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Case No: CR-2021-BHM-140
CR-2021-BHM-141

IN THE HIGH COURT OF JUSTICE
BUSINESS AND PROPERTY COURTS IN BIRMINGHAM
Insolvency and Companies List (ChD)

Birmingham Civil Justice Centre
Bull Street, Birmingham B4 6DS

Date: 04/11/2021

Before :

HHJ DAVID COOKE

- -

Between :

JT Development Solutions Ltd (1) **Citrus Training Solutions Ltd (2)**	**Applicants**
- and -	
Secretary of State for Education acting through the Education Skills Funding Agency	**Respondent**

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Mark Anderson QC and Iqbal Mohammed (instructed by **ORJ Law Ltd**) for the **Applicants**
Giselle McGowan (instructed by **Womble Bond Dickinson (UK) LLP**) for the **Respondent**

Hearing date: 12 October 2021

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Approved Judgment

I direct that pursuant to CPR PD 39A para 6.1 no official shorthand note shall be taken of this Judgment and that copies of this version as handed down may be treated as authentic.

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HHJ David Cooke:

Introduction

1. These are two applications by related companies seeking to restrain presentation by the Respondent Secretary of State of petitions to wind them up. The applicants (respectively "JTD" and "Citrus") entered into contracts with the Respondent, who now acts through the Education Skills Funding Agency and whom I will therefore refer to as "ESFA", for provision of training to apprentices, in respect of which they applied for and received substantial amounts of public funds by way of support for that training. By invoices dated (as amended) 17 February 2021 EFSA sought repayment of £353,509.32 from Citrus and £96,481.10 from JTD. Solicitors acting for EFSA sent letters dated 8 March 2021 demanding payment of those amounts by 29 March and threatening to present winding up petitions if it was not made. By these applications the applicants seek to restrain presentation of any such petition, on the ground that their liability for the amounts demanded is disputed and should be determined in ordinary proceedings under CPR Pt 7 and not by the Companies Court.

2. The relevant law is well known. The court may restrain presentation of a petition to wind up a company if satisfied, on application by the company, that the petition would be an abuse of process. A petition based on a debt that is genuinely disputed, on substantial grounds, by the company is an abuse of process because the standing of the petitioner as a creditor is in dispute and the Companies Court is not equipped, by virtue of the nature of the proceedings before it, to resolve that dispute. It is the settled practice of the Companies Court to dismiss such petitions if they come before it.

3. Mere assertion of a dispute is not however sufficient, the court must be satisfied that the dispute is genuine and based on substantial grounds. It is prepared to examine the evidence to ascertain whether grounds put forward are substantial or a "cloud of objections" without substance. If the evidence raises a dispute of fact which must be resolved in order to establish the debt, and which is such as to require cross examination of witnesses, that must be done in a conventional trial. Again however not every asserted dispute of fact is such as to require trial; the court may in an appropriate case conclude that the evidence asserted to dispute the debt is incredible or, to put it another way, has no real prospect of being accepted at trial.

4. While the court may be able to deal with short points of construction on hearing an application for an injunction, where difficult points arise, and particularly any that may require consideration of the factual context, that is likely to require to be dealt with in ordinary proceedings.

5. The onus is on the company to establish that a petition would be an abuse. The exercise performed by the court is very similar to that which would be required if the company were facing an application for summary judgment, though of course unlike a summary judgment application, the company will not have set out its defence by way of pleadings.

6. As examples of cases setting out these propositions, Ms McGowan referred me to *Coilcolor Ltd v Camtrex Ltd* [2015] EWHC 3202 (Ch) at [32]-[35], *Re a Company (No 006685 of 1996)* [1997] 1 BCLC 639 and *Angel Group Ltd v British Gas Trading Ltd* [2012] EWHC 2702 (Ch), among others. Mr Anderson and Mr Mohammed do not dissent in any respect.

Factual background

7. This is set out at some length in the witness statements before me, but I will abbreviate it greatly to set out only the matters material to the issues before me.

8. EFSA is an executive agency sponsored by the Department for Education. It provides funding for apprenticeship training under two types of contract, depending on whether the apprentices are employed by large employers (with a pay bill exceeding £3m) who pay an Apprenticeship Levy or not. These are referred to as Levy Agreements (or "LAs") and Non-Levy Agreements (or "NLAs") respectively. There are three contracts relevant to these applications:

   i) A Levy Agreement with Citrus (the "Citrus LA") dated 6 April 2017.

   ii) A Non-Levy Agreement with Citrus (the "Citrus NLA") dated 9 January 2018.

   iii) A Levy Agreement (the "JTD LA") dated 12 October 2017.

   The two Levy Agreements are in materially similar terms. The Citrus NLA is in a different format.

9. All the agreements require the training provider (ie Citrus or JTD) to comply with the "Funding Rules" from time to time in force. These are sets of standard terms published by EFSA and modified from time to time at its discretion. I am told that during the lifetime of these agreements there were six versions of the Funding Rules in force, though the provisions relevant for my purposes did not change in any material respect and I was therefore referred only to the version published for the academic year 2017-8.

10. These agreements were terminated as follows:

    i) The Citrus NLA was terminated by notice given by EFSA on 15 February 2019, relying on an adverse assessment of Citrus's financial health as shown by its latest accounts.

    ii) The Citrus LA was terminated by notice given by EFSA on the same day, but in this case relying on a 30 day notice provision.

    iii) The JTD LA was terminated by notice given by JTD dated 6 September 2019, relying on the same 30 day notice provision.

11. After termination of all the agreements, in November 2019, EFSA undertook audits of the records kept by Citrus and JTD with a view to checking whether they complied with requirements of the Funding Rules. These consisted of examination of the various physical and digital records provided by the two companies for a sample of 40 Citrus trainees (8 under the Citrus LA and 32 under the Citrus NLA) and 30 JTD trainees. Neither company was consulted or involved in this process, other than by being asked to deliver its records to the auditors.

12. An audit report was sent to each company with an email dated 20 December 2020 from Mr Ataul Ali saying "Please find attached a copy of our final report containing the findings and opinion arising from [the audit]…If you require any further information, please do not hesitate to contact me." Mr Macnamara, the director of both applicants who has filed a witness statement in support of their applications, says

however that when he spoke to Mr Ali he was told Mr Ali had not taken part in the audits and could give no information about them.

13. The audit reports are in similar format. That for Citrus (bundle p 743) includes the following:

    i) It says at para 5 “We have calculated actual errors totalling £453,957…we seek to correct the value of your funding claim to account for the funding that you have not claimed in accordance with the contractual requirements… We have instigated recovery action for all amounts by issuing an invoice.”

    ii) It contains a table headed Annex A (p 748) from which it appears that errors were said to have been found in all the sample cases examined, and that the “value” of those errors was said to be the full amount of funding paid to Citrus for the sampled trainees. That 100% error rate had been extrapolated to assume that there were also errors in relation to all the trainees whose records had not been examined, and in consequence the “value” of those assumed errors was equal to the whole amount of funding paid for the unsampled trainees. That produced the total amount referred to in para 5 as “actual errors totalling £453,957”.

    iii) A schedule headed Annex B is in a table format with sixteen subheadings. Each refers to a particular alleged deficiency in the records examined. So for instance the first is headed “Eligibility of funding”, refers to relevant provisions of the Funding Rules and then states “Issues/Findings. We identified 15 learners where the processes and documentation in the learner file do not confirm learner eligibility for the programme.”

    iv) In some cases the issues were said to relate to all the sampled cases. One particularly relied on by Ms McGowan was heading 1.3 “Negotiated price. .. For all learners within the sample no negotiated price breakdown has been provided to confirm if all costs within [the] total price agreed are eligible costs.”

    v) There are further columns in the table; one headed “Recommendation” is presumably intended to contain a proposal for remedial action but is in each case marked “N/A due to termination of contracts…”. Another headed “Provider response” is marked “N/A” in every case.

    vi) None of the errors identified relates on the face of it to an amount of money that could be said to be, in a direct sense, its “value”. The amounts ascribed in the reports represent the funding given for the trainees whose records are said to be inadequate, rather than directly to the errors identified.

14. The audit report for JTD is in a similar format; it also finds errors in all the sampled records and the 100% error rate is then extrapolated to all the trainees for which JTD had been funded and accordingly concludes that the “value” of those errors is the whole amount of funding paid, over the period of the contract, to JTD, ie £429,895.

15. Initially, invoices were issued for the recovery of the full amounts so stated. The applicants contend that the total so claimed (£883,852) was in fact some £62,000 more than they had actually been paid (£821,655).

16. The revised invoices now relied on are for lower amounts. In correspondence, EFSA's solicitors said on 20 December 2020 (p 1229) that while it would continue to rely on the audits of the sampled files in each case, and on the extrapolation in respect of the Citrus NLA trainees, it would now audit all the available files for LA trainees of both companies and adjust the amount claimed based on the results. In the event however, no further audit report was produced and the revised invoices are said to be based therefore on:

    i) Only the sampled files under the two Levy Agreements, and

    ii) All the trainees funded under the Citrus NLA, maintaining the extrapolation of the sampled files to the whole body.

17. The applicants raise a number of objections to this process; in particular:

    i) They were given no opportunity to comment on or respond to the alleged deficiencies in the records before the reports were produced, or before the conclusions stated in them were used to decide to demand repayment of the entirety of their funding. The first they knew of any of these matters was when they received the "final reports" which announced the decision to issue an invoice to recover all the funding provided..

    ii) Although EFSA has maintained since that the companies had the opportunity to "engage" with the reports after they had been served, or put forward their response, there was in truth no reality in that suggestion. The column for any response by them had been closed off as "N/A" before they even saw the report, which was stated to be "final", and they were not asked to provide any response but only to say if they sought "further information" about what had already been decided.

    iii) They were not even told which trainees' records had been included in the samples, and so could not check the records themselves to see whether the conclusions drawn by the auditors were justified. In some cases at least, they maintain that there is scope for challenge; for instance they are found not to have included a signed summary sheet with a checklist of the various eligibility and other requirements but, they say, the Funding Rules do not specifically require such a checklist and the information that would be translated onto it is in any event available in the underlying documents. It was said that they failed to document having verified that the trainee's age satisfied the Funding Rules, but, they say, each trainee signed an application form that recorded his date of birth, from which it could be seen whether he was eligible for funding. The applicants have now been provided with the auditors' working sheets, from which the sampled cases could be identified and more detail gleaned as to what the deficiencies found on each file were, but that did not happen until March 2021, long after the original reports and invoices, and even after the dates of the revised invoices now relied on.

    iv) EFSA has made no attempt to assess whether the alleged deficiencies show any actual loss, in the sense of funding paid for training that did not take place or where either the trainee themselves or the training provided were in fact ineligible for funding, or the degree of any real risk of such loss, but simply determined that any error found, however serious or trivial, justifies the recovery of all the funding provided. Mr Anderson points out that there has

been no complaint by any employer in relation to the training provided, and there is no evidence that any trainee funded was in fact not eligible to be funded, or that funding has actually been claimed for any training costs that were not eligible to be funded.

Relevant provisions of the agreements and the proposed defences

18. In view of the overall conclusion I have reached on this application that the alleged debts are genuinely disputed on substantial grounds which may have to be adjudicated on in a future trial, I shall keep what follows to the minimum necessary to explain that conclusion. I am not, of course, deciding whether any of the proposed defences will or will not succeed in due course.

19. In relation to each of the Levy Agreements, EFSA relies for its ability to recover funding on clause 10.2 which provides:

> "The [ESFA] reserves the right to recover from the Training Provider any Funding paid to the Training Provider … where the payment of Funding or any arrangement between the Employer and the Training Provider does not comply with the Funding Rules. The [ESFA] will act reasonably and proportionately in exercising its discretion to recover any sum from the Training Provider under this clause"

20. It also points to clause 5.1 which provides:

> "In order to receive payments from the [EFSA], the Training Provider agrees to:
>
> … c. comply at all times with the requirements detailed in the Funding Rules."

21. Mr Anderson refers me also to clause 10.3 as follows:

> "If [EFSA] becomes aware of a significant number of errors in any data or information provided by the Training Provider, [EFSA] shall give the Training Provider the option to either correct the errors and resubmit the data or information, or accept a reduction in the amount of Funding payable."

22. Mr Anderson submits that there has been no attempt to comply with clause 10.3. The auditors' investigation identified what they must have considered to be a significant number of errors in information provided by the companies, namely the compliance records kept, but gave no opportunity to correct that information before determining to recover all the funding paid. Ms McGowan counters that the evidence from the companies filed subsequently shows that they had no staff remaining or further documents or records from which they could have made any corrections, but I do not consider that is a conclusive answer- firstly if the provider was entitled to be given a chance to correct its records it is not in principle an answer to show that it could not in the circumstances have done so, and secondly it is not in any event possible in my view to say at this stage that the provider could not have done anything by way of correction that would not have been relevant to the outcome. For instance, insofar as the criticism is that there was not a summary or checklist of compliance requirements,

if it is the case, as the company contends, that the underlying information is in the records, the checklist can now be compiled from those records. If some but not all of the information is there, it would be possible to identify what was missing so that a view could be taken on its significance.

23. Mr Anderson further submits that there has been no attempt to comply with the contractual obligation in cl 10.2 to act reasonably and proportionately in exercising a discretion to make recovery. That requires, he submits, an assessment of the proportionality of the recovery sought to the seriousness of the breach found, and also a reasonable approach to the procedure employed, neither of which has occurred. Ms McGowan submits that the breaches identified were as to fundamental requirements of the funding scheme, such as the eligibility of the trainee to be funded and the "negotiated price" requirement, and accordingly a 100% recovery is inevitably justified.

24. The "negotiated price" obligation is a provision of the Funding Rules that requires the provider to negotiate a price individually for each trainee's funding and in doing so not to charge for any training that the trainee does not actually need. There is an obligation to keep in the records a breakdown of the price charged and what elements it covers, so that it can be seen that it does not include any ineligible items. In the case of both companies however there was no breakdown in any of the records, only a statement of the overall price agreed for the training package. It is said that individual trainees may have had prior experience or learning which meant that they did not need the full package of training available, and if so the Funding Rules require that the provider should identify and only charge for the elements that are actually needed. Whether this had been done could not be established without a breakdown of the price.

25. It is further said that the companies did not document any checks of their own into the entitlement of the trainees to work in the UK, as was required. The companies do not appear to deny this, though they point out that their records show that trainees were in fact employed, implying they say that their employers must have satisfied themselves as to the right to work.

26. There is, in my view, an argument that cannot be summarily dismissed that the obligation to act reasonably and proportionately required EFSA to make some assessment of the seriousness of the risk that these alleged faults posed, rather than simply demanding a 100% recovery in all cases. Further, it is reasonably arguable that even a breach of a requirement related to eligibility does not necessarily make it proportionate to seek full recovery. For instance, even if there had been a failure in every case to document an itemised negotiated price it may be unlikely that all of the training provided to all of the trainees was in fact ineligible for funding.

27. Further, the companies allege that during an earlier inspection, conducted before the agreements were terminated and therefore at a time when EFSA were motivated to ensure compliance with record keeping requirements while provision of training continued, rather than recovery of funds when it had ceased, the failure to keep itemised price records was pointed out but they were told that they need not go back and correct the records for trainees already on the books; they should however ensure that they made and retained the required information for future cases. EFSA has not provided any evidence directly contradicting this, but Ms McGowan submits I should find it is so unlikely as to be incredible, and in any event that it would apply only to one company. I do not however consider it inherently incredible that an inspector

would have acted as alleged. Whether any such indication was given, and if so in what terms and whether it should be construed as applying to one company or both, are matters of fact that cannot in my judgment be fairly determined without hearing the witness evidence. If there was any such assurance, there will clearly be an issue as to its effect and whether, for instance, the obligation to act reasonably and proportionately required it to be taken into account. That too could not be fairly determined in summary proceedings.

28. In relation to the Citrus NLA, EFSA relies on clause 12 of the NLA agreement, which is headed "Funding and Payment" and in particular on cl 12.10 which provides:

> "Where the ESFA carries out a review, investigation or audit of a sample of the evidence which the Contractor is required to provide under the Contract to support the payments made by the ESFA and identifies errors in that evidence which it deems are material, the ESFA reserves the right at its absolute discretion to require the Contractor to carry out 100% audit of all or part of the Services and/or to recover from the Contractor an amount based on the error rate identified and the total value of the Contract. Such amounts may be recovered by making adjustments to data submitted by the Contractor under the Contract, or by raising an invoice for payment by the Contractor, or making deductions from future payments due to the Contractor under the Contract. Failure to settle such amounts by the Contractor will constitute a Serious Breach under Clause 21 of the Contract. The decision of the ESFA as to the amount of recovery under this Clause is final."

29. EFSA'a position is that this clause is engaged because it has carried out an audit and found material errors in the NLA files sampled. It has not exercised its right to require a "100% audit" (it is not obvious why the clause envisages that such an audit would be carried out by the Contractor rather than EFSA, but nothing turns on that) and so is entitled to recover "an amount based on the error rate identified and the total value of the contract". This either means that the "amount" is always 100% of the funding on the files where errors were found, extrapolated to the whole number of trainees (and as the error rate was 100% the extrapolation results in recovery of all the funding provided) or, if the "amount" is not automatically 100% of the funding, EFSA has determined that it should be in this case, and by virtue of the final sentence its determination is final.

30. Citrus's position is that on the proper construction of this clause, "an amount" does not automatically mean 100% of the funding provided in every case where an error is found, and if it does not have that meaning, and despite the apparently absolute wording, designation of EFSA's decision as to the amount of recovery as "final" does not mean that it is entitled arbitrarily to require 100% recovery irrespective of any consideration of the seriousness of the breach.

31. Mr Anderson and Mr Mohammed point to clause 21 of the NLA agreement, which is headed "Breach" and classifies breaches of the agreement as "Minor" or "Serious" depending on whether (in general) they "materially or substantially affect the performance or delivery of the Services". A breach of record keeping obligations does not affect the delivery of the training and so in itself should be considered a "Minor" breach. Insofar as cl 12.10 specifies a deemed "Serious" breach, that is not the record

keeping error itself, but failure to pay the amount (properly) demanded for repayment in consequence of that error. The remedy provided for a "Minor" breach is only that a notice may be served requiring it to be rectified, and that if it is not then rectified it is then deemed to be "Serious". Construing the agreement as a whole, cl 12.10 does not require or permit that a "Minor breach", in respect of which no rectification notice has been given, should entitle EFSA to recover all the funding it has provided.

32. This is not, in my judgment, the sort of short point of construction that could properly be dealt with either on this application or in winding up proceedings. It requires consideration of the language of the contract against the context in which it operates, which in turn may require consideration of potentially disputed factual evidence.

33. Further, Mr Anderson and Mr Mohammed submit that if either clause 12.10 of the NLA or cl 10.2 of the LAs has the meaning contended for by EFSA, they amount to unenforceable penalties. Ms McGowan counters that it is of course no longer the law that a sanction for default that does not represent a genuine pre-estimate of loss is to be deemed a penalty; instead the court will consider whether it is exorbitant or unconscionable when measured against the non-defaulting party's legitimate interest in protecting itself against breach. EFSA has an obvious legitimate interest in protecting the public money it deals with by securing compliance with the Funding Rules. No doubt that is so, but the requirements of the Funding Rules are extensive and detailed, and obviously vary in the degree to which non-compliance represents any real risk to public funds. It is, it seems to me, a matter properly arguable whether a contractual provision entitling EFSA to determine in its absolute discretion whether a breach of any of those provisions is "material", and if so to recover 100% of the funding it has provided irrespective of the degree, objectively considered, of risk to public funds, is "exorbitant or unconscionable" when set against the interest it seeks to protect.

Conclusion

34. For these reasons, in my judgment the claims made are defended on genuine and substantial grounds, the appropriate forum for resolving those disputes is in ordinary proceedings and not by way of a winding up petition and the injunction sought should be granted.

35. This judgment will be deemed handed down, without attendance, by release of copies of the final approved version to the parties and to BAILII. I invite parties to submit an agreed order. If there are matters arising that cannot be agreed parties should contact my clerk with an agreed time estimate and availability for a hearing, which may be listed on the day of handing down or thereafter.