

Validation orders and the change of position defence: where are we now?

James Court Ltd (In Liquidation) v Hindsight Contractors Ltd

KEY POINTS

- The restitutionary nature of the remedy where a disposition is void under ss 127 and 284 of the Insolvency Act 1986.
- The corresponding availability of a change of position defence, and the constraints upon such a defence following *Abdulali v NISA Retail Ltd; Re MKG Convenience Ltd* [2019] EWHC 1383 (Ch) and *Changtel Solutions UK Ltd v G4S Secure Solutions (UK) Ltd; Re Changtel Solutions UK Ltd* [2022] EWHC 694 (Ch).
- The effect of a prior unsuccessful application for a validation order on the ability of a respondent to raise a change of position defence, following the decision in *James Court Ltd (In Liquidation) v Hindsight Contractors Ltd* [2023] EWHC 1101 (Ch).

INTRODUCTION

The apparent simplicity of s 127 of the Insolvency Act 1986 (the 'Act'), and s 284 of the Act, its counterpart in bankruptcy, belies the labyrinthine issues that have arisen in the significant volume of case law that each section has generated. One such issue, which first raised its head over two decades ago but has recently come back into the spotlight, is the availability of a change of position defence to a claim for recovery of the subject of the avoided disposition.

The most recent case in which that defence has been considered is *James Court Ltd (In Liquidation) v Hindsight Contractors Ltd* [2023] EWHC 1101 (Ch), a decision of District Judge Bond sitting in the Business and Property Courts in Leeds. In a novel twist on the usual tale, the recipient of the void dispositions of company property attempted to rely upon a change of position defence having already failed to obtain a validation order before the application for recovery was issued. The judgment therefore primarily considered issues of *res judicata* and abuse of

process, in addition to considering the merits of the defence.

WHAT ARE VOID DISPOSITIONS?

Section 127(1) of the Act provides that, in a winding up by the court, any disposition of the company's property, and any transfer of shares, or alteration in the status of the company's members, made after the commencement of the winding up is void, unless the court orders otherwise. As set out in s 129 of the Act, the date of the 'commencement' of the winding up is generally the date of presentation of the winding up petition, unless a resolution was passed for voluntary winding up before that date (in which case the winding up will commence on the date of the resolution), or the court orders the company to be wound up upon hearing an administration application (in which case the winding up will commence on the making of the order).

Section 284 of the Act similarly provides that, where a person is made bankrupt, any disposition made by that person in the period between the making of a bankruptcy

application or presentation of a bankruptcy petition, and the vesting of the bankrupt's estate in their trustee in bankruptcy will be void, unless made with the consent of, or subsequently ratified by the court.

WHAT IS THE NATURE OF THE REMEDY WHERE THERE IS A VOID DISPOSITION?

The void disposition provisions now found in ss 127 and 284 of the Act pre-date the enactment of the Act. Nevertheless, the legislature opted not to spell out the appropriate remedy where a disposition is void. That omission was pointed out as long ago as 1976 in *In re J Leslie Engineers Co Ltd* [1976] 1 WLR 292. In *Hollcourt (Contracts) Ltd v Bank of Ireland* [2001] Ch 555, the Court of Appeal held that, where s 127 of the Act operates to avoid relevant dispositions, the right of recovery of the company's property which has been disposed of is determined by the general law. It was further noted that the right of recovery is restitutionary.

The classification of the company's right of recovery as 'restitutionary' was accepted in *Rose v AIB Group (UK) plc* [2003] EWHC 1737 (Ch); [2003] 1 WLR 2791, *Clark v Meerson* [2018] BPIR 661 and *Brothers Produce Ltd (In Liquidation) v Tydene (Western) Ltd* [2022] EWHC 291 (Ch); [2022] BCC 640. In *Officeserve Technologies Ltd v Annabel's (Berkeley Square) Ltd* [2018] EWHC 2168 (Ch); [2019] Ch 103, HHJ Matthews (sitting as a High Court judge) considered what was meant by the use of the term 'restitutionary' in this context, and concluded that a claim

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arising out of an avoided disposition is not necessarily a claim in unjust enrichment, but is better seen as a claim for the 'return' of the property that was the subject of the disposition. Nevertheless, in respect of payments of money, HHJ Matthews was satisfied that, in principle, the nature of a claim for recovery of such sums is a claim in unjust enrichment (formerly known as a claim for money had and received).

WHEN IS A CHANGE OF POSITION DEFENCE AVAILABLE?

It is hardly surprising that, once the Courts clarified the nature of the remedy under s 127 or 284 of the Act, enterprising respondents to claims for recovery of the subject of void dispositions began asserting the defence of change of position. That defence, in its modern form, was first acknowledged in *Lipkin Gorman (A Firm) v Karpnale Ltd* [1991] 2 A.C. 548, in which Lord Goff stated that the defence was available where a defendant's:

'[...] position has so changed that it would be inequitable in all the circumstances to require him to make restitution, or alternatively restitution in full.'

In *Rose v AIB Group (UK) plc*, despite strident submissions by the company that there was no need or room for a defence of change of position in the context of s 127 of the Act, Nicholas Warren QC (sitting as a Deputy High Court Judge) refused to rule out the possibility of the defence being successfully utilised to resist a claim for repayment where a disposition has been avoided. The availability of the defence in principle was thereafter acknowledged in *Clark v Meerson, In re D'Eye* [2016] B.P.I.R. 883, and *Officeserve Technologies Ltd v Annabel's (Berkley Square) Ltd*, despite the judgment in *Rose v AIB Group (UK) plc* being subject to significant academic criticism.

The availability of the change of position defence in the context of restitutionary claims under ss 127 and 284 of the Act was further refined in *Abdulali v NISA Retail Ltd; Re MKG Convenience Ltd* [2019] EWHC 1383 (Ch). In *Rose v AIB Group (UK) plc*, Nicholas

Warren QC had expressed the view that the question of validation of a disposition was separate from that of the question of actual recovery absent validation. However, in *Re MKG Convenience Ltd*, HHJ David Cooke (sitting as a High Court Judge) held that, whilst a defence of change of position is, in principle, available in the context of a claim pursuant to s 127 of the Act, the circumstances in which the defence can succeed are constrained in the same way and for the same reasons as the exercise of the Court's discretion to validate.

HHJ David Cooke justified both the availability of the change of position defence, and the constraints that he considered to be imposed upon it, by reference to the reasons why a change of position defence is recognised as a defence to a restitutionary claim. In summary, on a restitutionary claim, the court has to strike a balance between the equities in favour of the claimant and those in favour of the defendant. In the context of claims to recover money or property in an insolvency process, the court must recognise that the equities in favour of the claimant are strengthened by the legislative policy under the Act of preserving and realising assets for the benefit of creditors.

The authorities to date were reviewed thoroughly in *Changtel Solutions UK Ltd v G4S Secure Solutions (UK) Ltd; Re Changtel Solutions UK Ltd* [2022] EWHC 694 (Ch). Having identified a conflict as to the approach to the availability of the change of position defence between *Rose v AIB Group (UK) plc* and *Re MKG Convenience Ltd*, ICC Judge Barber held that, in circumstances where she was not convinced that HHJ David Cooke was wrong in not following *Rose v AIB Group (UK) plc*, she should proceed on the basis that a change of position defence is constrained in the same way and for the same reasons as the exercise of the Court's discretion to validate.

IN WHAT CIRCUMSTANCES WILL THE COURT VALIDATE A VOID DISPOSITION?

The leading case on validation orders is *Express Electrical Distributors Ltd v Beavis* [2016] 1 WLR 4783, which set out the following principles:

- The *pari passu* principle is, of course, fundamental to the administration of any formal insolvency process;
- It may sometimes be beneficial to the company and its creditors that the company be able to trade post-presentation of a winding up petition;
- When considering whether to make a validation order the court must always do its best to ensure that the interests of the unsecured creditors will not be prejudiced;
- It is not the case that any disposition made in good faith in the ordinary course of business at a time when the parties are unaware of the petition will ordinarily be validated;
- The court should not validate any transaction which might result in one or more pre-liquidation creditors being paid in full at the expense of other creditors, in the absence of special circumstances making such a course desirable in the interests of the unsecured creditors as a whole; and
- Special circumstances therefore need to be shown to demonstrate that the transaction will be or has been for the benefit of the general body of unsecured creditors to justify the making of a validation order which will override the usual application of the *pari passu* principle.

WHAT IS THE CONSEQUENCE OF HAVING FAILED TO OBTAIN A VALIDATION ORDER?

In *James Court Ltd (In Liquidation) v Hindsight Contractors Ltd*, James Court Ltd ('JCL') sought repayment of monies paid to Hindsight Contractors Ltd ('HCL') after service of a winding up petition on JCL. Over two years after a winding up order was made against JCL, HCL applied for a validation order in respect of the payments. That application was dismissed after a fully contested hearing.

Approximately one year later, JCL issued an application pursuant to s 127 of the Act seeking restitution of the monies paid by JCL to HCL. In response, HCL raised a change of position defence, asserting that it had

changed its position some months after JCL was wound up by satisfying JCL's debts to a third party, and simultaneously discharging its indebtedness to JCL. The relevant payments were made after the making of the winding up order, but pursuant to the terms of a tripartite arrangement between JCL, HCL and the third party entered into before presentation of the winding up petition.

In addition to refuting the availability of the asserted change of position defence on the facts, JCL asserted that HCL was estopped from raising the defence as a matter of law, or that it would be an abuse of process for HCL to raise the defence, given that HCL's application for a validation order had failed.

What is issue estoppel? As explained by Lord Diplock in *Mills v Cooper* [1967] QB 459:

'a party to civil proceedings is not entitled to make, as against the other party, an assertion, whether of fact or of the legal consequences of facts, the correctness of which is an essential element in his cause of action or defence, if the same assertion was an essential element in his previous cause of action or defence in previous civil proceedings between the same parties or their predecessors in title and was found to be incorrect, unless further material which is relevant to the correctness or incorrectness of the assertion and could not be reasonable diligence had been adduced by that party in the previous proceedings has since become available to him.'

The bar created by issue estoppel can be avoided in special circumstances if injustice would otherwise be caused: *Virgin Atlantic Airways Ltd v Zodiac Seats UK Ltd* [2014] AC 160.

It was common ground in *James Court Ltd (In Liquidation) v Hindsight Contractors Ltd*, that the merits of the change of position defence itself had not been determined on the prior application for a validation order, such that *res judicata* did not prevent HCL from raising a change of position defence. However, JCL submitted that issue estoppel barred HCL from re-litigating an essential

element of the change of position defence, as clarified in *Re MKG Convenience Ltd* and *Re Changtel Solutions UK Limited*, namely whether the court would and should validate the payments.

The judge agreed that HCL's cause of action on the application for a validation order, and its change of position defence both depended on establishing the same essential requirement: that there were exceptional circumstances justifying the exercise of the Court's discretion to make a validation order. She therefore concluded that issue estoppel was *prima facie* a bar to HCL's defence. HCL's contention that there were special circumstances justifying the disapplication of the bar were roundly rejected:

- Firstly, it mattered not that the validation order application had failed solely because the court was not satisfied that the facts relied upon were made out on the evidence, without considering what the legal consequences would have been had those facts been proved;
- Secondly, issue estoppel was apposite to two different applications that have the same essential requirements;
- Thirdly, the refinement of the change of position defence in this context in *Re MKG Convenience Ltd* was of no significance;
- Fourthly, the fact that the questions before the court on an application for a validation order and in considering a change of position defence are qualitatively different was quite usual in a case where issue estoppel applied; and
- Finally, the mere fact that JCL delayed in issuing its application for restitution until after determination of the validation order application was irrelevant.

In the context of re-litigating issues, it was held in *Allsop v Banner Jones Ltd* [2021] EWCA Civ 7; [2022] Ch 55 that the role of the doctrine of abuse of process is much more limited as, generally speaking, for an issue to be the same, it will arise between the same parties. It was entirely accepted by JCL

that HCL were not mounting a 'collateral attack', in the technical sense, on the judgment of the judge who had dismissed HCL's application for a validation order, since 'collateral attack', as a species of abuse of process, applies only where the parties to the subsequent litigation are different. Rather, it was submitted that the abuse of process lay in HCL's attempt to re-litigate the same issue twice.

Having concluded that issue estoppel applied, the judge accepted that there were difficulties in applying the doctrine of abuse of process, following *Allsop v Banner Jones Ltd*. The judge was, however, satisfied that:

- It was 'manifestly unfair' for JCL to be vexed twice with the validation issue in two different sets of proceedings, particularly given that JCL had been required to deal with all elements of the change of position defence and the evidence produced in support of it when that defence was bound to fail because the validation element could not be satisfied; and
- It would bring the administration of justice into disrepute if unsuccessful applicants for validation orders could re-litigate the same issue, relying on new evidence, in response to a restitutionary claim by the company or trustee in bankruptcy.

CONCLUSIONS

Officeholders can take considerable comfort from the judgment in *James Court Ltd (In Liquidation) v Hindsight Contractors Ltd* that they will have an untrammelled route to restitutionary recovery of void payments if an application for a validation order has already been made and has failed.

The case establishes that an unsuccessful applicant for a validation order will be barred by issue estoppel from raising a change of position defence in response to a restitutionary claim, absent special circumstances. No indication was given by the judge as to what might amount to special circumstances in this context, but failing to adduce all relevant and available evidence on the validation order application will not be a sufficient factor.

Feature

Biog box

Jessica Powers is a commercial chancery barrister at New Square Chambers. She has a particular interest and expertise in insolvency, acting for office-holders, creditors, companies and debtors, and, during her five-year appointment to the Attorney General's C Panel, HMRC, the Official Receiver and SSBEIS. Jessica recently appeared, unled, in the Court of Appeal in the widely reported case of *Re Ide*. She is ranked as a leading junior in the Legal 500, who have recognised her as 'a name to note at the junior Bar'. Email: Jessica.powers@NewSquareChambers.co.uk

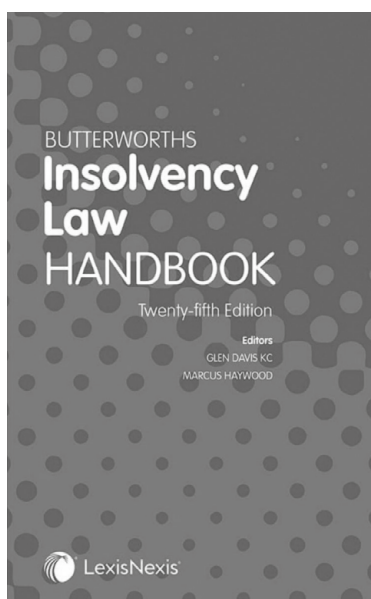
It might also be the case that it will not be open to a respondent to raise a change of position defence in response to a restitutionary claim if any other person has previously made an unsuccessful application for a validation order in respect of the same disposition. So, for example, the doctrine of abuse of process may well be engaged if the recipient of a void payment seeks to oppose a restitutionary claim in reliance upon a change of position defence in circumstances where the company itself made an unsuccessful application for a validation order before being wound up. In those circumstances, the raising of the change

of position defence would likely amount to a collateral attack on the decision of the court to refuse a validation order on the first application. ■

Further reading

- LexisPSL Restructuring & Insolvency; Insolvency Litigation; Claims by an insolvent estate or its insolvency office-holder; Change of position defence not available after unsuccessful validation order application (*James Court Ltd v Hindsight Contractors Ltd*)
- LexisPSL Banking & Finance; Claims and Remedies; Restitution, proprietary claims and tracing; Defences to restitutionary claims
- Restitutionary claims in 'failed' loan documentation (2021) 9 JIBFL 619

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