

Company Law

Train Limited has been in financial difficulties for the past twelve months.

Paul and James, the two directors of Train Limited, have been aware of the difficulties for some time, but have been trying to trade through them. However, in the last two months, things have got significantly worse.

Last month, James's brother Adrian was persuaded to lend the company £5,000. Two weeks ago, the loan was repaid from money received by the company from a completed contract.

Three weeks ago, James and Paul each bought their company car from the company. Each car was worth around £12,000. James and Paul each paid £2,000 respectively for their car.

Six months ago, Big Bank plc lent the company £4,000. The loan was originally unsecured, but three months ago, the Bank insisted on being given a floating charge over all the company's assets, which the company granted. The charge was duly registered.

Train Limited has now gone into insolvent liquidation.

Advise the liquidator of Train Limited as to the order of payment of the company's creditors and whether the assets available to the ordinary creditors, can be increased.

The order of payment of the company's creditors is as follows:

The liquidator will meet the expenses of the liquidation and his/her own fees before paying the preferential creditors, such as the **Inland Revenue and Customs & Excise**.

Next in order for payment are holders of floating charges. If there is any money left after paying the above creditors in full, it will be distributed amongst the company's ordinary creditors, that is the trade creditors. If there is insufficient money to pay all the trade creditors, they will each receive a dividend of so many pence in the pound. The money available will be distributed equally amongst the ordinary creditors, there being no order of payment within this category.

Any creditors holding a fixed charge will realise their security outside the above process.

The ordinary creditors are near the bottom of the list for repayment in a liquidation. It is therefore very important if the liquidator can challenge transactions made by the company prior to liquidation which result in more money being available to pay the creditors.

The liquidator may try and challenge the repayment of the loan to Adrian.

The repayment of Adrian's loan may be challenged as a preference, **section 239 Insolvency Act 1986 ("the Act")**. A preference is where the company has put a creditor in a better position on insolvent liquidation than would otherwise have been the case. Such transactions can be set aside if entered into within two years of the company being wound up where a connected person is involved, as in this case. They must occur when the company was insolvent or became insolvent as a result and the desire to prefer must be shown. However, in this case the desire is presumed because a connected person is involved. Here, the loan was repaid two weeks before liquidation and at a time when the company was in financial difficulties. The court can order the preference to be set aside, so Adrian may have to return the money received to the liquidator and claim as an ordinary creditor of the company for the money he lent to it.

The liquidator may also challenge the sale of the cars to James and Paul as undervalue transactions, **section 238 of the Act**. The court can set such transactions aside if made within two years of the company being wound up and at a time when the company was insolvent, or became insolvent as a result. This is presumed where, as in this case, the undervalue transaction is to connected persons. In this case, the cars were sold for far less than they are worth three weeks prior to liquidation when the company was already in financial difficulties. The court may set aside the transaction and order that James and Paul return the cars to the company, as long as to do so would not affect any innocent third party. A defence to the challenge by the liquidator would be if the company could show the transaction was entered into for genuine business purposes, such as to relieve temporary cash flow problems.

The money originally lent to the company by Big Bank plc was unsecured. The subsequently created floating charge could be challenged by the liquidator under **section**

of the Act. As the charge is created within twelve months of subsequent insolvency, it can be set aside because it secures an existing debt, provided that the company was insolvent at the time or as a result of its creation. This may not be the case if the financial difficulties have been more recent. If the charge is set aside, Big Bank plc will rank as an ordinary unsecured creditor in the order for payment by the liquidator.

The liquidator may bring an action for wrongful trading against James and Paul, **section 214 of the Act.** They appear to have carried on business as usual despite being aware of the company's difficulties. In such cases, they can be ordered to contribute to the assets of the company; thereby, increasing the funds available for the ordinary creditors.