will be the duty to collect assets from third parties and pass them on to the beneficiaries[1344]. This reduction in the obligations of resulting trustees has been justified on the basis of their lack of knowledge – that it would be remarkable to subject a trustee to obligations they had no knowledge of. This is in contrast to express trustees, who knowingly and voluntarily take on the position and responsibilities[1345]. Indeed, Lord Browne-Wilkinson in *Westdeutsche*[1346] concluded that liability could not be imposed should the trustee be unaware of his position. This is particularly the case if the trustee is a child such as in *Re Vinogradoff*[1347], as it would be unconscionable to impose liability on such an individual[1348].

Where there is a pre-existing duty however, such as in instances where there has been the failure of an express trust, the trustee has stricter standards of care compared to other resulting trustees[1349]. Owing to the trustee having already agreed to being bound by restrictive obligations, there is a prior fiduciary relationship of trust, confidence and loyalty to the transferor[1350]. In effect, the (now) resulting trustee has the same duties as would have been owed if they were or still were an express trustee, plus the duty to return the assets. It can be said that the duties of an express trustee are ongoing for the automatic resulting trustee and thus higher in standard than for the presumed resulting trustee.

In between these two positions are purchase price resulting trustees. As the contribution to the purchase price was known to the legal purchaser and now trustee[1351], they are aware that they cannot treat the property wholly as their own[1352]. Although this does not result

[1341] Chambers R, *Resulting Trusts,* (No.923) at 199
[1342] Ibid, at 201
[1343] Such as where property is being rented out or dividends are declared on shares
[1344] *Evans v European Bank* (2004) 7 ITELR 19 at 116
[1345] Chambers R, *Resulting Trusts,* (No.923) at 201
[1346] [1996] WLR 802 at 988
[1347] [1935] WN 68
[1348] Hayton D, *Underhill and Hayton,* (No.883) at 706; *Hardoon v Belilios* [1901] AC 118 at 123; *Re Rococo Developments (in liquidation), Evans v Jones* [2017] Ch 1
[1349] Chambers R, *Resulting Trusts,* (No.923) at 116-117
[1350] Ibid, at 199
[1351] As they must have been aware that the transferor was providing them with funds
[1352] Chambers R, *Resulting Trusts,* (No.923) at 116 and 201

in them being express trustees, there will be greater obligations such as maintaining the property (particularly if it is land) and ensuring it does not overly depreciate in value – higher burdens than imposed on the gratuitous transfer resulting trustee, and potentially increasing the chances of them being compelled to make up any shortfalls in the trust assets.

The effect of this distinction between the forms of resulting trust and the level of knowledge of the respective trustees is apparent[1353]. Should the resulting trustee have no knowledge of the trust, then according to MacFarlane, for as long as the trust property remains in his hands, "the beneficiary simply has a power to fix him with a duty to reconvey the property by bringing the existence of the trust to his attention."[1354] In this context, should assets subject to such a resulting trust be dissipated, and the liquidator be barred from tracing, then it would be impossible recover assets dissipated before the trustee had knowledge of their position. Obviously, should the dissipation occur after the trustee becomes aware of their position, then any such dissipation would be recoverable. Moreover, should the assets be subject to a purchase price resulting trust or automatic resulting trust, which means the trustee was already aware of their position, then it may be possible for the liquidator to recover dissipated, non-traceable assets from the trustee from the moment of the transfer.

Liquidators and third parties who are faced with the dissipation of non-traceable resulting trust assets may therefore recover commensurate property to cover the dissipation. However, as seen above, the ability to do so is limited to instances of where the trustee has become aware of their position before the dissipation has occurred – a position many resulting trustees do not find themselves in. It should also be noted that if the trustee be insolvent, owing to the personal nature of trustee liability, the chances of successfully recovering any award are minimal, as the claimant would rank merely as an unsecured creditor and be subject to a *pari passu* distribution of the insolvent trustee's assets. Hence, albeit resulting trust liability not being as encompassing as the personal liability analysed in Chapter 3, the availability of imposing liability in certain limited circumstances does

[1353] *R v Chester and North Wales Legal Aid Area Office, ex parte Floods of Queensferry Ltd* [1998] 1 WLR 1496 at 1500; *Allan v Rea Brothers Trustees* [2002] PLR 169 at 55.
[1354] MacFarlane B, *The Structure of Property Law*, (London: Bloomsbury, 2008) at 306; *Allied Carpets Group PLC v Nethercott* [2001] BCC 81; *Independent Trustee Services v GP Noble Trustees* [2012] EWCA Civ 195.

to some extent increase the potential of the resulting trust to be a valuable and beneficial mechanism of returning assets to the company's asset pool.

Section 2.3: The Costs of Enforcement

Should the liquidator or third party have a valid resulting trust claim, and the trust assets or their substitutes be identifiable, then they face a further potential issue – funding the necessary litigation to reclaim the asset. As concluded in Section 3, Chapter 3, liquidators face a funding predicament. Whilst this section will not rehearse the arguments set out in Chapter 5, it is necessary to restate the fundamental position of a liquidator's ability to fund litigation. Whilst the liquidator is permitted to recover litigation expenses owing to their 'super priority'[1355], they are limited to using the company's asset pool to fund litigation. Although there is the possibility of using outside sources of litigation funding, the desirability to make the necessary funds available is limited should the litigation have a low chance of success. Consequently, it is difficult for liquidators to be in a position to commence litigation.

However, whilst the Insolvency Act provisions are fundamentally flawed owing to substantive restrictions that prevent successful litigation being commenced or funded[1356], the resulting trust is not faced with such issues. As set out both in this chapter and Chapter 5, in instances where a resulting trust has arisen, there is usually an identifiable asset or a substitute asset identifiable through the rules of tracing. Furthermore, Chapter 5 and this chapter have proven that the law applying to the resulting trust is relatively clear. Notwithstanding there being issues surrounding the theoretical foundations of certain claims such as the *Quistclose* trust and mistaken payments, the practical impact of the claims – that property is held on trust for the transferor – is identical irrespective of the foundation adopted. Moreover, the requirements necessary to satisfy the majority of claims have been established with a high degree of certainty, and the right to trace and impose trustee liability ensures that it unlikely that there will not be available property to claim. It is therefore submitted that, should a liquidator have a viable resulting trust claim, owing to the existence of identifiable property and a high level of predictability as to the

[1355] S176ZA Insolvency Act 1986
[1356] See Chapters 3 and 4

result of any litigation identified in Chapter 5, creditors themselves or third-party financiers are more likely to make funding available. For the creditors this is primarily because unlike with the anti-deprivation provisions, where uncertainty causes them to be reticent in providing funding, the resulting trust provides much greater levels of predictability and a stronger guarantee that their funding will be recovered. Similarly for third-party funders, should the property be of substantial value, they will be able to reclaim their moneys and make a sizeable profit from the recovered property by charging fees.

Moreover, unlike with the Insolvency Act provisions, given that any resulting trust claim would be available prior to the onset of insolvency owing to such trusts arising upon the transfer of property, it would belong to the company[1357] and not the liquidator. Therefore, they are exceptions to the rule against champerty, and can safely be assigned to third-party financiers.

Whilst this use of third-party litigation funding may limit the amount that is recoverable by the liquidator as a consequence of fees, the reclaimed property will still be able to contribute to the company's asset pool. This is seen clearest in *Petrodel,* where the property at the centre of the dispute amounted to £17 million and could have been made available to the unsecured creditors had Petrodel or Vermont been liquidated. In *AAZ v BBZ*[1358]*,* high value property including land, a yacht and plane were subject to a resulting trust. It must be noted, however, that should the reclaimable property be low in value, and given the high costs of commencing litigation, it is unlikely that the necessary finance would be forthcoming.

Moreover, should the insolvent company be the resulting trustee, the cost of administering the trust may become problematic. As recognised by McCormack[1359], the issues are who must cover the costs of administration, and whether the liquidator can recover their costs as trustee from the assets. If the costs are recoverable by the liquidator, then the value recovered from the property by the third party will be diminished.

[1357] *Re Oasis Merchandising* [1998] Ch 170
[1358] [2016] EWHC 3234 (Fam) – see also *NRC Holdings Ltd v Danilitskiy* [2017] EWHC 1431
[1359] McCormack G, *Proprietary Claims and Insolvency*, (No.188) at 37

Historically, the courts have been unwilling to award remuneration to trustees unless the trust document, and thereby the settlor, had provided for it. However, in *Re Masters Decd*[1360] it was held the courts have the authority to authorise remuneration where appropriate, and in *Re Grimthorpe*[1361] it was held trustees were entitled to recover expenses incurred in fulfilling their duties. In a series of cases the courts' initial desire to see this authority used sparingly[1362] became more liberal[1363], with a greater willingness to award expenses. In *Re Berkley Applegate*[1364] it was found that a number of assets were held on trust by an insolvent company, and that there were insufficient assets to cover the costs of establishing and verifying the various claims by the company's customers. Claims made by the beneficiaries that the liquidator should not be able to recover their expenses in administering the trust were rejected owing to the maxim that those who seek Equity must do Equity, and that the liquidator should be allowed to recover the "skill and labour expended in connection with the administration of the property"[1365]. Hence, should a third party seek to enforce their rights to property held by an insolvent company, then the liquidator will be entitled to recover the costs of administering the trust either from the property itself or the third party.

This ability of the liquidator to recover their costs could therefore minimise the positive impact of any resulting trust, as the assets would first have to cover any liquidator expenses. However, given the limited nature of resulting trustee administrative duties[1366], it is unlikely that the expenses incurred by the liquidator will be substantial. In the majority of cases the resulting trust assets are relatively easy to locate as they are primarily land or known bank accounts. Should the asset be land, although administrative costs may be incurred, these can be offset should the property produce a rental income. The one exception to this may be resulting trusts arising as a consequence of mistaken payments, where the liquidator may be faced with the prospect of having to identify the location of the mistaken payment within the recipient's accounts[1367], leading to the incurrence of

[1360] [1953] 1 WLR 81 at 83
[1361] [1958] Ch. 615 at 623
[1362] *Re Worthington decd* [1954] 1 WLR 525
[1363] *Re Duke of Norfolk's Settlement Trusts* [1979] Ch 37
[1364] *Re Berkley Applegate (Investment Consultants) Ltd No2* [1989] Ch 32 – this is now codified in s31(1) Trustee Act 2000
[1365] Ibid, at 50
[1366] These primarily are the protection and returning of property to the transferor (see above)
[1367] *Chase Manhattan,* (No.1059)

substantial liquidator expenses. The overall effect on the creditor's reclamation of transferred assets is hence likely to be minimal, and will not adversely affect the impact of the resulting trust.

Section 2.4: Is the Resulting Trust a Preference?

The final practical hurdle facing the use of the resulting trust by a liquidator or third party is the possibility of such trusts being a preference, and so void under s239 Insolvency Act 1986[1368]. This is primarily the case with *Quistclose* trusts, because as seen in Chapter 5, they only arise when a company is experiencing financial difficulties that the provision of the funds subject to the trust cannot successfully address. Consequently, the recipient company regularly enters insolvency soon after the moneys are received. This is in contrast with the other forms of resulting trust, which regularly occur a sizeable time before the company finally enters insolvency, and so cannot meet the time restrictions[1369] nor be subject to the requisite desire on the part of the insolvent company[1370] necessary to successfully make out a preference claim.

A *Quistclose* trust potentially is caught by the preference provisions as, should the company be the recipient of the moneys, there will be an agreement that one creditor (the transferor) will be placed into a better position than had the resulting trust over the loan moneys not existed. This is owing to the fact that the lender would otherwise have taken on the position of an unsecured creditor and been subject to rateable distribution of the assets.

The issues surrounding trusts and the law of preferences were considered in *Re Kayford*[1371], which analysed the previous, but similar, preference provisions of the Companies Act 1948[1372]. Here, money was paid by customers to a mail order company. The company then, on the advice of its accountants, placed the moneys in a separate account, which were to be drawn on only once the orders were processed. Megarry J held that the placing of the moneys in the separate account was sufficient to create an express

[1368] Moffatt G, *Trusts Law*, (No.899) at 814
[1369] S240(1)(a) Insolvency Act 1986 s
[1370] *Re M.C. Bacon,* (No.429)
[1371] [1975] 1 WLR 279
[1372] S320 Companies Act 1948

trust, and that no issue of the company preferring the customers arose as the preference provisions[1373] required the benefitting party to be a creditor, and the creation of the trust thereby prevented the customers from becoming creditors[1374].

The reasoning of Megarry J has however been criticised by Stevens[1375]. He argues that the decision of which classes of creditors should be given preferential status should not be determined by the directors but by operation of law. Although this may be true for express trusts, where they would arise only as a result of directors' actions, given that the *Quistclose* trust is an automatic resulting trust[1376] – and so arises by an operation of law – Stevens' objection has no applicability to such trusts. This because it is not the directors who are dictating who has 'preferential' status, but equitable presumptions which encumbers the moneys with a trust upon receipt[1377]. The resulting trust is therefore institutional in nature and free of directorial influence.

One further issue with *Re Kayford* is the argument that rather than the company receiving the customer payments already subject to a trust, the company received the moneys unencumbered before declaring the trust[1378], so by subsequently declaring a trust over unencumbered assets, this may have constituted placing the customers in a better position than they otherwise would have been[1379]. Once again, whilst this is potentially applicable to the express trust[1380], in instances of resulting trust, the recipient company receives the moneys already impressed with a trust[1381], and so never became a debtor[1382]. As Stevens acknowledges, the resulting trust does not involve a trustee subsequently declaring a trust after receiving unencumbered asset, and so it is not the recipient company that is impressing the moneys with a trust – meaning that a creditor cannot have been 'preferred'.

[1373] Which is the same under the current provisions under s239
[1374] *Re Kayford* [1975] 1 WLR 279 at 28. 3
[1375] Stevens R, *Insolvency* at 158 in Swadling S, *The Quistclose Trust: Critical Essay,* (Oxford: Hart, 2004)
[1376] Ibid, at 159
[1377] Loi K, *Quistclose Trusts,* (No.892) at 423
[1378] Waters (1983) 21 Alberta Law Review 395
[1379] See also Anderson H, *Trust Assets in English Insolvency Law,* at 176 in McKendrick E, *Commercial Aspects of Trusts and Fiduciary Obligations,* (Oxford: OUP, 1992) at 177-178, who refutes accusations that a *Quistclose* trust could give rise a preference as the trust is created by an operation of law
[1380] *Re Chelsea Cloister Ltd* (1981) 41 P&CR 98
[1381] See Chapter 5 Section 1
[1382] Loi K, *Quistclose Trusts,* (No.892) at 423

A number of reasons have also been proffered for the recipient company of *Quistclose* funds not possessing a desire to prefer. These include that the directors were intending to rescue the company and prevent its moving into liquidation rather than preferring specific creditors[1383], that the lender's priority was 'foisted' upon the company who had no choice but to accede to the priority in order to receive the moneys[1384], and because resulting trusts "are fundamentally inconsistent with the notion of malpractice prior to the commencement of insolvency."[1385] In *Re Branson & Gothard ltd*[1386] for example, a stockbroking company set up a client account to segregate potential surpluses from general corporate funds. It was held there was no preference as the company was merely seeking to protect client moneys and the company had been ordered to do so after being informed by its regulator. Hence, irrespective of which factor is applicable, all prevent the company from forming the requisite desire, and so even if the company is said to be 'preferring' one creditor over another, the *Quistclose* trust will not be set aside as there is no desire to prefer. Whilst this may be different should the trust be an express trust in which the property was initially received unencumbered[1387], the recipient company receives the trusts already encumbered under a *Quistclose* trust. The liquidator or third party will therefore not be prevented from enforcing a *Quistclose* trust on preference grounds.

Section 3: The Efficacy of Utilising the Resulting Trust

Section 3.1: The Forms of Resulting Trust

Having analysed the practical factors that impact upon the use of the resulting trust, it is apparent that, generally, the resulting trust *is* a viable mechanism through which

[1383] Stevens R, *Insolvency* at 161 in Swadling S, *The Quistclose Trust: Critical Essay,* (Oxford: Hart, 2004)
[1384] Parry R, *Transaction Avoidance,* (No.271)
[1385] Anderson H, *Trust Assets in English Insolvency Law,* at 176 in McKendrick E, *Commercial Aspects of Trusts and Fiduciary Obligations,* 3rd edn (Oxford: OUP, 2018) at 178
[1386] [1999] 1 All ER (Comm) 289
[1387] Loi K, *Quistclose Trusts,* (No.892) at 424

liquidators or third parties can minimise the impact of a company entering liquidation[1388]. From the analysis of Chapter 5 it was established that the resulting trust has well-established substantive requirements[1389] that have the potential to increase the relevant asset pools. In having such provisions, liquidators or third parties are able to engage in litigation with a reasonable sense of predictability. This chapter has also established that although there are a number of potential practical hurdles to bringing resulting trust litigation in specific contexts, none applied to the majority of potential claims nor fundamentally undermined its use. Indeed, the ability to trace and to impose liability on the resulting trustee[1390] means that should the assets be dissipated, there is a likelihood that they or their substitutes will be recovered, thereby minimising any potential losses. As a consequence of these characteristics, when the resulting trust is taken as a whole, it is possible to conclude that it is, should any of the applicable matrices occur, capable of meeting the criteria set out in Chapter 3 for a more effective method of minimising the effect of liquidation. This is because: 1) it is capable of increasing the size of the company's asset pool, or preventing a party becoming a creditor; 2) it possesses relatively clear and easy to identify provisions; and 3) is potentially attractive to third party litigation financiers owing to existence of an identifiable asset or substitute asset.

Specifically, the purchase price resulting trust is capable of assisting in instances where either the insolvent company or a third party has provided all or some of the purchase moneys to an asset. The use of such trusts is practically viable as although resulting trusts can be rebutted by showing that the transfer was a gift or a loan, this is unlikely to occur with purchase price trusts in the context of corporate liquidation[1391]. Given that any purchase would involve at least one party being a company – either being the provider or purchaser – it is doubtful that in the majority of matrices there would be sufficient evidence that the provider of the funds intended for the moneys to be a loan or gift. This is because should the company be the provider, it is unforeseeable that it would willingly give away valuable assets to a third party and minimise its net value – the sole purpose of

[1388] See Millett P, *Proprietary Restitution* in Degeling S and Edelman J, *Equity in Commercial Law,* (Sydney: Thomson, 2005), 309 at 318 for succinct summary of the advantages of utilising the resulting trust.
[1389] See also Smith L, *Equity is Not a Single Thing,* at 144 in Klimchuk D, Samet I and Smith E, *Philosophical Foundations of The Law of Equity,* (Oxford: OUP, 2020) at 145
[1390] For breaches of trust *after* they have become aware of their fiduciary position
[1391] See Chapter 5

a company being to maximise its net value[1392]. Similarly, it is unlikely that a third-party provider would intend the recipient company to take the property beneficially, unless the moneys were provided by the sole shareholder of a company[1393]. An exception may occur if there is a parent/subsidiary relationship between two companies, but given that the two companies are separate legal persons[1394], a high level of evidence would have to adduced to evidence that a gift or loan was intended. Moreover, given that an identifiable and potentially valuable asset or substitute will be recovered[1395], and a strong expectation of successful litigation, there is a strong probability that such claims will be attractive to third party litigation funders, and so the necessary finance will be acquirable.

Similarly, the gratuitous transfer also offers a viable mechanism through which to reacquire property should an asset be transferred in the absence of consideration. For the most part Chapter 5 proved that the legal provisions are evident and well established, providing a good degree of predictability to liquidators and third parties should they initiate litigation. Whilst there are issues surrounding the gratuitous transfer of land, should the senior courts reject this thesis' submission, the rejection would merely provide an additional means to reacquire transferred property rather than provide any major uncertainty or restriction. Furthermore, despite the uncertainty surrounding the equitable mechanism utilised in instances of mistaken transfers, this debate does not affect the actual imposition of a trust to return the moneys to the transferor. As with the purchase price resulting trust, given that any claim by a liquidator or third party will involve at least one company, it is unforeseeable that it will be proven that a gift or a loan was present. Finally, as there is an identifiable and valuable asset, and an expectation of successful litigation, the gratuitous transfer resulting trust is likely to also be attractive to third party litigation funders.

As also concluded, automatic resulting trusts are the securest resulting trust claim that liquidators can commence as a consequence of there being explicit and established rules that elicit little debate or controversy. Also, given that the only viable means of rebutting

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[1392] See *Brady v Brady* [1988] BCLC per Nourse LJ; *Greenhalgh v Arderne Cinemas Ltd* [1950] Ch 286; Kershaw D, *Company Law in Context – Texts and Materials,* 2nd edn (Oxford: OUP, 2012) at 337

[1393] See *Arab Monetary Fund v Hashim* (15th June 1994, unreported), Ch D per Chadwick J

[1394] *Salomon v Salomon* [1896] UKHL 1

[1395] In *Prest,* (No.997) the total value of the properties subject to a resulting trust was £17 million

the automatic resulting trust's presumption is a gift over in the initial trust deed[1396], it will be both difficult to rebut and easy to identify if a rebuttal has occurred. This predictability, and the identifiable assets that are subject to the resulting trust, also make acquiring the necessary funding to commence litigation likely.

Finally, the *Quistclose* trust provides a workable mechanism through which lenders can prevent themselves from becoming unsecured creditors. Once again, and similarly to mistaken payments, whilst there is debate surrounding what form of trust the *Quistclose* is, this does not affect the application of the trust. Indeed, the requirements for a *Quistclose* trust are well documented, and provide for its application in a number of matrices other than the traditional loan for a specific purpose seen in *Quistclose* itself. As was also noted, the ability to establish such trusts will be dependent on the loan document and the clarity of its terms. Although Finch submits that establishing such trusts is an uncertain proposition owing to confusion surrounding there being a specific purpose[1397], Chapter 5 has shown that the courts have taken a flexible and relaxed approach to identifying the requisite purpose. Thereby, the lender will be able to reasonably foresee the likelihood of there being such a trust over the loan moneys by referencing the loan document. Furthermore, it has also been claimed that the administrative costs of such trusts make them undesirable[1398]. However, the majority of these costs are the creation[1399], and administration, of a separate bank account, and so these should not be over emphasised as being prohibitive in creating them or liquidators administering them in the event of insolvency. Furthermore, given that the majority of lenders providing moneys subject *Quistclose* trusts will be resource rich institutional or private parties, they will likely have the necessary financial resources necessary to cover any litigation costs[1400].

Section 3.2: Comparison with Other Creditor Protections

This thesis has shown that the resulting trust, in all of its forms, is a mechanism capable of minimising the impact of liquidation should a company become insolvent. However, it must be admitted that the use of the resulting trust is limited by the need for certain

[1396] *Smith v Cooke* [1891] AC 297; *King v Denison* (1813) 1 Ves & B 260.
[1397] Finch V and Milman D, *Corporate Insolvency Law* (No.6) at 563
[1398] Ibid, at 563
[1399] If a separate account is not already available
[1400] *Barclays Bank v Quistclose* itself, where the claimant was an institutional lender

factual matrices to occur. Whilst this is indisputable, and clearly a restrictive factor in the use of such trusts, similar restrictions are also applicable to all other forms of creditor protection. Other forms of trust such as the constructive and express trust require certain actions to occur[1401], and the Insolvency Act 1986 provisions are also severely limited to the occurrence of certain actions. It should be also be noted that whilst certain factual matrices must occur for a resulting trust to arise, these matrices do cover a wide range of property transfers, including gratuitous transfers, purchases of property, failure of express trusts, and loans for a specific purpose. Hence, although the resulting trust is restricted in its application, it is no more limited than any other form of creditor and quasi-creditor protection – and given that there are 3 forms of resulting trust[1402] that each cover a number of matrices, the reach of the resulting trust is large compared to each individual and alternative form of creditor protection.

Moreover, in even a cursory comparison with the other forms of creditor protection, the resulting trust has many other benefits. Taking the express trust first, this form of potential creditor protection is limited by the requirement for the prospective settlor to have clearly intended to create a trust[1403] and that any declaration of express trust over land must be made in writing[1404]. As established[1405], there must be an intention to impose legal obligations on the prospective trustee, rather than purely moral obligations, and the use of precatory words will be insufficient to create a trust[1406]. Problematically, phrasing obligations as moral requirements, and using indirect language, is a natural method of communicating for many people, and so it is foreseeable that the requisite intention will not be properly expressed[1407]. This is exacerbated by the fact that using the term 'trust' is not in itself sufficient to create a trust[1408], thereby removing a sure-fire method of establishing a trust. Consequently, expressing the requisite intention is potentially problematic, especially if legal advice is not sought in the creation of the trust. Expressing the necessary intention is particularly problematic in the commercial context, where the

[1401] See Thomas G, *The Law of Trusts* (No.185); Hayton D, *Underhill and Hayton* (No.883)
[1402] Presumed, Automatic and *Quistclose* resulting trusts
[1403] *Knight v Knight* (1840) 49 ER 58
[1404] S52(1) Law of Property Act 1925
[1405] *Re Snowden* [1979] 2 WLR 654
[1406] *Re Adams and the Kensington Vestry* (1884) 27 Ch D 394.
[1407] See *Re Snowden* for example
[1408] *Re Kayford* [1975] 1 WLR 279

courts have been reticent in finding that a trust was intended between parties[1409] - limiting the effectiveness of such trusts[1410]. This was seen in regard to the *Quistclose* trust, but is also evidenced in *North v Wilkinson*[1411]*,* where it was held that the language used in the trust document merely created a personal obligation rather than a propriety obligation. Should creditors seek to rely on the express trust as a means of improving their position, then they may be beset by uncertainty and depend on the judiciary's interpretation of unclear language – particularly if used in the context of consumer prepayments owing to consumers' lack of legal knowledge and the probability that they will fail to express the necessary intention[1412].

An express trust can also arise by mistake, should the parties express the requisite intention whilst not understanding the effects of what they are doing – seen most starkly in *Paul v Constance*[1413]. Here the repeated use of a phrase was sufficient to unknowingly create a trust. Similarly in *Rowe v Prance*[1414]*,* the declaration that a yacht was both the legal owner's and his mistress' was sufficient to evidence the necessary intention, even though the legal owner did not truly intend to grant a beneficial interest to his mistress. Hence, it is possible to create an express trust without intending to do so – meaning that company assets may be tied up without realising, and so unavailable to unsecured creditors.

The utilisation of the constructive trust can also be problematic for unsecured creditors. As has been extensively acknowledged, constructive trusts arise by operation of law where the defendant is aware of factors that attach to his conscience and thereby justify the imposition of a trust over property held by the defendant[1415].

Notwithstanding the breadth of matrices in which the constructive trust arises,[1416] utilising these trusts is not the simplest. It is not possible to analyse the applicable matrices in the

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[1409] *Henry v Hammond* [1913] 2 KB 5151 at 521; *Re Multi Guarantee* [1987] BCLC 257
[1410] Finch V and Milman D, *Corporate Insolvency Law* (No.6) at 554, 562-567
[1411] [2018] EWCA Civ 161
[1412] Finch V and Milman D, *Corporate Insolvency Law* (No.6) at 564
[1413] [1977] 1 WLR 527
[1414] [1999] 2 FLR 787
[1415] *Soar v Ashwell* [1893] 2 QB 390 at 393; *Westdeutsche,* (No.186)
[1416] See *FHR European Ventures LLP v Cedar Capital Partners LLC* [2014] UKSC 45; *Regal (Hastings) Ltd v Gulliver* [1942] UKHL 1; *Foskett v McKeown* [2001] 1 AC 102; *In the Estate of Crippen* [1911] P 108

context of the thesis, however, taking the applicability of the constructive trust in the context of bribery as an rough example, it was not until 2014[1417], 21 years after the Privy Council in *Attorney General v Reid*[1418] first acknowledged the possibility of a constructive trust arising upon the receipt of a bribe, that it was confirmed by the Supreme Court that a constructive trust do in fact arise in such circumstances[1419]. Hence, much uncertainty exists over if, and when, constructive trusts will actually be imposed, meaning that it is difficult to rely on their imposition. Moreover, the constructive trustee will only be liable once he is aware of factor that has attached to his conscience[1420], potentially resulting in dissipation of trust assets and no liability for the constructive trustee.

Finally, the explicit creditor protections of the Insolvency Act 1986 – the anti-deprivation and personal liability provisions – do not offer creditors effective remedies. It was concluded in Chapters 3 and 4 that the provisions are beset by three categories of flaw – remedial, substantive and evidential. It was shown that although the courts are granted remedial powers, they act primarily *in personam* rather than *in rem,* preventing the claimants from acquiring priority to the defendants' assets. Moreover, it was also demonstrated that all the provisions suffer from substantive uncertainty that make commencing litigation extremely difficult to do, and that high evidential burdens make all but the clearest cut cases un-litigable.

Given the limitations of these alternative creditor protections, it is apparent that the resulting trust offers a superior method of increasing the size of an insolvent company's asset pool in certain matrices. The resulting trust's relative clarity on its substantive requirements, use of presumptions rather than reliance on evidence, and right to trace into misappropriated assets, mean that it is a viable mechanism through which to retrieve company assets. As also concluded, whilst the use of the resulting trust may be limited by the need for certain factual matrices, these matrices still cover many instances of

[1417] *FHR European Ventures LLP v Cedar Capital Partners LLC* [2014] UKSC 45
[1418] *Attorney General for Hong Kong v Reid* [1993] UKPC 2;
[1419] In *Sinclair Investments (UK) LTD v Versailles Trade Finance LTD* [2011] EWCA Civ 347 the Court of Appeal originally rejected the prospect of constructive trusts arising upon the receipt of a bribe
[1420] Thomas G, *The Law of Trusts,* (No.185) at 715; *Bank of Credit and Commerce International v Akindele* [2001] Ch 437

property transfer, and are no more limiting than the substantive requirements of the alternative creditor protections.

Section 4: Policy

Notwithstanding the potential application of the resulting trust in instances of liquidation, it is necessary to also establish that the use of such trusts is justifiable – that it is fair to grant the transferor access to property subject to a resulting trust, and that granting such access does not unfairly prejudice the recipient of the property or third parties. The need to do so is apparent: should the use of the resulting trust not be capable of being justified, then although possibly beneficial to unsecured creditors and potential unsecured creditors, utilising the trust would be problematic owing to the unfairness created, and be open to question and attack by the recipients of the trust assets and their creditors.

Before considering the issue of 'justifiability' or 'fairness', it is necessary to define these terms to ensure clarity and avoid confusion over this section's reference points. For the purposes of this thesis, the terms justifiability, reasonableness and equitable have synonymous definitions with fairness. Whilst fairness can be defined as even treatment[1421], it is important to stress that this meaning has not been adopted by this section. This is because given the nature of the resulting trust – 'taking' property from the recipient and 'returning' it to the transferor – it is not possible to act evenly as a judgment must be made over who has a better right to the property. Consequently, it is not possible to split the property in two, as was advocated by the judgment of King Solomon – potentially the 'fairest' outcome the court could adopt for resolving any dispute over the property. Indeed, in resulting trust claims, they are, in all instances, a 'winner takes all' scenario with the property returning to the transferor. Instead, this thesis, when referring to any of the above terms, has adopted the alternative definition of fairness – "legitimate, in accordance with rules or standards"[1422]. The need to adopt this definition again stems from the nature of the resulting trust: whilst it is difficult to argue that such trusts allow for even treatment, it is evident from the analysis in Chapter 5 and immediately below that the resulting trust's usage and effect are attributable to, and as a consequence of,

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[1421] *The Shorter Oxford English Dictionary, Volume 2 A-M,* 6th edn, (Oxford: OUP, 2007) at 921
[1422] Ibid, at 920

delineated and identifiable legal rules not subject to judicial discretion[1423]. It is therefore necessary to analyse the resulting trust's justifiability in relation to its use of legal rules.

In analysing the justifiability of the resulting trust, two primary policy issues arise: the nature and cause of its redistributive effect and the lack of registration and notice for such trusts. The potential unfairness of the resulting trust, in the context of this thesis, is not limited to the recipient, but more importantly includes the creditors of the recipient. The obvious consequence of there being a resulting trust is should the recipient be insolvent, then the assets subject to the resulting trust will not be distributable to the insolvent's creditors[1424] - potentially causing adverse consequences and harm to these creditors, such as tipping them into insolvency themselves[1425]. Furthermore, the removal of the assets from the recipient's asset pool may cause the recipient to enter liquidation itself. The question is therefore whether these potentially negative effects can be justified, and whether it is fair to grant the transferor priority to the recipient's assets.

Section 4.1: Redistributive Effect

The redistributive effect of the resulting trust is apparent and well documented[1426]. By imposing a trust over property now held by the recipient and recognising a beneficial interest in favour of the transferor, the resulting trust is redistributive as it 'takes' property from one party and 'grants' it to another. Evans notes the controversial nature of this redistribution, submitting that such trusts are not the continuation of the transferor's property rights, and are instead "new rights created to respond to particular fact situations."[1427] It is argued that rather than the beneficiary's rights under a resulting trust arising upon the relevant 'event', they should be seen as being created by the judgment handed down by the court[1428]. The need to adopt this view, it is argued by Evans, revolves around the inability to distinguish between when the rights come into existence and the

[1423] Smith L, *Equity is Not a Single Thing,* at 144 in Klimchuk D, Samet I and Smith E, *Philosophical Foundations of The Law of Equity,* (Oxford: OUP, 2020) at 145
[1424] See Chapter 5
[1425] See Chapter 4, Section 1.6, and the example of Vaughan Engineering Ltd
[1426] Evans S, *Property,* (No.901) at 37
[1427] Ibid, at 37
[1428] Ibid, at 35 and 36; See also Hayton D, *Underhill and Hayton* (No.883) at 434 – "the imposition of a resulting trust leads to the creation of a new equitable property right for the transferor"; Chambers R, *Resulting Trusts in Canada,* (2000) 38 Alberta LR 379 at 389

courts' decision to redistribute the trust property – they are one and the same and the trust merely 'conceals' the distributive decision of the court[1429]. Consequently, the use of the resulting trust, according to Evans, is problematic for two reasons: firstly, it involves a disturbance of property rights, and secondly, the granting of new rights to the transferor occurs against the recipient's wishes and as a result of a decision of the court.

Elaborating on his objections, Evans goes further and redefines what is meant when it is stated that proprietary rights 'come into existence' on the occurrence of particular events. He submits that rather than the rights actually coming into existence, it merely means the courts have determined that the transferor's original rights to the property should receive protection from events occurring in the period between the transfer of property and the court's judgment[1430]. The transferor consequently has no actual rights in the period between transferring the property and receiving judgment in his favour, and it is only because of the court judgment that they are able to reclaim the property. Consequently, all rights over property granted by the courts are open to being questioned due to them being imposed rather than agreed to by the parties. The effect on the defendant (or recipient) must, therefore, be a factor considered in the court's granting of rights.

Evans' interpretation of the redistributive effect of the resulting trust has not been widely adopted[1431], however, and has indeed been rejected by the House of Lords[1432]. In contrast to the idea that all property rights are created by the court through their judgments, Loi acknowledges that rather than creating new rights, the resulting trust instead involves the retention of pre-existing beneficial interests in the transferred property[1433]. Consequently, the resulting trust beneficiary is merely asserting a pre-existing right (if unknown to the recipient), and no new rights have been created[1434]. In the words of Hackney, whom Loi relies upon, "what I once had and have not granted away, I keep."[1435]

[1429] Evans S, *Property,* (No.901) at 35
[1430] Ibid, at 36
[1431] Jaffey P, *Explaining the Trust,* (2015) 131 LQR 377
[1432] *Vandervell v IRC* [1967] 2 AC 291
[1433] Loi K, *Quistclose Trusts,* (No.892) at 416, 417; *Godbold v Freestone* (1695) 3 Lev 406 at 407
[1434] See Mee J, *'Automatic' Resulting Trusts: Retention, Restitution, or Reposing Trust?,* in Mitchell C, *Constructive and Resulting Trusts,* (Oxford: Hart, 2010) at 207, who acknowledges that this is the basis adopted in the existing authorities
[1435] Hackney J, *Understanding Equity and Trusts,* (London: Fontana Press, 1987) at 148-153; also at 148. *Samme's Case* (1609) 13 Co Rep 54 at 56

Hence, according to Loi, rather than adversely affecting the recipient through the court creating new, remedial rights, the resulting trust asset "remains the property of the [transferor] unless and until it is applied in accordance with his directions, and insofar as it is not so applied it must be returned to him."[1436] The beneficiary's interest is therefore not created by the court, and has always existed in the property – firstly when they were the sole legal and beneficial owner, and secondly when they transferred the property to the recipient and retained the beneficial title[1437]. In retaining an interest, rather than being granted a right, it cannot, therefore, be argued that it is unfair on the recipient as they never had a right to the property.

This view of the resulting trust is also made clear in the existing authorities. In *Vandervell v IRC,* Lord Upjohn categorically stated that the rights in the trust were retained by the transferor. His Lordship stated that "if the beneficial interest was in A and he fails to give it away effectively to another or others or on charitable trusts it must remain in him"[1438]. Lord Wilberforce reiterated this by commenting that "the equitable, or beneficial interest, cannot remain in the air: the consequence in law must be that it remains in the settlor"[1439]. This was also echoed in *Northern v Carnegie*[1440]*,* where Kindersley VC held that "[S]o far as [the settlor] had not parted with the beneficial interest, it remained in him as a resulting trust. It was not a new estate, but merely so much *remaining* in him as he has not parted with." Thus, the adopted position within English law is that the resulting trust involves the retention of a beneficial interest in the property by the transferor, with the recipient never acquiring a beneficial right to the property[1441].

Chambers[1442], however, proffers that Lord Browne-Wilkinson's comments in *Westdeutsche* rejected this view, and that new rights are in fact created. His Lordship stated that "A person solely entitled to the full beneficial ownership of money or property, both at law and in equity, does not enjoy an equitable interest in that property. The legal title carries with it all rights. Unless and until there is a separation of the legal and

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[1436] *Twinsectra Ltd v Yardley* [2002] 2 A.C. 164 at [81]
[1437] Hackney J, *Understanding Equity and Trusts,* (London: Fontana Press, 1987) at 148, 153
[1438] *Vandervell v IRC* [1967] 2 AC 291 at 313
[1439] Ibid, at 329; See also *Shephard v Cartwright* [1955] AC 431 at 454; *Tribe v Tribe* [1996] 1 Ch 107 (CA) 129 at 134-135
[1440] (1859) 4 Drew 587 at 593
[1441] Jaffey P, *Explaining the Trust,* (2015) 131 LQR 377 at 387
[1442] Chambers R, *Resulting Trusts,* (No.923) at 52

equitable estates, there is no separate equitable title."[1443] Chambers interprets this as meaning that a different and new proprietary right to that originally held before the transfer. As stated, "The interest which the settlor has at the end of the story, as the beneficiary of a resulting trust, is an equitable interest which is different from the legal ownership he or she had at the beginning."[1444] According to Chambers, this alleged difference in the transferor's equitable right before and after the transfer prevent the transferor from ever having 'retained' a set of rights[1445].

However, it is submitted that a new right is not in fact created. Instead, if the beneficial and legal interests are 'fused' prior to the transfer[1446], then transferring the property merely 'defuses' these two forms of title and the separate equitable title is retained by the transferor, whilst the legal title is acquired by the recipient. Rather than a new right being created, the transferor is merely retaining part of their original bundle of proprietary rights[1447], and so the comments in *Vandervell* that the rights are retained rather than created remain authoritative[1448]. Evans' interpretation that new rights are created, therefore, cannot be sustained and neither can the objection to the resulting trust on the grounds of *de novo* rights.

Furthermore, and addressing Evans' other objections, it is important to note that *Vandervell* undermines the notion that resulting trusts are capable of causing injustice by accepting that they arise as a consequence of strict legal rules rather than judicial discretion[1449]. As was set out in Chapter 5, the resulting trust arises upon the occurrence of strictly defined events, and the courts do not themselves impose the trust - they merely recognise its existence.

[1443] *Westdeutsche,* (No.186) at 707
[1444] Chambers R, *Resulting Trusts,* (No.923) at 52
[1445] Ibid, at 53
[1446] *Wade v Paget* (1784) 1 Bro CC 363 at 368
[1447] Honoré, A. M, *Ownership* in Guest A.G, *Oxford Essays in Jurisprudence,* (Oxford: OUP, 1961) at 107
[1448] Mee J, *'Automatic' Resulting Trusts: Retention, Restitution, or Reposing Trust?,* in Mitchell C, *Constructive and Resulting Trusts,* (Oxford: Hart, 2010) at 219 does accept that there is some truth to the idea that the transferor retains a proprietary interest in the trust assets but argues (at 220) that additional rights are created against the trustee that did not exist previously
[1449] Evans S, *Property,* (No.901) at 38

This is confirmed by *Westdeutsche*[1450]. As set out in Chapter 5, Lord Browne-Wilkinson held there were two categories of resulting trust: where the transferor voluntarily transfers property to third parties, and where they transfer property to an express trustee but where the whole beneficial interest is not exhausted. In setting out these categories, His Lordship emphasised the lack of discretion granted to the court in imposing a resulting trust. His Lordship repeatedly made reference to the resulting trust 'arising' from substantive, established legal rules rather than being 'imposed' by the court's discretion. Moreover, by referring to the presumptions of resulting trust, Lord Browne-Wilkinson reinforced the notion that such trusts arise 'organically' as a consequence of the legal rules rather than the discretionary views of the judiciary. In dealing with these comments, Evans therefore acknowledges the view that the redistributive effect of the resulting trust is not intentional, and is instead "incidental or consequential"[1451] - a result of such trusts being 'animate' and 'explained, rather than created.'[1452]. Hence, it has also been established in the authorities that the resulting trust cannot be attacked for any intentionality in regards redistribution of property, and that fears about the resulting trust's redistributive effects and the fears of judicial discretion are unfounded[1453].

Within the context of this thesis, a further justification for the resulting trust's redistributive effect is that the unsecured creditors themselves have no rights to the property. Oakley, in reviewing proprietary claims in insolvency generally, points outs that irrespective of the issue of whether the transferor is retaining their rights in the trust asset, the general creditors never had a right to the property and so "any prejudice which they may suffer by reason of the disappearance of that property is more illusory than real."[1454] Therefore, according to Oakley, as the unsecured creditors never had any rights to the trust assets they cannot be prejudiced – just as the recipient cannot be prejudiced by the transferor reclaiming the asset through their retained beneficial interest in the transferred property. Although the creditors may be 'prejudiced' by not having notice of the trust,

[1450] *Westdeutsche,* (No.186) at 707
[1451] Evans S, *Property,* (No.901) at 38
[1452] Ibid, at 39
[1453] Allton N, *The Boundaries of Proprietary Claims,* (1997) 13 QUTLJ 276 at 277; Birks P, *The End of the Remedial Constructive Trust?,* (1998) 12(4) Trust Law International 202
[1454] *Oakley A, Proprietary,* (No.905) at 380, 381

and so be expecting to eventually have access to the assets in the event of insolvency[1455], this is a separate issue and is considered in the next section.

The lack of prejudice to unsecured creditors was previously acknowledged by Lord Templeman in *Space Investments v Canadian Imperial Bank of Commerce Trust*[1456]. His Lordship set out the reasoning for granting the transferor priority as "This priority is conferred because the ... unsecured creditors voluntarily accept the risk that the [creditor] might become insolvent and unable to discharge its obligations in full." This can be contrasted with the transferor, who if they are not granted priority, would be deprived of a pre-existing proprietary right that, potentially, they were legitimately relying on[1457]. Consequently, it is the creditors' assumption of risk, in contrast to the transferor's lack of acceptance of risk, that justifies the creditor not having access to the trust asset.

One final consideration in whether the resulting trust's use can be justified is the lack of a uniform effect. As proven in Chapter 5, the resulting trust does not have one single outcome in the context of this thesis – it is both able to increase the size of a company's asset pool by returning assets to the company, and also reduce the size of the asset pool by returning property to third parties. Thus, as also concluded, the resulting trust can both assist and hinder a company's unsecured creditors. To therefore object to the imposition of the resulting trust in instances where it removes property from the company's asset pool, whilst accepting its use in instances where it increases the size of the asset pool, is not feasible. This is especially so as, in instances of insolvency, the removal of the asset prevents the third party from becoming a creditor in the first instance. This dual faceted nature of the resulting trust means that it cannot be pigeonholed as being solely prejudicial to unsecured creditors in the context of insolvency.

Thus, owing to the institutional nature of the resulting trust, and risk accepted by the unsecured creditors, the redistributive effect on the recipient and the recipient's unsecured creditors can be justified[1458]. The resulting trust can be justified both should a liquidator of an insolvent company seek to utilise it to increase the size of the asset pool, and also

[1455] Ibid, at 380-381
[1456] [1986] 3 All ER 75 at 76-77
[1457] *Oakley A, Proprietary,* (No.905) at 410
[1458] Birks P, *The End of the Remedial Constructive Trust?,* (1998) 12(4) Trust Law International 202

should a third party seek to remove assets from the asset pool of an insolvent company and prevent themselves from becoming unsecured creditors.

Section 4.2: Registration

Notwithstanding the justifiability of the resulting trust's incidental redistributive effect on a theoretical level, one issue that was not analysed above was the lack of forewarning unsecured creditors have of the resulting trust's existence[1459]. Whilst it may be correct that the unsecured creditors never had any proprietary rights over the resulting trust property, they will probably have been unaware of the trust, and so may have made credit available on the understanding that should the company become insolvent, they would eventually have access to the asset to discharge the outstanding debt.

As resulting trusts are not true security interests, there is no requirement for them to be registered either by the transferor or the recipient[1460], nor any need for other parties to have notice of them. This is in contrast to charges created by a company, which must be registered[1461], and if not, become void should the company enter insolvency[1462]. It must be noted that the reason for this difference in treatment is fundamentally due to the fact that resulting trusts arise as operations of law. Hence, as they are not actively created by the parties, no formal documents need (or can) be drafted or executed. In many instances the parties will only be aware of the possibility of such a trust should legal advice be sought, and will only know of the trust's existence when the court's judgment is handed down. As a result of these factors, it is impossible to register such trusts in the first place[1463].

The potential knock on consequences of it not being possible to register resulting trusts were noted in Chapter 5. It was acknowledged that in regard to the use of the gratuitous transfer resulting trust, it is possible to utilise such trusts to artificially boost a subsidiary's

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[1459] Finch V and Milman D, *Corporate Insolvency Law,* (No.6) at 567
[1460] McCormack G, *Reservation of Title,* (London: Sweet & Maxwell, 1990) at 5
[1461] Ss 859A, 859B Companies Act 2006
[1462] S859H Companies Act 2006
[1463] Clarke R, *The Quistclose Trust: A Welcome Facilitator of Corporate Rescue,* (2017) 26 Nottingham LJ 130 at 139

appearance of creditworthiness[1464] and encourage creditors to lend on the basis of this untrue appearance – also known as the 'false wealth' effect[1465]. The same possibility may occur with the *Quistclose* trust, which, as also noted, may also create an inaccurate impression of the borrowing company's asset pool[1466]. This inaccurate impression may then be the cause for some creditors to make credit available to the company when there is no possibility of them having access to assets that appear to be the borrower's. The potential outcome of there being an unknown *Quistclose* trust was neatly summarised by Beglan and Belcher[1467]:

> "They [*Quistclose* trusts] do not have to be registered and they are unlikely to be discoverable from the borrower's accounts. Given the short-term and emergency nature of most *Quistclose*-type loans, it may seem unlikely that a set of annual accounts including such a loan would be prepared and approved in time to influence an outsider's decision making, but they may be…So the loan will appear to increase the pool of assets available for unsecured creditors generally....However, when the unsecured creditors need it most, at the point when the purpose of preserving the company as a going concern fails, the fund must be returned to the lender rather than being made generally available."[1468]

It must be acknowledged that the resulting trust is also able to make more assets available to unsecured creditors than originally expected. However, although this is unquestionably advantageous for these creditors should it occur, it must be accepted that any increase in the asset pool is merely a 'windfall' or 'added bonus', and that they are not assets known to, and actively relied upon by, the unsecured creditors. Despite any increase being welcomed, it does not detract from the potential for misrepresentation of the insolvent company's asset pool to occur at the time of the credit being made available.

[1464] McCormack G, *Reservation of Title,* (No.1459) at 5
[1465] Law Commission, *Registration of Security Interests: Company Charges and Property Other Than Land – A Consultation Paper*, Cmnd 164 at 2
[1466] Moffatt G, *Trusts Law*, (No.899) at 804
[1467] Beglan W and Belcher A, *Jumping the Queue*, (1997) JBL 1 at 9
[1468] Ibid, at 9-10

Whilst it is possible for all forms of resulting trust to be used as a mechanism to misrepresent any company's creditworthiness[1469], the prospect is particularly acute with *Quistclose* trusts owing to their regular use in attempts to prevent a company entering insolvency[1470]. Chan has even gone so far as to comment that their existence may encourage unsecured creditors to lend sufficient amounts under false pretences that they themselves may become insolvent[1471] – an obviously unjust outcome.

Notwithstanding the real possibility of such abuses occurring, it must also be noted that *Quistclose* trusts are created and operate in very short timeframes. Chapter 5 has shown that the underlying loan contracts are created *ad hoc* and are extremely time sensitive due to the imminent insolvency of the borrowing company. The authorities, such as *Quistclose, Re Northern Development* and *Re Carreras Rothmans,* also show that such trusts, should the borrower eventually enter insolvency, are not in existence for long periods of time. This limited window in which it is possible for unsecured creditors to rely on the falsity, therefore, severely limits the probability that such trusts will be used as instruments of misrepresentation[1472]. Moreover, given that the borrower will, in all probability, be in visible economic distress, potential creditors will likely be forewarned that the company is not in a healthy financial position and that making credit available would be an unviable venture.

Furthermore, the resulting trust's non-inclusion on the companies register can be justified. The companies register, through which diligent creditors might check whether there are restrictions on company property[1473], was never intended to form a comprehensive account of corporate encumbrances[1474]. Instead it was only ever intended to provide a snapshot of the company's position in regards a limited number of potential third-party interests. More fatally, English law has never objected to unknown third-party proprietary

[1469] Apart from the automatic resulting trust, as this is concerned only with the company reacquiring assets
[1470] Thomas G, *The Law of Trusts,* (No.185) at 268
[1471] Chan A, *The Tree that Was Not Meant to Be - The Quistclose Trust Moving on From the Twinsectra Model and Why it May Never Be an Established Transactional Arrangement,* (2015) 9 HKJLS 1, 23
[1472] Bridges M, *The Quistclose Trust in a World of Secured Transactions*, (1992) 12 OJLS 333
[1473] Such as charges and mortgages
[1474] Loi K, *Quistclose Trusts,* (No.892) at 428; Davies P, *Gower and Davies: Principles of Modern Company Law,* 10th edn (London: Sweet & Maxwell, 2016) at 122-125

rights that are not included on a register[1475]. As put by Stevens[1476], if a creditor is willing to lend solely on the basis of the borrower purporting to own an expensive car, when that car is actually borrowed and the true legal owner's title is hidden, then they themselves have taken on the risk of the borrower not being in a position to repay the borrowed moneys by not undertaking sufficient enquiries of the creditor's circumstances.

Forbye, even if the lender undertook the necessary due diligence and satisfied themselves of the borrower's credit worthiness, establishing the existence of an unknown resulting trust would be nigh on impossible. As has been illustrated, to establish the existence of a resulting trust it is necessary to have a detailed knowledge of the relationship between the transferor and recipient and the movement of assets between the two parties. As is unsurprising, none of this information is available to the company's creditors, and so for the overwhelming majority of creditors it is impossible to identify a resulting trust without being informed by one of the parties.

To overcome these pitfalls, Brown and Pawlowski[1477] have suggested that beneficial interests should be included on the land register. Although their proposal is limited to land and the land register, the potential suggestion could apply equally to beneficial interests over company property. They proffer that for purchasers (or in the context of this thesis, lenders) to be properly protected, proprietary interests should be included on the register[1478]. Nonetheless, whilst the inclusion of express trusts on the register may be practically possible due to the existence of a trust deed[1479], as seen above, owing to the resulting trust arising as an operation of law, inclusion of such trusts on a register would not be possible until after litigation – thereby preventing creditors from being forewarned via a register.

Irrespective of the small potential for abuse to occur through misrepresentation of a company's assets, it must be kept in mind that the *Quistclose* trust – the most problematic form of resulting trust – does serve an important an important role in corporate

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[1475] Loi K, *Quistclose Trusts,* (No.892) at 427; Cork K, *Report,* (No.2) at 1641
[1476] Stevens R, *Insolvency,* in Swadling W, *The Quistclose Trust: Critical Essays,* (Oxford: Hart, 2004) at 165
[1477] Brown J, Pawlowski P, *Behind the Veil,* (2017) 351 Property Law Journal 15
[1478] See also Edwards A, *The Registration Quintennial Review,* (June 2001)
[1479] S53(1)(b) Law of Property Act 1925

turnaround. Therefore, the 'emergency' nature of the *Quistclose* trust cannot be ignored[1480]. Although not limited to corporate rescue, the majority of *Quistclose* trusts are utilised in (sometimes vain) attempts to rescue a distressed company. The lender is therefore taking a great and apparent risk in making the moneys available in this scenario, and so needs some form of protection to mitigate their large exposure to risk. Moreover, the necessary finance may only be available in this form, and so the *Quistclose* trust may be the only viable method to encourage the rescue of a company[1481]. This is particularly so if the other assets have been subjected to fixed and floating charges or the overdraft has reached its limits[1482].

Finally, it must be noted that attempting to rescue companies that are not fatally flawed is a worthwhile endeavour that is capable of outweighing any potential prejudice to unsecured creditors[1483]. As Watt states, "A rescued company is a rescued trader and a rescued employer. A failed company very often results in unemployment and consequent social ills."[1484] Hence, the prospect of rescuing a company and saving individuals' jobs is in itself enough to justify the *Quistclose* – even if it is not possible to register them.

So, whilst creditors may lend on the mistaken basis of the recipient borrower appearing to 'own' the asset, it is not feasible to provide them with information to the contrary. Moreover, although they may lose out, the motivations behind the transactions involved, such as the protection of jobs, justifies the use of the resulting trust.

Section 5: Conclusion

As stated in the introduction, this chapter has built upon the conclusions reached in Chapter 5 that the resulting trust can assist unsecured creditors in instances of insolvency, either by returning assets to the now insolvent company for distribution through the liquidation dividend, or by preventing parties from becoming unsecured creditors in the

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[1480] Beglan W and Belcher A, *Jumping the Queue*, (1997) JBL 1 at 7
[1481] Parmar D, *The Uncertainty Surrounding the Quistclose Trust - Part Two*, (2012) 9 Int C R, 202.
[1482] Clarke R, *The Quistclose Trust: A Welcome Facilitator of Corporate Rescue,* (2017) 26 Nottingham LJ 130
[1483] Finch V and Milman D, *Corporate Insolvency,* (No.6) 569; Goodhart W and Jones G, *The Infiltration of Equitable Doctrine into English Commercial Law,* (1980) 43 MLR 489 at 494
[1484] Watt G, *Trusts and Equity*, 8th edn (Oxford: OUP, 2018) at 164

first place by granting them priority to assets held by the now insolvent company. This chapter has built upon these conclusions by analysing whether, notwithstanding the theoretical possibility of the resulting trust assisting, such trusts would operate effectively from a practical perspective – put simply, whether the resulting trust is capable of providing actual, real-world assistance. It is concluded that, owing to a number of separate factors, the resulting trust is capable of providing actual, practical assistance to unsecured creditors.

Specifically, it was concluded that whilst it is possible to rebut the imputed intentions of the transferor (and thereby defeat a resulting trust claim), this possibility is restricted to instances of there being *sufficient* evidence to rebut, rather than just the *slightest* evidence advocated by some. Similarly, although the transferor is restricted to only adducing evidence of actions before and up to the transfer, this is unlikely to impact commercial transfers of property owing to the likelihood that the requisite intentions will have been evidenced prior to the transfer – if they are evidenced at all. Finally, despite the rules of illegality being unclear and potentially extremely discretionary, due to the very small number of trust cases involving instances of illegality[1485], the rules are unlikely to be applicable to claims of resulting trust, particularly owing to the contexts in which they are utilised. Consequently, liquidators or third parties intending on commencing litigation will have a sound degree of certainty as to whether there is a substantial chance that the presumptions will be rebutted, and so will not be placed in the position of wasting resources by commencing futile litigation.

Secondly, it was also established that the ability of the transferor to trace is extremely beneficial to resulting trust claims, as it ensures that, in the majority of situations, the original or a substitute asset will be made available to the transferor. Moreover, it was concluded that given the illiquid nature of the property involved in purchase price and gratuitous transfer resulting trusts[1486], it is unlikely that there will be a regular need for transferors to resort to tracing. Whilst *Quistclose* trusts and instances of mistaken transfers are more problematic owing to the more liquid nature of the assets transferred, the extensive rules of tracing generally favour the transferor, with only a few limitations

[1485] Including all three forms of trust – express, resulting and constructive trusts
[1486] Primarily land or moneys placed into a bank account to purchase property

imposed on the right to trace. Thus, it is probable that should there be a resulting trust claim available to a liquidator or third party, the transferred assets or their substitute will be recoverable.

Notwithstanding the advantageous evidential and tracing provisions, the potential personal liability of resulting trustees is more problematic, with applicability very limited to instances of when the trustee becomes aware of their fiduciary position. As noted, resulting trustee liability varies depending on the form of the resulting trust. For automatic resulting trustees, owing to their previously known express trusteeship, they appear to have a high level of obligations and liabilities similar to those of express trustees. In respect of purchase price resulting trustees, it is probable that as they will have received the moneys with the knowledge that they are to be used purchase property, they will probably be obligated to maintain, and maintain the value of, the purchased property. However, given that recipients of voluntary transfers are unlikely to become aware of their trusteeship until the initial stages of the litigation process, their liability for maintaining the integrity of the trust assets will arise not until then. Hence, for the majority of resulting trustees, there will only be limited liability, and limited opportunities for transferors to recover any assets from the recipient that cannot be followed or traced into.

In addition to the practical factors, this chapter has also shown how the resulting trust cannot be criticised on policy grounds. It was concluded that, as the transferor retains the beneficial interest in the asset throughout, rather than being granted a right to the asset by the court (which merely recognises the transferor's beneficial title), the asset never becomes the property of the recipient. Consequently, although the resulting trust does *prima facie* have the appearance of having a redistributive effect, it merely involves the return of property to its beneficial owner. Moreover, it was also concluded that there was no prejudice to the recipient's unsecured creditors due to two factors: 1) the unsecured creditors never having a right to the trust assets; and 2) the unsecured creditors voluntarily accepting the risk of not having their debts discharged, whereas the transferor does not accept any such risk in the recipient becoming insolvent. This is further supplemented by the resulting trust not constituting a preference, thereby ensuring it is outside the scope of unconscionable corporate behaviour outlined in the Insolvency Act 1986.

Linked to this, it was also found that the lack of registration for resulting trusts is justifiable. Owing to the impossibility of registering the resulting trust due to the lack of a trust deed, and the lack of knowledge that a resulting trust exists until the receipt of the court's judgment, registration is not practicable. Equally as important, English law, and the companies register in particular, have never objected to third-party proprietary rights – meaning that the registration system on which unsecured creditors may rely on was never intended to incorporate the resulting trust. The short timeframe in which the potentially most problematic form of resulting trust – the *Quistclose* trust – operates, moreover minimises the chances that unsecured creditors will be misled into thinking that the creditor has greater assets that they in fact do, and making credit available based on this misapprehension.

One caveat to the above analysis, though, is that it must be acknowledged that whilst the resulting trust may be of use to unsecured creditors, with its ability to revest property in a transferor evident, it does not provide a mechanism through which to directly address the issues identified in Chapter 3 and 4 in relation to the Insolvency Act 1986's anti-deprivation and personal liability provisions. Specifically, it is not able to address the most problematic factual matrices not dealt with by the Insolvency Act identified in Chapter 4. In relation to the excessive declaration of dividends, owing to the clear and unquestionable intention of the company to part with the beneficial interest in moneys, the resulting trust's presumptions would not apply as there would be sufficient evidence to rebut them. Similarly with late payments, given that this involves the non-transfer of property, and the resulting trust only operates upon the transfer of property, the above analysis would have no applicability. Consequently, the resulting trust, instead of directly remedying these shortcomings, provides an effective *alternative* form of protection through the means of revesting property in different factual matrices to those of the Insolvency Act. In doing so, some of the Act's pitfalls (the limited revestment of assets) can be covered, and the resulting trust provides for a limited alternative rather than an outright replacement or improvement.

Returning back to the conclusions of Chapter 3, it is necessary to consider whether the resulting trust meets the three criteria of an alternative to the Insolvency Act – which Section 3 of this chapter concluded the resulting trust did meet. These three criteria are:

a) is it capable of increasing the size of the company's asset pool?; b) does it possess clear and clear to identify provisions?; and c) is it attractive to third party litigation financiers?

Addressing the first criteria, both Chapter 5 and this chapter have proven - theoretically and practically – that the resulting trust is capable of increasing the size of an insolvent company's asset pool in certain, clearly defined matrices. However, these chapters have also proven that these trusts are also capable of removing assets from a company, and thereby prevent parties from becoming unsecured creditors in the first place. Moreover, the ability to trace, and to a lesser extent the liability imposed on resulting trustees, mean that should the assets be dissipated, there is a likelihood that they or their substitutes will be recovered – resulting in a minimisation of any potential losses. As a consequence of these factors, the resulting trust is able to reduce the impact of a company's insolvency on creditors and potential creditors.

Dealing with the second criteria, it has also been proven that the resulting trust possesses clear and easy to identify provisions. It was shown that in the three forms of resulting trust, although there are areas of uncertainty that unquestionably require clarification from the courts, these do not greatly inhibit the use of the resulting trust, and the resolution of these uncertainties may indeed expand the use of the gratuitous resulting trust to transfers of land. Furthermore, this chapter has also shown that the 'supplemental' provisions – evidential, tracing, trustee liability – also have largely clear and identifiable provisions, ensuring their effect is easy to determine. Both the resulting trust and the 'supplemental' provisions therefore enable liquidators and third parties to engage in litigation with a reasonable sense of predictability.

Finally, it has also been shown that owing to the valuable assets recovered by resulting trusts and the relative predictability of any litigation instigated, third party litigation financiers and creditors are likely to be attracted to providing the necessary litigation funding should the liquidator or third party have insufficient access to financial resources. The only caveat to utilising third party litigation funding is the fees incurred to the financier, meaning the full value of the assets will not be recoverable. Nevertheless, irrespective of these fees, the resulting trust is still a far more attractive proposition to third party litigation financiers than the Insolvency Act 1986 provisions.

This chapter has therefore proven that the resulting trust is a viable mechanism through which unsecured creditors can minimise the impact of insolvency. This can be done through either returning assets to a creditor company for distribution through the liquidation dividend, or by segregating assets in the now insolvent company and thereby preventing the transferor becoming an unsecured creditor. It also shown that whilst being a viable mechanism, the resulting trust is not able to directly address the limitations of the Insolvency Act 1986's provision that were identified in Chapter 3 and 4, and instead is able to assist through alternative means.

Chapter 7: Conclusion

This thesis, in Chapter 1, identified that the liquidation of a company poses a number of substantial problems for unsecured creditors. Most impactful is the low return rate they receive from the liquidation process – with unsecured creditors on average only recovering 4% of outstanding debts from the now insolvent borrower. This is in stark contrast with the borrower's secured creditors, who, on average, are able to recover 36% of debts owed – or 9 times that of the typical unsecured creditor. The reason for this disparity, as also identified in Chapter 1, is the secured creditor's priority to the company's assets as a consequence of their security interests, which removes (apart from a small fraction of floating charge assets) these secured assets from the company's distributable asset pool. A further cause is the statutory priority of distribution, which results in the asset pool being first used to discharge the debts of parties[1487] other than the unsecured creditor – ensuring the already insubstantial and stretched asset pool does not have the resources to discharge unsecured creditor debts. This unfavourable position has led to sustained calls for reform to assist these creditors and improve their return rate from instances of liquidation.

To address these issues, this thesis posed in Chapter 1, and answered in the subsequent chapters, the following research questions:

1. To what extent does the English law of liquidation impact upon an insolvent borrower's unsecured creditors;
2. What role can the resulting trust, in the factual matrices that it is imposed, play in addressing any impact on unsecured creditors by the liquidation regime;
3. What advice can be provided, or recommendations proposed, to the relevant parties to provide more safeguards to unsecured creditors.

<u>Section 1: The Impact of the English Law of Liquidation upon an Insolvent Company's Unsecured Creditors</u>

[1487] The liquidator and their expenses and the preferential creditors

In answering the posed research questions, Chapter 2 established that the predominant underlying theories of insolvency law – Creditor Wealth Maximisation, the Multiple Values Approach and Contractarianism – all support the existence and use of unsecured creditor protections. However, notwithstanding their universal agreement that unsecured creditors are deserving of protection, the level of assistance that should be afforded is vociferously debated.

At the very minimum, all the theories necessitate an intact company asset pool upon a company entering insolvency. In doing do, they condone the existence of the anti-deprivation and personal liability provisions analysed in Chapter 3, as they – theoretically at least – enable insolvency practitioners to revest incorrectly divested assets back into the company's asset pool.

Beyond this agreed minimum, the preponderant theory – Creditor Wealth Maximisation – merely seeks to distribute non-secured assets in accordance with the statutory priority of distribution according to the *pari passu* principle, and strictly forbids any changes to this scheme of distribution. The alleged benefits of adopting such a system rest with its predictability and reduced procedural costs – meaning any additional unsecured creditor protections must come from outside the law of insolvency. Whilst Creditor Wealth Maximisation's antithesis – the Multiple Values Approach – does permit unsecured creditors receiving a greater share of the asset pool, it also permits their share being decreased or even reduced to nothing when judged expedient to do so – meaning there is no predictable outcome owing to each insolvency being judgment on its own merits.

Hence, it was concluded that the theories, at a minimum, permit unsecured creditor protections provided they do not negatively impact upon other classes of creditor (particularly secured creditors), and so it is theoretically permissible to extend the assistance provided to these creditors by areas of the law other than insolvency law.

Moreover, it was also concluded that English legal commentators have called for unsecured creditor protection. Both Cork and Goode, in their practical reviews of insolvency law, call for mechanisms including limitations to the classes of preferential debt, personal liability provisions, abolition of receivership, and creation of a 10% fund. These mechanisms are designed, along with the anti-deprivation provisions, to protect

unsecured creditors, and are premised as being necessary to ensure a fair and equitable outcome for unsecured creditors and, on a more macro level, safeguarding creditors' confidence to provide credit to companies. Notwithstanding these mechanisms, both authors also recognised that limitations must be placed upon them, particularly respecting the pre-insolvency entitlements of secured creditors.

These conclusions, reached by analysing both the underlying theoretical foundations of insolvency law and English legal commentators, proved that whilst providing additional creditor protections was permissible, any protection mechanisms must respect secured creditor interests.

Chapter 3 analysed the unsecured creditors protections provided under the Insolvency Act 1986, and concluded, along with Chapter 4, that they fail to adequately protect creditors and maximise return rates. It was found that the anti-deprivation provisions, which are intended to prevent improper divestments of a company's asset pool and instances of unjust enrichment, and the personal liability provisions that impose liability on directors for wrongful and fraudulent trading, do not provide sufficient means to revest assets in the now insolvent company nor deter parties who seek to misappropriate company assets.

Notwithstanding the flaws in the provisions being many, it was concluded that most fell into three categories: remedial, substantive and evidential. With the remedial limitations, although the provisions have *prima facie* satisfactory remedial powers, due to any potential orders' reliance on the court's judgment to become effective, unsecured creditors are at risk of dispositions of property to *bona fide* purchasers for value or beneficial interests being granted over assets to third parties. Moreover, the defendant may be sufficiently impecunious and possess insufficient assets to give effect to the judgment. Consequently, it is a distinct possibility that defendants will not be able to meet any awards made against them, and the unsecured creditors be unable to recover the sums awarded.

In regard the substantive requirements, it was concluded, for example, the preference provisions' need for the liquidator to prove that the defendant company subjectively 'desired' the end result means that it is almost impossible for the liquidator to successfully evidentially prove this subjective element. This is mirrored in the fraudulent trading

provisions, where it is necessary for the liquidator to prove the defendant separately defrauded creditors and that they did so intentionally – something that is also impracticable to successfully evidence.

Finally, under the many evidential limitations, the liquidator faces not only the issue of proving the market value of the transaction but must also disentangle many potential collateral contracts that could be argued to have provided the company with valuable consideration. Similarly, the liquidator must also establish the chain of causation in wrongful trading claims, and prove that the trading caused the loss – a link that many claimants have failed, and will fail, to adequately prove.

Compounding these limitations, liquidators do not have access to large sections of the company's asset pool to fund the litigation of any potential claim, and despite the attempts at legislative reform, owing to floating charge holders retaining the right to refuse use of their assets to fund litigation, limitation funding remains a substantial barrier to enforcing the creditor protections.

These theoretical conclusions were proved empirically in Chapter 4 and the case studies conducted. It was found that notwithstanding the objectionable conduct of Carillion and BHS' directors, the Insolvency Act's provisions were mostly inapplicable. In the case of Carillion, it was concluded that none of the provisions, owing to the substantive limitations and the available subjective defences, were applicable, and so were unable to provide Carillion's roughly 30,000 unsecured creditors any protection. Moreover, whilst it was concluded that some of the provisions were applicable in the case of BHS, it was also established that this applicability was heavily qualified. Firstly, although many of the provisions may be applicable, they only apply to a very few of BHS' actions, resulting in duplicate applicability and the deceptive image that the Insolvency Act provides sufficient protection to BHS' creditors. Secondly, given the impecunious position of RAL and its directors, should the liquidator elect to initiate litigation, it is foreseeable that any judgment would not be enforceable and the moneys due recoverable, meaning that even the limited applicability of the Insolvency Act would not provide any protection to the unsecured creditors. It was also finally concluded two issues greatly affect unsecured creditors – issues that the Insolvency Act provisions do not address. Firstly, the use of reverse factoring enables companies to increase their available credit whilst placing the

burden of risk on to their unsecured creditors. Secondly, the Insolvency Act also fails to provide any protection from the excessive declaration of dividends unless it caught by s423 Companies Act 2006 – an extremely unlikely possibility.

Chapter 3 also set out the three features that any prospective alternative method of unsecured creditor protection would require if it were to address the limitations imposed by the underlying insolvency law theory and overcome the limitations of the anti-deprivation and personal liability provisions. The first feature it is that revested assets must be available to the general body of creditors through the liquidation dividend. Owing to the issues of the anti-deprivation provisions, this remedy should be proprietary in nature to ensure priority to any assets. Secondly, the remedy should have clear and easy to establish provisions, enabling the liquidator or third party to be confident of initiating litigation. Finally, any potential remedy should be attractive to third party litigation financiers, as it is unlikely the transferor will have insufficient assets to fund litigation. It was proffered in Chapters 1, 5 and 6 that the resulting trust was the most viable mechanism to possess these three features.

Section 2: The Potential Use of the Resulting Trust to Assist Unsecured Creditors in Liquidation

The resulting trust was analysed in Chapter 5 as it is a mechanism through which property can be recovered from the possession of another and returned to its original owner – meaning that potentially such trusts have the capability of revesting property in an insolvent company for distribution to unsecured creditors, or revesting property to third parties and preventing them from becoming creditors in the first place. Furthermore, given the limited analysis of the resulting trust in the context of liquidation – and that limited analysis focussing exclusively on the negative impact of the resulting trust – this thesis' analysis of the potential uses of the resulting trust fills a lacuna in the existing literature.

Additionally, the resulting trust was analysed owing to its beneficial features. The priority afforded to resulting trust beneficiaries prevents the assets subject to the trust from forming part of other secured credit instruments, ensuring the assets will be made

available for distribution to unsecured creditors – in stark contrast with the Insolvency Act 1986 provisions. Moreover, the ability to trace further assists by permitting substitute assets, and any increase in the value of those assets, to form part of the resulting trust asset pool and potentially undo any misapplication of the transferred property.

Each of the three forms of the resulting trust, it was concluded, is able to the assist the unsecured creditors and third parties.

Under the gratuitous transfer resulting trust, property transferred in the absence of consideration is held on trust for the transferor unless it can be proven that the transfer was intended to be a gift or a loan. Although its application to personal property is unquestionable, and its application to genuine mistaken transfers is theoretically permissible, it is submitted that despite the uncertainty created by *Petrodel,* it is not applicable to gratuitous transfers of land. Hence, should the company gratuitously transfer property or mistakenly transfer property, it will be held on resulting trust. As concluded in Chapter 5, this is of use in the corporate group, where it is foreseeable that property would be transferred between corporate entities gratuitously. Further, should a third-party transfer property gratuitously to a company, then this too would be held on resulting trust.

Likewise, under the purchase price resulting trust, should the company or third party provide the purchase moneys to either personal or real property, this too will be held on trust for the transferor unless it can be proven that the moneys were intended to be a gift or a loan. It was also concluded that such trusts would be particularly effective in two factual matrices. Under the first, as with the gratuitous transfer, should one company within a corporate group provide purchase moneys to another within the group, then the provider will the beneficial owner of the purchased property, which will either prevent them from becoming an unsecured creditor or be distributable to their unsecured creditors should they be insolvent themselves. Under the second, and 'one-man companies', should a shareholder utilise the company for their own personal activities and provide moneys, and these funds then be used to purchase property, the purchased assets will be held on trust for the company. These can then be used, if that company enters insolvency, to assist the liquidator in discharging unsecured debts.

The automatic resulting trust, which arises upon the failure of an express trust, also potentially assists unsecured creditors by returning to the company assets previously held on trust. It was concluded that this would most likely apply to instances of tax efficiency schemes and surpluses from charitable causes. However, it is the *Quistclose* trust – a form of automatic resulting trust – that has the greater applicability, and places assets provided for a specific (but now failed) purpose, and that were intended to be segregated, on resulting trust. As concluded in Chapter 5, this is applicable to loan moneys provided for a specific purpose, moneys provided by employees to employers, misapplication of client funds, and the purchase of equipment. In each of these matrices, the provider of the property is prevented from becoming an unsecured creditor.

Finally, Chapter 6 evidenced that beyond the theoretical uses, the resulting trust is also viable from a practical perspective. It was concluded from the analysis that the presumption of a resulting trust is only rebuttable should there be sufficient, actual evidence of there being a gift or loan – meaning that an adverse inference is not, in itself, sufficient. Thereby, there is a relatively high degree of certainty for liquidators and third parties initiating litigation as they can analyse the available evidence early on and determine whether or not there is a gift or loan. Moreover, it was also shown that the ability to trace and impose liability on trustees for breach of trust, when taken together, ensures that in the majority of resulting trusts there is an asset to recover. The relative certainty of the resulting trust, and the probability of recovering assets, means that the liquidator should be in a position to be able to acquire the necessary litigation funding for any prospective resulting trust claims. However, the amounts that are recoverable will depend on each individual insolvency, and so it is impossible for this thesis to provide a detailed conclusion as to the effect of the resulting trust on the liquidation process generally.

Given the factors identified in Chapters 5 and 6, it is apparent that the criteria identified as being necessary for an alternative method to assist unsecured creditors are met through use of the resulting trust. Firstly, the resulting trust's proprietary nature ensures priority to the trust assets. Secondly, the relative clarity over the resulting trust's substantive provisions provides liquidators with confidence to commence litigation. Finally, acquiring the necessary litigation funding should also be practicable. Consequently, although the resulting trust may not be able to directly address the deficiencies of the

Insolvency Act 1986's anti-deprivation and personal liability provisions, it is able to increase the liquidation divined of unsecured creditors or prevent third party transferors from becoming unsecured creditors where the applicable matrices occur. In doing so, it also fits within the Credit Wealth Maximisation theory's limitations of protecting secured creditor's interests, as these interests remain undisturbed.

<u>*Section 3: Recommendations to Liquidators*</u>

Given the analysis and conclusions of Chapters 5 and 6, it is necessary for this thesis to provide recommendations for liquidators and third parties in how the resulting trust can be utilised. Unfortunately, given that the resulting trust is an operation of law, and so arises due to a combination of presumptions and lack of rebutting evidence, and moreover is reliant upon the actions of parties before the company entered liquidation, the liquidator is not able to take a positive or active role in creating such trusts. As becomes apparent from the recommendations made below, the liquidator must instead take a passive role and merely identify whether the relevant conduct has occurred, rather than actively seek the imposition of a resulting trust.

As a consequence of this enforced passivity, the recommendations for liquidators, and third parties, must centre on vigilance and interrogation. Indeed, the primary set of actions these parties must undertake is to interrogate any transfers of property involving the insolvent company, either as transferor or recipient. In this interrogation, it will be necessary to identify whether the transactions involved an absence of consideration (for potential gratuitous transfer resulting trusts), whether moneys or assets were provided to third parties to which property was eventually purchased (for potential purchase price resulting trusts), whether moneys were placed on trust for a purpose that has now failed (for potential automatic resulting trusts) or whether moneys were provided for a purpose that has now failed (for potential *Quistclose* trusts).

Notwithstanding the applicability of this advice to both liquidators and third parties, it is evident that it will be easier for third parties to identify if any of the relevant conduct has occurred. Given that third parties will have been directly involved in the transaction – as either the recipient or transferor – it is much more likely that they will be cognisant of the terms of the transfer, and so aware (after becoming familiar with the pertinent law) of the

possibility of there being a resulting trust. Liquidators, meanwhile, must rely upon the written and oral evidence of the company, its employees and third parties. It is therefore much more difficult to first gather the relevant evidence, secondly analyse the gathered evidence, and then thirdly interpret the applicability of these interpretations. Although undoubtably a potentially arduous undertaking if the company has engaged in poor record keeping, the complexity and prospective challenge should not be overstated – particularly in comparison with the evidential hurdles involved in the Insolvency Act 1986 provisions.

The necessary actions to be undertaken to identify the relevant conduct would include analysing any property transfer documents, analysing any loan documents, and should such documentation not be available, then oral evidence from those involved in the transfers must be gathered and analysed. Whilst this may give the impression of an increased workload for liquidators, such actions on their part would be necessary irrespective of attempts to identify possible resulting trusts, as they must ensure that correct title to property is identified. Hence, identification of resulting trusts could, and it is submitted should, form a standard and non-laborious action undertaken by liquidators and third parties upon a company entering liquidation, and one that would, should the applicable matrices occur, assist the company's unsecured creditors or prevent a third party from an becoming unsecured creditor.

Section 4: Theoretical Impact and Potential Future Research

In addition to the recommendations made by thesis, and the potential practical impact of these recommendations, a number of theoretical submissions relating to the law on the resulting trust have been made that could, potentially, assist in clarifying the broader jurisprudence of the resulting trust.

First of all, this thesis has submitted that the presumptions underpinning the resulting trust should be interpreted as taking on a positive characteristic (the property remains the transferor's) and that rather than inferring an intention, they involve the imputation of an intention. As submitted in Chapter 5, this assists in explaining the underlying theory of the resulting trust in line with the historical jurisprudence of the courts and also does away with the problematic use of inferences. Moreover, it was also submitted that in contrast to claims that the presumptions can be rebutted by the 'slimmest of evidence' – such as

adverse inferences – they can only be rebutted should there be actual evidence adduced that a gift or a loan was intended.

Secondly, this thesis has, building upon previous research by the author, proffered that the presumption of gratuitous transfer resulting trust does not apply to transfers of land owing to s60(3) Law of Property Act 1925, despite the confusion and uncertainty created by *Prest v Petrodel.* This thesis has also submitted that 'genuine' mistaken transfers are subject to a gratuitous transfer resulting trust, and although not being the first to suggest that *Quistclose* trusts are resulting trusts, has also added to the debate by analysing the competing arguments, confirming it is an automatic resulting trust, and clarifying when and how such trusts can be utilised.

Furthermore, this thesis has also provided empirical evidence as to the effectiveness of the anti-deprivation and personal liability provisions of the Insolvency Act 1986 – a previous lacuna in existing literature. Through the two case studies of BHS and Carillion, it was evidenced that the provisions have both an extremely limited applicability, and moreover, should they be applicable, then the chances of recovery are severely limited by the potential impecuniosity of the defendants.

Finally, it must be noted that further empirical research into the Insolvency Act 1986 provisions is necessary. Despite this thesis having conducted two case studies, it is acknowledged that further case studies on the provisions, focusing on the provisions individually, is needed. Moreover, although this thesis has proven the potential of the resulting trust theoretically, and this has been to some extent proven empirically by reference and application of the existing case law, further empirical research (should the relevant evidence ever become available from companies) could be conducted on the application of the resulting trust to liquidation. This would take the form of case studies on companies that enter liquidation and have engaged in multiple transfers of property.

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