[2019] EWHC 3927 (Ch)

IN THE HIGH COURT OF JUSTICE
BUSINESS AND PROPERTY COURTS OF ENGLAND AND WALES
INSOLVENCY AND COMPANIES COURT (ChD)

Case No: CR-2017-002950

Courtroom No. 9

7 Rolls Buildings
Fetter Lane
London
EC4A 1NL

9.45am – 10.21am
Monday, 2nd December 2019

Before:
DEPUTY INSOLVENCY AND COMPANIES COURT JUDGE SCHAFFER

B E T W E E N:

TOUCHSTONE RETAIL LIMITED

Applicant

-And-

GRABAL ALOK (UK) LIMITED,
SIMON BONNEY,
PAUL ZALKIN and CARL JACKSON

Respondents

PETER SHAW QC appeared on behalf of the Applicant instructed by Debenham Ottway
JONATHAN LOPIAN appeared on behalf of the Respondents instructed by Royds Withy King

JUDGMENT
(Approved)

DEPUTY INSOLVENCY AND COMPANIES COURT JUDGE SCHAFFER:

1. The application I have before me is made by Touchstone Retail Limited ("Touchstone") within which it seeks, primarily, a declaration that the respondent liquidators ("liquidators") of Grabal Alok (UK) Limited (the company") are not entitled to recover various payments made to Touchstone after the presentation of a petition against the company on 12 April 2017, and/or alternatively those payments are not void under Section 127 of the Insolvency Act 1986.

2. Appearing on behalf of Touchstone was Peter Shaw QC, and for the liquidators Jonathan Lopian. Both filed skeleton arguments, and I am grateful to them for their submissions which concluded late last Thursday 28 November precluding me from handing down judgment at that time.

3. Three witness statements were filed on the application two by Rajpal Singh Sahni ("Mr Sahni") on behalf of Touchstone, and one by Simon James Bonney, one of the liquidators. From that evidence the following facts can be gleaned

3.1 The company was incorporated on 4 July 2001 and traded in over 200 stores as retailers in clothing and wearing jewellery.

3.2 Touchstone entered into a written concession agreement with the company in May 2011 supplying jewellery and other products.

3.3 The sale of Touchstone's products was facilitated by concession stands owned by Touchstone, which operated in the company's stores.

3.4 The concession agreement expressly stated that neither party acted as agent for the other.

3.5 Touchstone's products remain Touchstone's property until sales were made to the company's customers.

3.6 Those stands were staffed by the company's employees who were trained by Touchstone

3.7 The company was to send to Touchstone daily and weekly sales figures.

3.8 Sale receipts were banked in the company's account. Its tills and accounting systems were used, and those receipts were mixed with all other sales receipts and not separately identified. It is also noted that most of the post-petition payments made to Touchstone were out of an overdrawn account.

3.9 The company was entitled to retain 38% of all net sales inclusive of VAT, with an additional 1% if net sales exceeded £2 million in any 12-month period.

3.10 Under the terms of the concession agreement at paragraph 7.2 within 14 days of the month end the company was obliged to send to Touchstone a statement of all sales for that preceding month, and Touchstone was then to send an invoice based on its share of the sales payable within 30 days of receipt of the invoice. Payment terms appear subsequently to have changed (by acceleration) to the advantage of Touchstone, although I can find no documentary evidence of any agreement signed by the company to amend those terms of payment.

3.11 The company was, therefore, contractually obliged to account to Touchstone for the balance of 62% of net sales, as I referred to at 3.10 above.

3.12 The company entered into a company voluntary arrangement on 15 July 2016 at which time Touchstone was owed it appears over £161,000.

3.13 Touchstone was entitled to terminate the agreement when the company voluntary arrangement had been proposed, but chose to support it.

3.14 Under the company voluntary arrangement Touchstone, defined as a critical creditor within the terms of the voluntary arrangement, was to receive 50p in the pound on its crystallised debt. The terms of its concession agreement were to remain extant as to the future supply of its products.

3.15 Touchstone continued to supply its products from July 2016.

3.16 HM Revenue and Customs presented a winding up petition to this court on 12 April 2017.

3.17 The company paid £9,184.20 to Touchstone on 21 April 2017.

3.18 The directors of the company sought to appoint administrators on 28 April 2017, and continued to trade over that period.

3.19 The company paid £8,478.88 for pre-petition products supplied on 2 May 2017.

3.20 The company paid Touchstone £7,629 on 8 May 2017.

3.21 The company paid Touchstone £8,050.33 on 23 May 2017.

3.22 The company paid Touchstone £7,070.17 on 26 May 2017.

3.23 The company paid Touchstone £14,001.18 on 1 June 2017.

3.24 The company paid Touchstone £9,828.28 on 12 June 2017.

3.25 The initial application of administration was withdrawn but the company continued to trade.

3.26 The winding up petition was advertised on 20 June 2017.

3.27 The company paid Touchstone £10,422.81 on 22 June 2017.

3.28 The company made a second application for administration on 23 June 2017.

3.29 The company continued to trade and make losses said to be, by the liquidators, in the region of £3.851 million post-petition.

3.30 The second application for administration was abandoned for reasons which are not materially relevant to this application, and the company was compulsory wound up by this court on 10

July 2017 with unsecured creditor claims estimated at over £4.35 million.

3.31 Touchstone received payments, therefore, totalling £74,877.10 from the company for goods supplied after the petition was presented. There is a small dispute on the figures, as the liquidators say the sum received was £75,305.67.

3.32 The company received and retained £71,524.34, representing part of its share of the net proceeds of those sales, but failed to account to Touchstone for a further sum of £41,817.17 from such sales.

3.33 The supervisors of the company voluntary arrangement advised creditors including Touchstone, of the winding up petition, Touchstone says, for the first time, in their report dated 8 August 2017. I recognise there is a dispute about whether an earlier letter sent by the supervisors of the arrangement in May 2017 was received by Touchstone. However, Touchstone would have received constructive notice of the petition when it was advertised in June 2017.

3.34 In accordance with the supervisors' report dated 8 August 2017 the company voluntary arrangement was terminated with effect from 7 August 2017.

3.35 The liquidators made demand for payment of sums received by Touchstone post-petition, namely, after 12 April 2017, initially in September 2018, and served a statutory demand in October 2018.

3.36 Touchstone applied to this court for relief on 6 December 2018.

THE APPLICANT'S SUBMISSIONS

4 Mr Shaw focused the application as one seeking a retrospective validation order under Section 127 of the 1986 Act, although in the alternative he argued that if any payments were made to the liquidators, to which they now claim they were entitled, this would be unjustly enriching the company, Touchstone having changed its position. He argued that the products supplied were always owned by Touchstone until their sale to the ultimate customer. They were never owned by the company. If the company had gone into insolvency the products would not form part of its assets. They would have been recovered by Touchstone. He further identified the benefits enjoyed by the company in receiving 38% gross profit on each sale concomitant with the obligation to account to Touchstone for the balance. As he put it, the company had no assets before sale. The products had never been owned by them. The only asset the company had was in the form of cash receipts.

5 He submitted the court should retrospectively validate the transactions not only in respect of the post-petition Touchstone receipts of £74,877.10 in respect of post-petition sales, but also post-petition receipts totalling £8,478.88 in respect of pre-petition sales. He maintained that the company had benefitted from these sales in a number of ways. Firstly, it had made a profit from the sales of Touchstone products. He likened it to realisation costs from a property sale where the cash receipts had swelled the assets. Secondly, the company would retain additional sums from post-petition sales, some £41,817.13, which it had not accounted for to Touchstone over and above the sums now sought from Touchstone. Thirdly, the company's ability to remain in business, and its ability to refinance had been dependent on critical creditors, of which

Touchstone was one, continuing to supply. If payments had not been agreed within the CVA terms, the CVA may well have failed as Touchstone would have terminated the commission agreement and not supplied.

6 As for the pre-petition supply and post-petition receipt of £8,478.88 that should also be validated as the company received benefits from it, namely, the continued supply, no termination of the concession agreement and the retaining of the £41,868.83 to which I have earlier alluded.

7 Mr Shaw said that these transactions were for the general benefit of creditors. The same test applied whether the application for the validation was prospective or retrospective. Clearly on that test the company had benefitted, as has the general body of creditors. It had received its share of the sales, and, indeed, had retained some of Touchstone's monies to which it was not entitled. He relied upon the comments of Oliver J in *Re J Leslie Engineers Company Limited* [1976] 1 WLR 292 at p304

> "I think that in exercising discretion the court must keep in view the evident purpose of the section which, as Chitty J. said In re Civil Service and General Store Ltd., 58 L.T. 220,221, is to ensure that the creditors are paid pari passu. Obviously there are circumstances where this cannot in fairness be the sole criterion in cases where, for instance, the creditor concerned has since the presentation of the petition helped to keep the company afloat, or has swollen the company's assets, salvage cases and that sort of thing "

8 The court he said had also to consider the practice direction, and he drew the attention of the comments of the court in *Re A.1. Levy (Holdings) Limited* [1964] Ch 19 quoting from re Gray's Inn Construction Co Ltd [1980] 1 WLR 711 at p 714 at p 719 D-E where Buckley LJ said

> " In re A.I. Levy (Holdings) Limited [1964] Ch 19 the court validated a sale of a lease which was liable to forfeiture in the event of the tenant company being wound up, and also validated, as part of the transaction, payment out of the proceeds of sale of arrears of rent which had accrued before the presentation of the petition for the compulsory liquidation of the company. If that case was rightly decided, as I trust that it was, the court can in appropriate circumstances validate payment in full of an unsecured pre-liquidation debt which constitutes a necessary part of a transaction which as a whole is beneficial to the general body of unsecured creditors "

9 The liquidators' arguments to recover the money were wrong, he said. He reverted to his analogy of a property realisation where the costs of any sale would be validated or where by further example employees, having continued to work post-petition, would be entitled to be paid.

10 Alternatively, the company had been unjustly enriched and a restitutionary defence was available. The company had changed its position. He relied on *Rose v AIB Group Limited* [2003] 1 WLR 2791, a decision of Sir Nicholas Warren, as he then was, where at paragraph 35 he said, quoting Lord Goff in the *Lipkin Gorman v Karpnale Ltd* [1991] 2 AC 548 case:

> 'I do not wish to state the principle any less broadly than this: that the defence is available to a person whose position has so changed that it would be inequitable in all the circumstances to require him to make restitution, or alternatively to make restitution in full'.

11 Touchstone, Mr Shaw maintained, had changed its position making its product available for sale

to enable the company to generate commission and relief should in those circumstances be granted.

THE LIQUIDATORS' SUBMISSIONS

12 Mr Lopian for the liquidators rejected the contentions of Touchstone. This was nothing more than a debtor/creditor relationship. No trust or propriety interest arose in the proceeds of sale, nor was there any fiduciary relationship. Touchstone was seeking to be paid over and above the general body of creditors.

13 Any retention of the title of the products did not impose an obligation to account, nor was there any obligation to hold the proceeds on trust. The company was entitled to and did mix the monies. The company was also entitled to use all the proceeds as they saw fit. Their only obligation was to pay on an invoice being raised.

14 Nothing in Touchstone's evidence, Mr Lopian argued, supported its claim to retrospective validation. Only special circumstances should validate those transactions. The transactions in issue he maintained were not the sales of products to customers, but the payments to Touchstone. Those payments discharged an unsecured debt. Issues of how much benefit the company received through the retention of all sale proceeds or Touchstone's lack of knowledge about the petition were not relevant. He relied on the Court of Appeal decision in *Express Electrical Distributors Limited v Beavis and Others* [2016] 1 WLR 4783.

15 Touchstone took a risk in supporting the company, and the fact it did not pay off did not support retrospective validation. It would, in fact, put Touchstone in a better position than other unsecured creditors. It follows that no exceptional or special circumstances arose here to override the *pari passu* principle. No validation order should be made. The payments to Touchstone were not necessarily part of the transactions. All sales gave rise to a liability, but the company chose to use the money as it wished. If Touchstone had sought a prospective validation order the court will have wanted to see if it benefited the general body of creditors. That would have included the cost of keeping the business alive. Touchstone was similar to any other supplier with a retention of title clause.

TOUCHSTONE'S REPLY

16 In reply Mr Shaw maintained that these were special circumstances. Touchstone enhanced the company's assets. If the test was whether these transactions were for the benefit of the company then they clearly were. If the application failed then the company would also be keeping some of Touchstone's money. Section 127 should not be used to allow that retention. The payments were a necessary expense. The court may well have granted a prospective validation order even if the company was not trading insolvently. Touchstone elected not to terminate because it was being paid. Any commercial decision to continue was irrelevant. The test was whether this was for the benefit of the company.

17 Finally, Mr Shaw maintained that Touchstone did change its position. It fitted within the criteria set out in *Philip Collins Limited v Davis and Another* [2000] 2 AER 808.

THE LAW

18 I start with Section 127 of the Insolvency Act 1986. This states under subsection (1), which is the only relevant subsection,

"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, unless the court otherwise orders, void".

19 In considering any application under Section 127 one has to recognise that any post-petition payments are void. That encapsulates all post-petition dispositions, whether they are harmful or of benefit to the company. It does not matter if they are *bona fide*, made in the ordinary course of business or increase the assets of the company, all are caught necessitating a validation order. The court needs to determine if there has been a disposal of the company's property. Whilst here the products were always owned by Touchstone, when converted to cash and paid into the company's account, a payment out of that account in accordance with the contractual obligation to account must, in my judgment, be construed as a disposition. It is critical to distinguish between the two transactions, the sale of the product and the payment by the company. It is not the sale transaction which the company has to consider. That is not a disposition as it was never company property. It is a payment of monies from a mixed fund, which is the void transaction.

20 No trust arises here, as Mr Shaw accepts, and there is nothing in the concession agreement, as Mr Lopian correctly points out, which placed the company under a fiduciary obligation to account. There is no principal/agent relationship. That is clear from the agreement itself. The money in the account was the company's property, and was not ring-fenced for the benefit of Touchstone. Once in the account the relationship was, as Mr Lopian correctly analyses, one of debtor/creditor.

21 The issue, therefore, I need to determine is whether in all the circumstances of this case the court should make a retrospective validation order. The obligation to do so lies on the applicant to show why the court should do so. As both parties agreed, special or exceptional circumstances must be shown. As indicated by Sales LJ in *Express Electrical Distributors Limited v Beavis and Others* at paragraph 24 where he says at line G:

> 'The court has to look to see whether the transaction in issue, for which validation is sought retrospectively, was one which could properly be regarded as being for the benefit of the general body of creditors, despite the departure from the application of the *pari passu* principle, which will be the consequence of making the validation order, which is sought. (There may be other exceptional circumstances which might possibly justify the making of a validation in a retrospective application case, for example, if a director of the company who knows about the winding up petition suppresses that information and deceives someone into dealing with the company: the merits in such a case will need to be argued out between the person dealing with the company and its liquidator, and I express no view on what the result should be)'.

22 Turning to special circumstances the starting points are outlined in *Denney v John Hudson & Company Limited* [1992] BCLC 901, the headnote of which reads as follows per Fox LJ:

> 'The principles on which the court ought to validate a transaction under

Section 522 of the Companies Act 1985 were as follows:

(a) The discretion of the court under Section 522 is at large subject to the general principles that apply to any type of transaction, and to the limitations on the discretion which flows from the general principles of insolvency law.

(b) The basic principle was that the assets of an insolvent company existing at the time of the commencement of the liquidation should be distributed *pari passu* among the company's unsecured creditors.

(c) There may be occasions where it is beneficial to the company, and also the unsecured creditors, that the company should be able to dispose of some of its assets after a winding up petition has been presented, but before an order has been made.

(d) In determining whether an order should be made under Section 522 the court should ensure that the interests of the unsecured creditors are not prejudiced.

(e) The desirability of the company carrying on its business is often speculative, and the court has to carry out a balancing exercise.

(f) The court should not, except in special circumstances where it was in the interest of creditors generally, validate a transaction which would result in one or more pre-liquidation creditors being paid in full where other such creditors only receive a dividend.

(g) A disposition carried out by the parties in good faith at a time when they were unaware that a petition had been presented would normally be validated unless there are grounds for thinking that the transaction was an attempt to prefer the disponee.

(h) The *pari passu* principle has no application to post-liquidation creditors since such a transaction at full market value involves no dissipation of the company's assets'.

23 As to what are special circumstances, this was explained by Sales LJ in *Express Electricals* to which I have already referred. At paragraph 20 he said, after quoting some comments by Buckley LJ from *Gray's Inn Construction Company Limited* [1980] 1 WLR 711 at line H:

> 'Thus, the policy of the law in favour of distribution of the assets of an insolvent company in the course of the liquidation process on a *pari passu* basis between its unsecured creditors is a strong one, and it needs to be shown that special circumstances exist which make a particular transaction one in the interest of the creditors as a whole before a validation order will be made to override the usual application of the *pari passu* principle'.

MY CONCLUSIONS

24 The court in these applications has a discretion. See my reference to *Denney* at paragraph 22 above. Every case must be considered on its own particular facts within the parameters of respecting the *pari passu* principle in reaching a view as to whether the transactions were of benefit to the general body of creditors. In other words, was the company's position improved by the payments being made? The answer to that question is more difficult when considering a retrospective validation order when events have passed by, and the company by that time is in liquidation. However, in my judgment, the principles remain the same, and whilst the arguments in this case are very finely balanced, in my discretion on the facts here I have reached the view that the post-petition payments made should not be validated for the following thirteen reasons:

24.1 As was conceded by Touchstone there was no trust in place.

24.2 There was no agent principal relationship, and hence no fiduciary relationship or obligation outside the normal contractual obligations imposed on the company.

24.3 The concession agreement did not, within its terms, preserve Touchstone's share of the proceeds of sale or direct payment from any nominated account to it.

24.4 It is not the sales which are sought to be validated by Touchstone but the payments for which purpose the circumstances surrounding those payments need to be considered, and whether those circumstances were special.

24.5 The sale receipts were paid, by agreement, into the company's own general account.

24.6 That account held mixed funds from sales of goods originating from numerous suppliers.

24.7 Touchstone's monies could not be clearly identified from that account.

24.8 The monies in the account were exclusively the property of the company.

24.9 The relationship between Touchstone and the company when payments were made could only have been that of creditor/debtor.

24.10 Invoices having been raised by Touchstone for payment by the company the company chose to pay Touchstone from its account to discharge its contractual liability to it.

24.11 Critically in my judgment it made that payment to Touchstone in preference to other creditors, in particular, the Crown.

24.12 Touchstone's argument that it enhanced the company's assets by retaining its commission on sales may have merit, but its claim is no different to that of any other creditor who either agreed the company could sell its goods on the basis that the company accounted to it for the net proceeds of sale to which it was contractually entitled to receive, or sold its goods to the company but for which it was never paid.

24.13 In making payments to Touchstone and no other creditors the company was not treating those

other creditors on a *pari passu* basis when those payments were being made post-petition.

25 In any retrospective application for validation, as is the case here the court has to take into account what has happened with the company. Ultimately the company could not be saved and went into compulsory liquidation. Between the time the petition was presented and the winding up order efforts were made to place it into administration, but it is important to recognise that the success of those attempts at administration was dependent on fresh financing, so far as the first application was concerned, or a prepack sale, so far as the second application was concerned. Over that period the company's financial position worsened to the detriment of the general body of creditors. That was the view of the joint liquidators in their evidence, see paragraph 9 of Mr Bonney's witness statement dated 5 March 2019 when he concluded that losses of £3.851 million had been sustained in the post-petition period, a view that was not challenged by Touchstone in its evidence in reply.

26 Here, therefore, I can see no special circumstances which would persuade the court to validate the payments. Touchstone received payment from a general mixed fund as a creditor unlike many others who received nothing. In addition, whatever the benefits the company took by way of commission were far outweighed by the trading losses it suffered. If the application had been a prospective one the court would have looked closely at the company's trading position in accordance with its Practice Direction, and in all probability, although I recognise this is hypothetical, would have declined to make the order when it was faced with a faltering CVA, and an outstanding administration order, depending on fresh capital injection.

27 As was put so aptly by Buckley LJ in *Gray's Inn Construction* the court has to carry out a balancing exercise. He went on to say that the court must always do its best to ensure that the interest of unsecured creditors will not be prejudiced. Regretfully, Touchstone falls on the wrong side of that exercise, and the unsecured creditors who are entitled to a *pari passu* distribution of the monies in the account would, absent repayment, be prejudiced. As Sales LJ said in the *Express Electrical* at paragraph 56:

> 'The true position is that, save in exceptional circumstances, a validation order should only be made in relation to dispositions occurring after presentation of winding up petition if there is some special circumstance which shows that the disposition in question will be (in a prospective application case) or has been (in a retrospective application case) for the benefit of the general body of unsecured creditors, such that it is appropriate to disapply the usual *pari passu* principle'.

Here there is insufficient, in my judgment, to disapply that principle.

28 That leaves the secondary argument raised by Mr Shaw that Touchstone has changed its position by continuing to allow its product to remain with the company. The question I ask myself is whether Touchstone's position has "so changed that it would be inequitable in all the circumstances to require it" to repay the monies? The *Rose* decision, to which I have already referred at paragraph 10 opened the door to this defence, even if the court refused to validate a void disposition. As the Court there acknowledged, the defence has to be considered on a case-by-case basis.

29 In *Philip Collins Limited* (see paragraph 17 above) Jonathan Parker J when analysing a change of position defence set out four conjunctive principles to engage the defence, At page 827 of the judgment at paragraphs D to H, he said this:

> 'In the first place, the evidential burden is on the defendant to make good the defence of change of position. However, in applying this principle it seems to me that the court should be beware of applying too strict a standard. Depending on the circumstances it may well be unrealistic to expect a defendant to produce conclusive evidence of change of position, given that when he changed his position he could have had no expectation that he might thereafter have to prove that he did so, and the reasons why he did so in a court of law (see the observations of Slade LJ in *Avon CC v Howlett* [1983] 1 All ER 1073 at 108-1086, [1983] 1 WLR 605 at 621-622, and in *Goff and Jones* at page 827). In the second place, as Lord Goff stressed in the passage from his speech in the *Lipkin Gorman* case quoted above, to amount to a change of position there must be something more than mere expenditure of the money sought to be recovered, "because the expenditure might in any event have been incurred in the ordinary course of things". In the third place, there must be a causal link between the change of position and the overpayment. In *South Tyneside Metropolitan BC v Svenska International Plc* [1995] 1 All ER 545 Clarke J, following Hobhouse J in *Kleinwort Benson Limited v South Tyneside Metropolitan BC* [1994] 4 All ER 972, held that, as a general principle, the change of position must have occurred after receipt of the overpayment, although in *Goff & Jones* the correctness of this decision is doubted (see pp 822-823). But whether or not a change of position may be anticipatory, it must, as I see it, have been made as a consequence of the receipt of, or (it may be) the prospect of receiving the money sought to be recovered: in other words, it must, on the evidence, be referable in some way to the payment of that money. In the fourth place, as Lord Goff also made clear in his speech in *Lipkin Gorman* case, in contrast to the defence of estoppel the defence of change of position is not an, "all or nothing" defence; it is available only to the extent that the change of position renders recovery unjust'.

30 What Mr Shaw says is that Touchstone meet all those four tests. Firstly, the evidential burden is on Touchstone but I am in some doubt on the evidence that this is established. Secondly, the change of position must be something more than expenditure that might have been caused in the ordinary course of business. Here the change of position was a conscious decision in not taking steps to remove its product. That was in my judgment a commercial decision on its part. See paragraph 12 of Mr Sahni's second witness statement. Indeed, he goes further at paragraph 17 of that same witness statement conceding that Touchstone's approach to payment had to be "subtle", and that any threat to remove stock by exercising its retention of title clause would have compromised its ongoing relationship. From that I conclude that Touchstone did not change but in fact consciously maintained its position. It kept matters as they were, but was using the threat of removing stock as a vehicle to secure payment. It could have terminated the concession agreement but it chose not to, and there was no evidence put before me that Touchstone ever seriously thought of doing so and removing its product. Indeed, the evidence all points the other way.

31 Thirdly and in any event there has to be a causal link between the change of position and here, the decision to do nothing. If it is linked to the pressure to recover monies outstanding that the evidence shows the causal link is broken, as after the email of 20 April 2017 Touchstone received all the payments, which are now subject to the repayments sought to be recovered by the liquidators.

32 Fourthly, the defence is only available if the change of position makes recovery unjust. Given what I have said above, I do not think in this case that arises on the facts I have found.

33 For all of the above reasons the application fails.

End of Judgment

Transcript from a recording by Ubiqus
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This transcript has been approved by the judge.