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Going Bust:

The dangers of making payments when your company is insolvent

A recent High Court judgment has once again highlighted the need for directors of insolvent companies to take care when considering any transfers of assets out of the insolvent company, particularly to other group companies. What may seem like a neat way of moving assets out of the reach of an administrator can lead to personal liability for directors and an order that the money be repaid.

The Facts of the Case

In *Re Algrave Ltd v Safe Solutions International Ltd*, the defendant company provided administrative services to 727 other companies. As part of the management agreement pursuant to which those services were provided, the defendant company held funds on trust for those other companies.

The second defendant, an individual, was a director of Safe Solutions International Ltd (the defendant company), and the 727 companies who received administrative services from Safe Solutions International Ltd.

Those companies were advised in June 2007 that they owed around £4.4 million to HMRC in respect of unpaid VAT. Between November 2007 and June 2008 the defendant company paid an aggregate amount of £375,000 to itself from the account in which the funds were held on trust for those companies.

In September 2008 the companies were placed into administration on account of the VAT shortfall. The administrators of the companies applied to the court for declarations that the payments of £375,000 were "voidable preferences" under the Insolvency Act, and that the second defendant had caused those sums to be paid in breach of his fiduciary duties.

The Outcome

The legal basis for the administrators' application was section 239 of the Insolvency Act 1986. This provides that in certain circumstances payments to creditors or guarantors made in a period of up to two years prior to entry into a formal insolvency procedure such as administration can be ordered to be repaid.

The court held that, although a portion of the payments made could be justified on the basis that the defendant company had already become entitled to those sums, the balance of the payments from the trust account to the defendant company constituted a clear breach of the law.

The second defendant was found personally liable for breaching his duty to protect the interests of creditors by arranging the payment.

The money was ordered to be repaid to the companies in order that the administrators could distribute it fairly and legally among their creditors.

The Lesson

If insolvency is looming on the horizon, it is understandable that the directors of a company may want to disperse of its assets if there is some advantage to be gained. The law, however, operates to allow liquidators and administrators to claw back those assets in certain circumstances – particularly where any transactions or payments have not been made on an arms' length basis - so that blameless creditors are not disadvantaged. Those provisions may also impose personal liability on directors.

If you are a director of a company which is insolvent, or which is experiencing difficulties and may be approaching insolvency, this case is a reminder of the need to proceed with caution and in particular the dangers of moving assets to connected companies where there is no objective reason for doing so other than to remove them from the reach of creditors.

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