

Neutral Citation no. [2007] NICH 3

Ref: **TREC5805**

*Judgment: approved by the Court for handing down
(subject to editorial corrections)**

Delivered: **01/05/07**

**IN THE HIGH COURT OF JUSTICE IN NORTHERN IRELAND
CHANCERY DIVISION (COMPANIES WINDING UP)**

BETWEEN:

LEVY McCALLUM LIMITED

Applicant;

and

MARK ALLEN (AS LIQUIDATOR OF FULFORD HYMAN LIMITED)

Respondent.

TREACY J

INTRODUCTION

[1] The Applicant is an advertising agency based in Glasgow, Scotland. The Respondent is the liquidator of Fulford Hyman Limited ("Fulford").

[2] The central issue, crystallised at hearing, raised by these proceedings is whether the Respondent liquidator was correct in refusing to admit the Applicant's debt into liquidation on the basis that the relevant transaction was a transaction at an undervalue within the meaning of Article 202 of The Insolvency (Northern Ireland) Order 1989 ("the Order").

FACTUAL BACKGROUND

[3] Fulford is a wholly owned subsidiary company of SERE Holdings Limited ("Holdings"). Other companies within the group are SERE Motors Limited ("Motors") and SERE Properties Limited ("Properties").

[4] Between January 2003 to May 2003, the Applicant supplied advertising services to Motors which included the design, publication and distribution of promotional advertisements for the business of Motors. On 23 December

2002, prior to the provision of these services, Fulford executed a guarantee in favour of the Applicant, in consideration of its agreement to supply goods or services to Motors. The guarantee was given in respect of "all sums which are now or may hereafter become owing to [the Applicant] (by) [Motors]". The guarantee was executed by Stanley Edgar, Director of both Fulford and Motors.

[5] By the end of May 2003, £107,207.08 was owed by Motors to the Applicant for advertising services. The Applicant commenced proceedings against both Motors and Fulford. Neither Defendant entered an Appearance and on 23 November 2003, the Applicant obtained a default judgment against both Motors and Fulford.

[6] On 8 December 2003, the Applicant issued a statutory demand to Fulford on foot of the default judgment. Fulford did not respond to the statutory demand and on 26 February 2004, the Applicant issued and presented a Petition for the winding up of Fulford.

[7] On 10 June 2004 Fulford made an application to set aside the default judgment. The application to set aside the judgment was dismissed by Master McCorry on 21 June 2004. This judgment was not appealed. On 21 July 2004 Fulford went into voluntary liquidation and accordingly on 4 August 2004 the Applicant's winding-up petition was dismissed.

[8] On 20 July 2004 the Applicant submitted a Statement of Claim regarding the outstanding debt and was afforded voting rights at the meeting of creditors. The Respondent liquidator wrote to the Applicant, as a Creditor, on 28 November 2005 and again on 19 October 2006 (almost 1 year later) to report on progress in the liquidation. These letters contained no reference to any query regarding the status of the Applicant's debt.

[9] Following receipt of the report of 19 October 2006 the Applicant's solicitor was instructed to write to the Respondent liquidator seeking clarification of a number of matters including the basis of the substantial increase in the Respondent liquidator's costs.

[10] A brief response was received from the Respondent liquidator. A more substantive response was received on 6 November 2006 which sought information, inter alia, regarding the Applicant's debt. According to para 10 of the Applicant's affidavit this was the first occasion any query had ever been intimated relating to this debt since the dismissal of the application to set aside the default judgment.

[11] By letter dated 8 December 2006, the Respondent liquidator rejected the Applicant's claim and gave his written reasons. He gave a number of reasons for rejecting the claim. Those reasons included the three which had

been canvassed unsuccessfully before the Master when Fulford had attempted to set aside the default judgment. He also gave two additional reasons (i) that the guarantee was not supported by any valid consideration and (ii) that the benefit received by Fulford was substantially less than the consideration provided by it thus the guarantee represented a transaction at an undervalue within the meaning of Article 202 of the Order. This last reason was the sole ground ultimately advanced at hearing in support of the Respondent liquidator's rejection of the Applicant's claim.

[12] When the Respondent liquidator refused to admit the Applicant's debt into the liquidation the Applicant issued a summons seeking an Order pursuant to Rule 4.089 of The Insolvency (Northern Ireland) Rules 1991 to reverse and/or vary the decision of the Respondent liquidator refusing to admit their claim.

[13] By cross-summons dated 9 February 2007 the Respondent liquidator sought, inter alia, a declaration that a transaction made on 23 December 2002 by which Fulford guaranteed the payment of all sums payable by Motors to the Applicant was a transaction at an under value within the meaning of Article 202 of The Insolvency (Northern Ireland) Order 1989.

LEGISLATIVE PROVISIONS

[14] Article 202 of the Order states:

“Transactions at an undervalue

202 - (1) This Article applies in the case of a company where-

- (a) an administration order is made in relation to the company; or
- (b) the company goes into liquidation;

and “the office-holder” means the administrator or the liquidator, as the case may be.

- (2) Where the company has at a relevant time (as defined in Article 204) entered into a transaction with any person at an undervalue, the office-holder may apply to the High Court for an order under this Article.

- (3) Subject to paragraph (5) the High Court shall, on such an application, make such order as it thinks fit for restoring the position to what it would have been if the company had not entered into that transaction.
- (4) For the purposes of this Article and Article 205, a company enters into a transaction with a person at an undervalue if-
 - (a) the company makes a gift to that person or otherwise enters into a transaction with that person on terms that provide for the company to receive no consideration, or
 - (b) the company enters into a transaction with that person for a consideration the value of which, in money or money's worth, is significantly less than the value, in money or money's worth, of the consideration provided by the company.
- (5) The High Court shall not make an order under this Article in respect of a transaction at an undervalue if it is satisfied-
 - (a) that the company which entered into the transaction did so in good faith and for the purpose of carrying on its business, and
 - (b) that at the time it did so there were reasonable grounds for believing that the transaction would benefit the company."

[15] Article 204 of the Order states:

“ ‘Relevant time’ under Articles 202, 203

204 - (1) Subject to paragraph (2), the time at which a company enters into a transaction at an undervalue or gives a preference is a relevant time

if the transaction is entered into, or the preference given-

- (a) in the case of a transaction at an undervalue or of a preference which is given to a person who is connected with the company (otherwise than by reason only of being its employee), at a time in the period of 2 years ending with the onset of insolvency,
 - (b) in the case of a preference which is not such a transaction and is not so given, at a time in the period of 6 months ending with the onset of insolvency, and
 - (c) in either case, at a time between the presentation of a petition for the making of an administration order in relation to the company and the making of such an order on that petition.
- (2) Where a company enters into a transaction at an undervalue or gives a preference at a time mentioned in paragraph (1)(a) or (b), that time is not a relevant time for the purposes of Article 202 or 203 unless the company-
- (a) is at that time unable to pay its debts within the meaning of Article 103, or
 - (b) becomes unable to pay its debts within the meaning of Article 103 in consequence of the transaction or preference;

but the requirements of this paragraph are presumed to be satisfied, unless the contrary is shown, in relation to any transaction at an undervalue which is entered into by a company with a person who is connected with the company.

- (3) For the purposes of paragraph (1), the onset of insolvency is-
- (a) in a case where Article 202 or 203 applies by reason of the making of an administration order or of a company going into liquidation immediately upon the discharge of an administration order, the date of the presentation of the petition on which the administration order was made,
- [aa] [in a case where Article 202 or 203 applies by reason of a company going into liquidation following conversion of administration into winding up by virtue of Article 37 of the EC Regulation, the date of the presentation of the petition on which the administration order was made,] and
- (b) in a case where the Article applies by reason of a company going into liquidation at any other time, the date of the commencement of the winding up."

THE RESPONDENT LIQUIDATOR'S SUBMISSIONS

Was the guarantee a transaction at an undervalue?

[16] It was not in dispute that, in principle, guarantees fell within Article 202 of the Order. In this respect the Respondent liquidator referred the Court to the commentary at paragraph 11-33 of *Principles of Corporate Insolvency Law*, Goode, (Thompson, Sweet & Maxwell, 3rd Edition, 2005).

[17] It was common case that the requirements of Article 202(1)(b) of the Order were satisfied since Fulford had gone into voluntary liquidation on 21 July 2004. It was also common case that the impugned transaction had been entered into at a time mentioned in Article 204(1)(a) (ie the execution of the guarantee [23 December 2002] was at a time in the period of two years ending with the onset of insolvency [21 July 2004] as defined in Article 204(3)(b) of the Order).

[18] However, even though a transaction was entered into at a time mentioned in Article 204(1)(a), that time is not a “relevant” time for the purposes of Article 202 unless the company (a) is at that time unable to pay its debts within the meaning of Article 103 or (b) becomes unable to pay its debts within the meaning of Article 103 in consequence of the transaction.

[19] On this aspect of the case the Respondent liquidator submitted that when Fulford executed the guarantee, it was unable to pay its debts as above defined. They pointed out that Fulford ceased trading on 1 January 2002 and no further business was transacted by Fulford after that date. Fulford’s Statement of Affairs is dated July 2004 and since no business was transacted by Fulford between January 2002 and July 2004, the Statement of Affairs of July 2004 reflected Fulford's ability to pay its debts as at January 2002. The Statement of Affairs showed that Fulford's only asset was a criminal damage claim for £1,250,000, whilst it had liabilities of £2,136,961. Fulford's inability to pay its debts persisted throughout the period January 2002 to July 2004. The guarantee was executed during that period and thus executed at a time when Fulford was unable to pay its debts. Alternatively, they submitted, Fulford became unable to pay its debts as above defined in consequence of the transaction. In consequence of the guarantee, the Applicant issued debt proceedings and then a statutory demand. Once the statutory demand was issued and not satisfied, Fulford was insolvent for the purposes of the Article 103.

[20] Whilst Article 202(4) provides for two potential types of transaction at an undervalue the heart of the debate related to Article 202(4)(b) set out at para 14 above.

[21] The Respondent liquidator submitted that the execution of the guarantee was a transaction at an undervalue and referred the Court to para.11-33 of Goode which states:

“The crucial question is whether there is a broad equality of exchange, that is, whether the benefit conferred on the [Applicant] by the issue of the guarantee is significantly greater than the value to [Fulford] of the advance to [SERE Motors Limited].”

[22] In assessing the benefits received, or the value given up, to each side, the Court must look at the reality of the situation: see Agricultural Mortgage Corp plc v Woodward [1994] BCC 688.

[23] It was submitted that under the guarantee, the Applicant obtained a significant and substantial benefit ie the right to recover from Fulford the sum of £120,760.28 and that by contrast Fulford obtained “absolutely no benefit”

from the Applicants readiness to supply goods or services to Motors. There was no direct relationship between Fulford and Motors. That is to say, they did not stand in a relationship of parent/holding company-subsidary, nor were they part of the same group. Thus, it was contended there was no opportunity for any benefits flowing from the relationship between the Applicant and Motors, to percolate to Fulford. Given that Fulford was not even trading at the time when it executed the guarantee, no benefit can have been obtained by it.

[24] The court may not make an order under Article 202 if it is satisfied that the company which entered into the transaction did so in good faith and for the purpose of carrying on its business, (Article 202(5)(a)); and that at the time it did so there were reasonable grounds for believing that the transaction would benefit the company (Article 202(5)(b)). It was submitted by the Respondent liquidator that the "defences" in Article 202(5) are not applicable since Fulford had ceased trading and therefore, they asserted, the guarantee cannot have been executed "in good faith *and for the purpose of carrying on its business*" (Article 202(5)(a)). Furthermore, given that Fulford had ceased trading, the Respondent liquidator submitted that there cannot have been reasonable grounds for believing that the transaction would benefit the company (Article 202(5)(b)).

[25] If the transaction was at an undervalue the Respondent liquidator submitted that under the Court's general power in Article 202, the Court should restore the position to what it would have been if the company had not entered into that transaction ie the guarantee should be set aside.

THE APPLICANT'S SUBMISSIONS

[26] The Applicant drew attention to the provisions of Article 204(2) that the transaction should not be regarded as occurring within the "relevant times" unless, the company (a) at the time of entering the transaction is unable to pay its debts, or (b) becomes unable to pay its debts in consequence of the transaction. It was submitted that neither of these provisions applied.

[27] The Applicant submitted that the Respondent liquidator's case (summarised at para 20 above) that the assets and liabilities as at 21 July 2004 "would reflect" the assets and liabilities on 1 January 2002 was bare assertion and unsupported by clear evidence. The Applicant maintained that in the absence of detailed information regarding the financial position of Fulford on 1 January 2002, it was not accepted that at the date of the guarantee (23 December 2002) Fulford was unable to pay its debts.

[28] In respect of (b) it was submitted that it was not correct to say that the company became unable to pay its debts in consequence of the guarantee, within the meaning of Article 204(2)(b). The appropriate time at which to

judge such a consequence is the date of the guarantee. At that time, it was not clear whether the guarantee would or would not be called upon. Accordingly, it could not be said, at that time, that the contingent liabilities under the guarantee caused the company to become unable to pay its debts.

[29] The Applicant challenged the Respondent liquidator's contention that the impugned transaction was at an undervalue. Inter alia, they identified the consideration provided by the company and the consideration received by the company. They submitted that the consideration provided by Fulford was the guarantee. The consideration provided by the Applicant was the promise to supply services to Motors.

[30] As regards the balancing and weighing of the competing considerations they submitted the date upon which the competing considerations must be weighed against each other is the date of the guarantee (23 December 2002). In the case of any guarantee, this will always be a difficult exercise since the company will rarely receive a direct benefit and one cannot judge the value of the guarantee without detailed information regarding the financial health of the ultimate creditor. In this case, the Applicant submitted that it was clear that Fulford did obtain some direct commercial benefit from the guarantee. In January 2002 [11 months pre-guarantee], the entire business and goodwill of Fulford was transferred to Motors. The return consideration was a loan in favour of Fulford. At the date of the guarantee, this loan was still outstanding. The important point, it was contended, was that Fulford must have received some direct commercial benefit from the continued provision of advertising services to a company which owed substantial monies to it at the date of the guarantee and that it was a legitimate and natural inference that these continued services helped to keep Motors in business during the period of the advertising services.

[31] The Applicant complained that the Respondent liquidator provided no financial information regarding the trading position of Motors at the date of the guarantee and that the Court was nonetheless being asked by the Respondent liquidator to balance the benefit received against the value of the benefit given away. In the case of a guarantee, the Applicant submitted that one cannot begin that exercise without knowledge of the financial state of the ultimate creditor and accordingly the likelihood that the guarantee will be called upon. The Respondent liquidator, it was asserted, had produced no information of this nature, as of December 2002. Accordingly, despite the fact that the Respondent liquidator brings the application and asks the Court to carry out that process, it has not made available the information which is necessary in order to do so.

[32] It was submitted that even if it were possible to say that the benefit received by Fulford was less than the benefit contained in the guarantee, on the information available, it was not possible to say that it was significantly

less in money or monies worth. Accordingly, it was submitted that the statutory requirements of a transaction at an undervalue were not made out in this case.

[33] It was submitted that as the party bringing the application and asserting that the transaction was weighed in favour of the Applicant, it must be incumbent upon the Respondent liquidator to produce the factual and evidential foundation to support that assertion. It was asserted that the Applicant was and remains ignorant of the financial position of Fulford and Motors at the date of the guarantee and that accordingly, the Applicant could not be expected to carry the evidential burden of rebutting the Respondent liquidator's case. It was pointed out that there is no statutory presumption in favour of a transaction at an undervalue and that accordingly, the failure of the Respondent liquidator to adduce sufficient material upon which to judge and thereafter weigh the benefit disposed of by the company was fatal to the application.

[34] It was submitted that even if the Court were able to find that the benefit disposed of by Fulford was significantly less than that received, that the Applicant was entitled to avail of the statutory defence in Article 202(5). They submitted that there was nothing in the information put forward by the Respondent liquidator to suggest that the guarantee was given otherwise than in good faith and for the purpose of carrying on its business. This was, they said, supported by the inferences arising out of the inter company debt between Fulford and Motors. For the same reason they also submitted that there were "reasonable grounds for believing that the transaction would benefit the company".

CONCLUSIONS

[35] On the basis of the material before the Court I am satisfied that at the time of the transaction Fulford was unable to pay its debts within the meaning of Article 103. I accept the Respondent liquidator's contention that the assets and liabilities on 21 July 2004 would "reflect" the assets and liabilities on 1 January 2002 particularly bearing in mind Fulford had ceased trading on 1 January 2002. Accordingly, the impugned transaction was entered into at a "relevant time" within Article 202 (as defined by Article 204) of the Order.

[36] In light of that conclusion it is not necessary to express a view on the Applicant's submissions regarding Article 204(2)(b).

TRANSACTION AT AN UNDERVALUE?

[37] In accordance with the provisions of Article 202(4)(b) a company enters into a transaction with a person at an undervalue if the company enters into a

transaction with that person for a consideration the value of which, in money or money's worth, is significantly less than the value, in money or money's worth, of the consideration provided by the company.

[38] A company enters into a transaction at an undervalue where it gives a guarantee and receives by way of benefit significantly less than the value of the benefit conferred by the guarantee [see Goode para 11-14].

[39] Goode gives a series of examples of transactions at an undervalue the common feature of which is that the company either receives nothing for what it supplies or pays too much or receives too little to ensure equality of exchange.

[40] Where a transaction is impugned on the grounds of significant inequality of exchange difficult questions of valuation may arise. These are particularly acute in the case of guarantees. Indeed it has been said that "the valuation of a guarantee is in many cases a matter of judgment rather than of science and that a broad brush approach is needed" [see Goode para 11-35].

[41] The onus of proof lies on the Respondent liquidator to show that the conditions under Article 202 are satisfied [see Goode para 11-16].

[42] Goode has also stated:

"In practice it is unlikely that a guarantee will be impeached as a transaction at an undervalue except where it is clearly of no benefit to the surety company. There are serious problems of valuation on both sides of the equation and the onus is on the office-holder who is impeaching the transaction to prove that the guarantee is a transaction at an undervalue. Hence the difficulties of valuation lie primarily on him rather than on the creditor". [para 11-36]

[43] The question to be determined in each case is whether the value of the consideration given by the company significantly exceeds the value received by the company - which has to be assessed from the viewpoint of the company and not the other party [see *Re M C Bacon Ltd (No.2)* [1990] BCLC 324, per Millett J at 340].

[44] The benefits given and received by the company have to be valued at the time of the transaction. As to the relevance of subsequent events in testing the accuracy of the value ascribed to the benefit in question at the time of the transaction see *Phillips v Brewin Dolphin Bell Lawrie Ltd* [2001] 1 WLR 143 and the discussion in Goode at para.11-30 et seq.

[45] The particular difficulty in applying Article 202 to guarantees is that "... the issue of a guarantee by the company merely involves it in a contingent liability which may never crystallise and the *quid pro quo* is the making of an advance to a third party, the principal debtor. So in contrast to the usual case a guarantee does not at the time of its issue involve any form of transfer either from or to the company and, indeed, it may never pay anything or receive anything as a result of the transaction. But these are matters which go merely to the valuation of benefit and burden and they do not affect the applicability of [Article 202]..." The "crucial question is whether there is a broad equality of exchange, that is whether the benefit conferred on the creditor by the issue of the guarantee is significantly greater than the value to the surety of the advance to the principal debtor ... this involves an assessment at the date of the guarantee of what is likely to happen when payment becomes due" [see Goode para.11-33].

[46] The value of a guarantee to a creditor depends on the financial strength/weakness of the principal debtor and the extent to which the creditor is therefore dependent upon the guarantee. Inevitably such an assessment would require the Respondent liquidator, upon whom the onus lies, to put the necessary material before the Court to enable this assessment to be made. In this respect I consider that there is considerable force in the Applicant's submission that the Respondent liquidator has provided no or insufficient financial information regarding the trading position of Motors at the date of the guarantee to enable this assessment to be properly made.

[47] The other side of the balancing exercise involves an assessment of the value of the consideration received by the surety Fulford. The Respondent liquidator's contention was that Fulford received "absolutely no benefit" from the guarantee. On the basis of the material available I cannot accept that contention. At the time of the guarantee there was a not insignificant commercial benefit to Fulford from the continued provision of advertising services to Motors which, at the time of the guarantee, owed substantial monies to Fulford and that the continued advertising services helped or may have helped to keep Motors in business during the period that those services were being provided.

[48] For these reasons the Respondent liquidator has not discharged the burden of proving that the relevant transaction was at an undervalue within the meaning of Article 202 of the Order.

[49] Even if I had been persuaded that the transaction was at an undervalue I am satisfied that the Applicant has made out the statutory defence under Article 202(5). Under this provision the Court may not make an Order in respect of a transaction at an undervalue if it is satisfied that the company which entered into the transaction did so (a) in good faith; and (b) for the

purpose of carrying on its business; and (c) that at the time it did so there were reasonable grounds for believing that the transaction would benefit the company.

[50] There was no suggestion that the transaction had not been in good faith and the argument on this aspect of the case centred on requirements (b) and (c). The fact that Fulford had ceased trading was relied upon by the Respondent liquidator, without more, as demonstrating that these conditions could not be satisfied. The Applicant, on the other hand, countered this by relying upon the inter-company debt between Fulford and Motors. In *Re Sarlax Ltd* [1979] Ch 592, a decision on the meaning of “carrying on a business” in Section 332(1) of the Companies Act 1948, Oliver J held that the phrase was not confined to the active carrying on of the trade but encompassed the collection of assets and the distribution of their proceeds in discharge of liabilities in the course of closing down the business. That authority is cited by the authors of Goode in support of the proposition that transactions entered into by a company in the course of closing down its business would be considered “for the purpose of carrying on its business” within the relevant statutory provision (ie Article 202). By analogy therefore, entering into a transaction which ensured the continued provision of advertising services to a company which owed it substantial monies at the date of the guarantee and which helped to keep that company (Motors) in business during the period of the advertising services comes, in my view, within the statutory definition.

[51] Accordingly, I reverse the decision of the Respondent liquidator refusing to admit the Applicant’s claim and the cross-summons is dismissed. I will hear the parties as to the appropriate order as to costs and any other consequential relief.