FIRST DIVISION, INNER HOUSE, COURT OF SESSION

[2018] CSIH 7
CA225/14

Lord President
Lord Drummond Young
Lord Malcolm

OPINION OF THE COURT

delivered by LORD DRUMMOND YOUNG

in the reclaiming motion by

STEWART MACDONALD and PAMELA COYNE, the joint liquidators of GRAMPIAN MACLENNAN'S DISTRIBUTION SERVICES LTD

Pursuers and Reclaimers

against

CARNBROE ESTATES LTD

Defenders and Respondents

Pursuers and Reclaimers: McBrearty QC, Ower; Harper Macleod LLP
Defenders and Respondents: Lord Davidson of Glen Clova QC, Sanders; DAC Beachcroft Scotland LLP (for Levy & McRae, Glasgow)

23 January 2018

Introduction

[1] The pursuers are the liquidators of Grampian Maclennan's Distribution Services Ltd ("Grampian"). On 12 September 2014 the first pursuer was appointed provisional liquidator of Grampian, and at a meeting of creditors held on 21 November 2014 both pursuers were appointed liquidators. On 24 July 2014 Grampian had granted a disposition of heritable property at 9 Stroud Road, East Kilbride ("the property"), in favour of the defenders for a

stated consideration of £550,000. The disposition was registered in the Land Register on 25 July 2014, with title number LAN86957. Following their appointment as liquidators the pursuers raised proceedings for reduction of that disposition and an order ordaining the defenders to execute a disposition of the property in favour of the pursuers on the ground that the disposition was a gratuitous alienation falling within section 242 of the Insolvency Act 1986. Following a proof, the commercial judge held that the consideration granted for the disposition was adequate in the particular circumstances in which it was granted, which is a defence under section 242(4)(b). He therefore assoilzied the defenders from the conclusions of the summons. The pursuers have reclaimed against the commercial judge's interlocutor.

Facts

[2] Grampian's business was established in 1984. It ran a distribution service throughout Scotland and in other parts of the United Kingdom. For many years it was controlled by Mr Derek Hunter and his wife, Mrs Hazel Hunter, who held all the shares in the company; Mr Hunter was the sole director. The centre of Grampian's operations was at the property, which consisted of an industrial unit on the Kelvin Industrial Estate in East Kilbride. That property was Grampian's principal asset. It comprised a warehouse, a vehicle workshop and a yard with a gatehouse. These were situated on an area of 4.4 acres. The buildings had been constructed during the 1970s. The yard was sufficiently large that part of it could have been sold separately from the buildings. Grampian had purchased the property in August 2005 for a price of £630,000. It obtained loan facilities from the National Westminster Bank PLC ("NatWest"), and in return it granted a standard security over the property in favour of NatWest together with a bond and floating charge over its assets.

[3] In March 2013 DM Hall, chartered surveyors, were instructed to provide a valuation for the property. They valued it at £1.2 million on the open market. If a restricted marketing period of 180 days were assumed, however, they indicated that that valuation would fall to £800,000. The buildings were noted as requiring maintenance and repair. By early 2014 it had become apparent that Grampian was encountering financial difficulties. In May 2014 Mr Hunter consulted an independent insolvency practitioner in order to obtain advice as to whether he should place Grampian in members' voluntary liquidation. At that time Mr Hunter thought that if the property were sold Grampian would have sufficient assets to allow for a distribution to the shareholders after paying all sums due to creditors. That belief was supported by the valuation that had been provided by DM Hall. Nothing further occurred in May 2014.

[4] In July 2014, however, Mr and Mrs Hunter sold their entire shareholding in Grampian to Mr Kevan Quinn. Mr Quinn became the sole shareholder and director. He had discussed Grampian's problems in detail with Mr Hunter, but hoped initially that he could turn the business round and make it profitable. At that time Grampian owed in excess of £1 million to its two principal creditors, HM Revenue and Customs and NatWest. Loan repayments of approximately £4,600 per month were due to NatWest. Shortly after Mr Quinn took over the company, it became clear to him that Grampian could not meet its obligation to pay that amount each month, and NatWest indicated that it was not prepared to support Grampian any further. No alternative source of funding was available, at least in the short term. Moreover, at approximately the same time the finance company that provided invoice finance withdrew their factoring facility and were not prepared to provide further support. This obviously created serious difficulties for Grampian's cash flow; in the witness statement that forms part of his evidence Mr Quinn stated that cash flow

"collapsed" at this point. Mr Quinn considered alternative funding but quickly realized that none was available, and certainly not available quickly. He did, however, make sure that Grampian's trucks, which were all on hire purchase contracts, were sold off; the principal advantage of this was to cut outgoings, as there was little equity in the trucks. It is thus apparent that by late July 2014 Grampian was in very serious financial difficulties. In view of the withdrawal of the factoring facility and the disposal of the trucks, it seems that its business had to cease at this point.

[5] Throughout this period Mr Quinn discussed Grampian's financial position with Mr James Gaffney, who was and remains the sole director and shareholder of the defenders. The defenders are a company carrying on business in the fields of haulage, plant hire and property. Mr Quinn and Mr Gaffney had had business dealings with each other for 30 years. They had previously been directors of the same company. The registered offices of Grampian and the defenders were at the same address. The defenders had previously expressed an interest in acquiring Grampian's property. In April 2014 the defenders' solicitor had written to Grampian to state that the defenders would be willing to pay £900,000 for the property. That was not a formal offer, and Grampian, which was still owned and operated at the time by Mr and Mrs Hunter, did not respond to it.

[6] On 24 July 2014 Grampian sold the property to the defenders for a price of £550,000, and thereupon granted the disposition whose reduction is now sought. The property had not been exposed on the open market; it was sold on an off-market basis following private negotiations between Mr Quinn and Mr Gaffney. The defenders' purchase of the property was financed by a loan from the Bank of Scotland PLC. In accordance with standard practice, the Bank of Scotland instructed a valuation from DM Hall. DM Hall valued the property at £1.2 million on the open market, or £800,000 if a restricted 180-day marketing

period were assumed; these were the same figures as in the valuation made in March 2013. On 28 July the Bank of Scotland wrote to the defenders' solicitors, Peterkins Robertson Paul, to express concern at the apparent discrepancy between the open market value as estimated by DM Hall and the price that had actually been paid by the defenders; they feared that their standard security might be adversely affected if a liquidator of Grampian sought to challenge the transaction as a gratuitous alienation. Peterkins Robertson Paul replied on the same date to the effect that, because NatWest were calling for payment under threat of enforcing their securities, there was no willing seller and no willing buyer for the property. As a result the six-month window (the 180-day marketing period) in which to dispose of the property was absent. Moreover, DM Hall considered that even with a marketing period of 90 days the property valuation could be reduced by 50%. On that basis Peterkins Robertson Paul had put through the transaction at £550,000. Following that response, on 15 August 2014 the Bank made a loan of £600,000 to the defenders. This was secured by a standard security over the property.

[7] On 18 August 2014 the defenders made a payment of £473,604.68 to Grampian. That was the sum that was then due by Grampian to NatWest, and the sum received by Grampian was immediately paid to NatWest in settlement of the whole of Grampian's indebtedness. In return, NatWest discharged the security that had been granted by Grampian in their favour over the property. Although the liability of Grampian to NatWest was extinguished, its other liabilities, principally the debt due to HM Revenue and Customs, were not paid, and following the sale of the property it lacked sufficient assets to make payment of anything more than a small part of those liabilities. HM Revenue and Customs initiated proceedings in Edinburgh Sheriff Court for the winding up of Grampian on the basis of unpaid tax due by Grampian amounting to approximately £550,000. As already

noted, the first pursuer was appointed provisional liquidator of Grampian on 12 September 2014, and at a meeting of creditors held on 21 November 2014 the pursuers were appointed joint liquidators of the company. In June 2016 the balance of the price of the property, £76,395.32 (the agreed price of £550,000 less the sum of £473,604.68 paid to Grampian on 18 August 2014) was paid by the defenders to Grampian. This followed an undertaking given by counsel in advance of the proof in the present action.

Court proceedings

[8] Thereafter the liquidators initiated the present proceedings for reduction of the disposition granted by Grampian in favour of the defenders. The proceedings were intimated to the Bank of Scotland, which has not entered the process. Following sundry procedure the action proceeded to a proof in the Commercial Court which, as we have noted, resulted in a decree of absolvitor. The contention for the liquidators was that the sale by Grampian to the defenders in August 2014 was at a significant undervalue, and therefore constituted a gratuitous alienation falling under section 242 of the Insolvency Act 1986. The defenders, by contrast, contended that the sale was in all the circumstances for adequate consideration, with the result that the defence in section 242(4)(b) was available. In the proof before the commercial judge expert evidence was led from two surveyors as to the valuation of the property. The commercial judge described both of these to be "careful and measured witnesses". The pursuers' expert, Mr Iain Prentice of Colliers International, valued the property at £820,000; the defenders' expert, Mr Alistair Buchanan of Shepherds, valued the property at £740,000. Both of these were market values, which assumed a bargain between a willing seller and a willing buyer at arm's length with a proper marketing period and no element of compulsion. The two valuations were within 10% of each other,

which was regarded as an acceptable tolerance within the surveying profession. The main difference between the two valuations was that Mr Prentice had taken into account the possible sale of a surplus part of the yard for £131,000.

[9] Both surveyors considered that a discount of 25% to 30% would be acceptable if marketing were restricted to a period of six months, and a further discount could be anticipated under more stringent marketing conditions. Mr Prentice was aware that another company had contacted his firm to express an interest in the property in the middle of 2014. Had such a purchaser been interested, the subject might have been sold in six months. Otherwise Mr Prentice would have expected marketing to take between 12 and 24 months to achieve a sale. Neither surveyor considered that a price of £550,000 was unreasonable in all the circumstances. Nevertheless, it is clear from the context that those circumstances included the assumption that the sale was a distress sale.

[10] The commercial judge held that the defenders had established that £550,000 was adequate consideration for the property. While the price was short of the open market value, Grampian had very limited options. It was in a perilous financial position and could not afford the leisure of a lengthy marketing period. NatWest was threatening to call up its standard security and to use other diligence under the bond and floating charge that it held. The defenders’ offer presented an opportunity to obtain a quick sale, without the significant expense of placing the property on the open market. There was no clear indication that a sale would be achieved with the standard marketing period of 12 to 24 months. Mr Quinn and Mr Gaffney were not “associates” in the sense in which that word is used in section 242, but the commercial judge held that the long business relationship between the two men justified very close scrutiny of the transaction. Both of the expert surveyors, however, had stated that a price of approximately £550,000 would not be unusual or inappropriate if the

property had been marketed on those bases for a period of six months. On that basis the commercial judge held that £550,000 was adequate consideration but that the sum of £473,604.68 that had been paid to Grampian at the time of the disposition was inadequate consideration for the property.

[11] The critical issue is accordingly whether the sum of £550,000 agreed between Grampian and the defenders at the time of the sale on 24 July 2014 was "adequate consideration" for the purposes of section 242(4) of the Insolvency Act 1986. As we have indicated, expert evidence was led as to the adequacy of the consideration on certain assumptions, notably that because of Grampian's immediate need for funds a quick sale was required. The most important issue arising in the case is whether that assumption was justified. This depends in our opinion on certain fundamental principles of insolvency law, in particular those that underlie the disposal of the debtor's property where either the debtor is insolvent or the disposal occurs within two years (or in some cases five years) before formal insolvency proceedings. We will now consider those general principles.

Principles of insolvency law

[12] Section 242 of the Insolvency Act 1986 empowers the liquidator of a company, following its winding up, to challenge an alienation that has been made during the period of two years prior to the commencement of winding up; winding up by the court is deemed to commence at the date of the presentation of the petition for winding up: Insolvency Act 1986, section 129(2). If the alienation is to an associated person (as defined in subsection (3)), the corresponding period is five years, but that is immaterial for present purposes as the alienation under challenge occurred a matter of months before the commencement of winding up. Section 242(4) is in the following terms:

"(4) On a challenge being brought under subsection (1), the court shall grant decree of reduction or for such restoration of property to the company's assets or other redress as may be appropriate; but the court shall not grant such a decree if the person seeking to uphold the alienation establishes –

> (a) that immediately, or at any other time, after the alienation the company's assets were greater than its liabilities, or
>
> (b) that the alienation was made for adequate consideration,
>
> …
>
> Provided that this subsection is without prejudice to any right or interest acquired in good faith and for value from or through the transferee in the alienation".

In this way a liquidator is permitted to challenge any gratuitous alienation made by an insolvent company during the two years prior to insolvency. Section 242 forms a fundamental part of the legislative structure governing corporate insolvency in Scotland. In cases of personal insolvency, the corresponding provision is section 98 of the Bankruptcy (Scotland) Act 2016, which replaced section 34 of the Bankruptcy (Scotland) Act 1985.

[13] These provisions are not new. The general structure of both is found in the Bankruptcy Act 1621, c 18, and that Act itself had antecedents in the *actio Pauliana* of Roman law (based on the Praetorian Edict, "De Actione Pauliana", which in turn was based on the principles stated in the Digest at 42.8.6.11). The underlying rationale is set out with characteristic lucidity by Bell in the *Commentaries*, II, 170-171 (7th Ed), 182-183 (5th Ed); the passage forms part of the extended commentary on the Bankruptcy Act 1621:

> "From the moment of insolvency a debtor is bound to act as the mere trustee, or rather as the *negotiorum gestor*, of his creditors, who thenceforward have the exclusive interest in his funds. He may, as long as he is permitted, continue his trade, with the intention of making gain for his creditors and for himself; but his funds are no longer his own, which he can be entitled secretly to set apart for his own use, or to give away as caprice or affection may dictate. This is the great principle on which the creditors of an insolvent debtor are, by the law of Scotland, entitled to proceed in detecting embezzlement. They are not required to enter on any scrutiny into the secret plans and fraudulent views of their debtor and of his friends; but have to direct their inquiries to these points alone: Whether was this man insolvent when

> he granted this deed, or constituted this debt? and, Whether did he receive a valuable consideration, or was it granted without a true and just cause?”
>
> “In Scotland, not only has the general principle been recognized on which, under the Roman law, all gratuitous deeds made in prejudice of creditors were annulled; but a special statute has been enacted for the purpose of aiding the operation of this principle, and rendering it more efficacious. As it is scarcely less difficult to prove the gratuitous nature of a deed than to prove the fraudulent intention of the parties, the law has, by the aid of certain presumptions, thrown the *onus probandi* on the receivers, where, after insolvency, a person is found to have alienated his property in favour of any of his near relations or confidential friends. To establish these presumptions, was the object proposed in the first branch of the statute made in 1621”.

[14] The critical features of this area of law are thus essentially three in number. First, once a debtor is insolvent, his assets must be managed in such a way as to protect the interests of his creditors. The reference to acting as a trustee or *negotiorum gestor* points towards what in modern law is described as a fiduciary duty, under which a person, in this case the debtor, must always act, in a defined area, in the interests of another person rather than his own interests or the interests of his family or friends. That is the general principle that underlies the Scots law of insolvency. Secondly, it follows from that first principle that, if a debtor alienates property once he is insolvent, he must obtain full consideration for the property alienated. Thirdly, under the statutes that have addressed gratuitous alienations a series of presumptions operate whereby it is the person who receives the debtor’s property who must establish that full consideration was given. That flows from the difficulty of establishing the gratuitous nature of a deed or the fraudulent intention of the parties in making an alienation for less than full consideration. It is in this way that the law advances the fundamental policy that once insolvency supervenes a debtor’s property must be managed in such a way as to protect the interests of his creditors.

[15] We should observe that these principles apply regardless of the debtor’s knowledge of his insolvency. The statutory provisions that strike down gratuitous alienations apply

with retrospective effect if winding up or sequestration follows within a specified period: five years if the alienation is to an associate and two years in all other cases. Thus the law operates in an objective manner. Any disposal of property that adversely affects the funds that are available for the creditors as a body will be struck down by the statutory provisions if it occurs within the specified period.

[16] The foregoing summary of the law also applies, in the case of entities with legal personality, to those managing the entity. Thus company directors (who are themselves subject to fiduciary duties towards the company) must ensure that in a case of insolvency the company acts with proper regard to the interests of its general creditors. Likewise, partners (who are subject to fiduciary duties towards the partnership) must conduct the affairs of the partnership in such a way that the interests of its general creditors are not prejudiced. The "creditors" in question are the creditors as a general body. A transaction that involves the payment of one creditor to the prejudice of others may well amount to a gratuitous alienation, except in cases where the debt paid was fully secured prior to payment and the security is not itself subject to challenge as a gratuitous alienation or unfair preference; when an effectually secured debt is paid, the creditor provides adequate consideration by giving up the preference that he would otherwise have in the insolvency.

[17] A further summary of the law is found in Goudy, *The Law of Bankruptcy* (4th ed) at 47; the passage forms part of the commentary on the Bankruptcy Act 1621, and the references to statutory wording are references to that Act, but it is relevant in general terms to the modern provisions in section 242 of the Insolvency Act 1986 and section 98 of the Bankruptcy (Scotland) Act 2016:

> "Value received in money or money's worth will be a good defence to the challenge. A 'just price' is taken to mean a price fairly adequate for what has been given for it.… The price must also have been paid *bona fide* – a just price 'really payed'. Where there

> is any objection to the good faith of a transaction, the receiver of the deed must produce evidence *dehors* the deed of his having paid the price alleged".

[18] We were referred to a number of cases in which section 242 and the corresponding provisions dealing with personal insolvency were considered. It is unnecessary to discuss these in detail, as they relate to specific situations that are not analogous to the present, but some of the cases contain useful statements of legal principle. Thus in *MacFadyen's Trustee* v *MacFadyen*, 1994 SC 416, Lord McCluskey provided a helpful definition of "consideration" at pages 421E-422B. It was held that the word "consideration", which is not defined in the Act, must be "given its ordinary meaning as something which is given, or surrendered, in return for something else". Furthermore, a consideration acquires its character as such not later than the time when the giving or surrendering takes place. The bankrupt debtor must be regarded as a trustee for creditors (a proposition which echoes the discussion in Bell), and in that context "a consideration must mean something of material or patrimonial value which could be vindicated in a legal process". That is the standard meaning in Scots law, which avoids the technicalities of the concept of consideration that are found in English law.

[19] In *Lafferty Construction Ltd* v *McCombe*, 1994 SLT 858, Lord Cullen (at 861C-F) considered the question of what amounts to "adequate" consideration:

> "In considering whether alienation was made for 'adequate consideration', I do not take the view that it is necessary for the defender to establish that the consideration for the alienation was the best which could have been obtained in the circumstances. On the other hand the expression 'adequate' implies the application of an objective standpoint. The consideration should be not less than would reasonably be expected in the circumstances, assuming that persons in the position of the parties were acting in good faith and at arms length from each other".

Finally, in *John E Rae (Electrical Services) Linlithgow Ltd* v *Lord Advocate*, 1994 SLT 788, the insolvent company had granted a bond in favour of the Inland Revenue in respect of past tax liabilities of an associated company. In return for the bond, the Inland Revenue granted

certificates exempting the company and an associated company from the requirement that persons who employed them should deduct tax from payments made to them as contractor or subcontractor. Lord Clyde held (at 791E-H) that the agreement comprising the bond and the exemption should be looked at as a whole, at the time when the agreement was entered into rather than in the light of subsequent events. At the time when the bond was granted, several years previously, the company would have been unable to continue trading without the certificates granted by the Revenue. Thus:

> "The effect of granting the bond therefore was to stave off the imminent demise of the company and it is difficult to imagine a more valuable consideration than that".

In the light of the whole circumstances, the decision to enter into the bond was an alienation for which valuable consideration was granted. It was therefore not a gratuitous alienation within the meaning of section 242.

[20] The present case is an example of a situation that occurs with some frequency: a company (or partnership or sole trader) requires to pay a debt or to grant security for a debt as a matter of urgency to avoid a threat to its ability to continue in business. In such a case, the threat to the continuance of the company's business means that it is relatively easy to infer that the consideration was adequate, as occurred in *John E Rae*, where it was a critical part of Lord Clyde's reasoning that the company could not have continued to trade if the certificates had not been granted. If avoiding a threat to the company's business is to amount to consideration, however, it is essential in our opinion that the business should be capable of continuing after the payment of the debt or the granting of the security. If this condition is not satisfied, it cannot be said that the continuation of the business amounts to valuable consideration, for obvious reasons.

Solvency and liquidity

[21] The foregoing question leads on to a further issue which is of some importance in insolvency practice, the competing claims of solvency and liquidity. "Solvency" is a word that can have various significations, but for present purposes we intend it to mean balance sheet solvency: a comparison of total assets and total liabilities, with a view to determining whether the overall value of the assets is adequate to meet the liabilities. "Liquidity", by contrast, relates to the ability of a company or other trading entity to meet its debts as they fall due; it is generally dependent on cash flow. Either insolvency or illiquidity is a ground for winding up in terms of sections 122 and 123 of the Insolvency Act 1986. For present purposes, the crucial factor is that a company facing liquidity problems may have to raise money rapidly in order to meet its debts as they fall due; if it fails to do so, it may be subject to a petition for winding up based on section 123(1)(a), (c) or (e) on the ground that it has failed to make payment following a statutory demand, or the induciae on a charge for payment have expired, or it is otherwise proved that the company is unable to pay its debts as they fall due. Consequently the company may require to take urgent measures to pay its debts promptly. That requires funds, and in order to raise such funds it may be necessary to proceed to the immediate sale of assets. Almost any such sale will be a forced sale, and the consideration that is obtained from the sale is likely to reflect that fact. As we have already noted, this was the major consideration that underlay the decision in *John E Rae (Electrical Services) Linlithgow Ltd* v *Lord Advocate*, *supra*: an urgent act was required to ensure that the company could continue to trade.

[22] As the evidence led in the present case clearly demonstrates, a forced sale is likely to result in a lower price than a sale under ordinary market conditions, where there is no compulsitor to achieve a bargain within a limited period. Both of the expert surveyors gave

evidence of two valuations. In each case the first valuation assumed a sale with a full marketing period and no element of compulsion. The second valuation assumed that only a limited marketing period was available. The surveyors agreed that a discount of between 25% and 30% on the normal market price following a full marketing period would be acceptable if marketing were restricted to six months. They further agreed that a further discount beyond that might be appropriate if the restrictions on marketing were even more stringent: see paragraph [9] above. The difference between the two valuations was substantial. The first produced figures of £820,000 from the pursuers' expert and £740,000 from the defenders' expert (the difference being largely attributable to the possibility of selling part of the yard separately). The second valuation provided justification for the final sale price of £550,000, which represented a discount of 33% in one case and 26% in the other.

Consequences of a forced sale for section 242

[23] It follows that in any case of a forced sale that is driven by the need for liquidity the price obtained is likely to be less than the full market price that would be obtained through an ordinary sale in the open market without any element of compulsion. Thus any such sale is likely to be *prima facie* at an undervalue. The critical question for present purposes is how such a sale should be treated for the purposes of section 242, and in particular in determining whether the sale at an undervalue constitutes "adequate consideration" within the meaning of section 242(4)(b). In particular, is the circumstance that the sale is forced, driven by the seller's need to maintain liquidity, a factor in assessing the adequacy of consideration?

[24] At this point it is important in our opinion to take account of the fundamental principles of insolvency law as described at paragraphs [13] and [14] above. Once a debtor

appears to be insolvent, he is obliged to manage his assets in such a way as to protect the interests of his creditors, as a general body. That is the basic reason for providing sanctions to deal with sales and other transactions at an undervalue, and is thus the fundamental rationale for section 242 of the Insolvency Act 1986 and section 98 of the Bankruptcy (Scotland) Act 2016. For this reason, we are of opinion that the courts should take a relatively strict view of the adequacy of consideration. Adequacy must be assessed objectively, and on that basis it should be assumed that, in the words of Lord Cullen in *Lafferty Construction*, "persons in the position of the parties were acting in good faith and at arms length from each other". The need for a strict and objective approach is particularly important if the debtor's business has ended or is about to come to an end. In such a case, although a solvent winding up is possible, in many cases there is an obvious risk – frequently a likelihood – of insolvency. In that event the policy of protecting the interests of creditors operates with full force. Moreover, quite apart from the possibility of an insolvent winding up, once a business has ceased to operate the discipline of ordinary commercial relations goes with it. Normally those in business are constrained to act in a fair and reasonable way towards their suppliers, customers and other creditors because they want to do repeat business. On cessation of business this consideration no longer operates, as can be observed with insurance companies in run-off.

[25] Furthermore, if the debtor's business is about to come to an end, the need for a forced sale to maintain the liquidity of the business and hence its continuation simply disappears. In that situation the company or other entity carrying on the business should observe the general policy of the law of insolvency by giving paramount importance to the interests of creditors as a body; in other words, considerations based on insolvency should prevail over the need for payment of debts as they fall due. In such a case, if a sale of assets is necessary

in order to pay creditors, the sale does not require to be a forced sale, because the urgent payment of debts has ceased to be a relevant consideration. Instead, assets may be disposed of in the normal way, with appropriate marketing and advertising and time for potential purchasers to reach a considered view about the property that is for sale. For these reasons we are of opinion that the need for a forced sale to provide immediate liquidity is not normally a factor that should be taken into account in determining the adequacy of consideration obtained for a sale of the debtor's assets in any case where the debtor has ceased business or is about to cease business. In such a case the continuation of the business will not be part of the consideration for the sale because the business is not going to continue. That is the normal situation, although we accept that there might be exceptional cases where the payment of a particular debt as a matter of urgency is necessary in order to protect the general interests of the creditors. For example, it might be that a sale at an undervalue enables an important debt to be paid with the result that formal insolvency procedures are avoided. Such cases will be exceptional, however, and will turn on their specific facts. We observe that we see nothing exceptional in the present case, where Grampian's financial difficulties were major.

[26] The foregoing discussion applies if cessation of business is expressly contemplated. In many cases, however, it will be apparent that the business cannot continue following the sale. Thus if a trading company sells its principal asset, for example its principal place of business, its ability to continue trading is obviously threatened. In such a case the court must scrutinize the company's commercial situation in order to determine how realistic the possibility of continued trading may be. That will depend on the circumstances of the particular case. For example, a company might sell its principal place of business subject to leaseback arrangements, which would allow continued trading but would do so at the cost

of the rental payments made under the leaseback. Alternatively it might be possible to move to smaller premises. The sale of part of the goodwill of the company's business is another situation where the continuance of the business might be under threat, but if the part of the goodwill sold is sufficiently small continuation may be possible. In all such cases we consider that the court should examine the information that is available about the business to determine whether the business as a whole, or the remaining part of the business, is realistically viable. If it is not, the general policy of putting the interests of the general creditors first applies with full force, and the need for a quick sale to maintain liquidity will not normally be an element in assessing the adequacy of the consideration. As we have previously indicated, in all cases the approach taken to the transaction must be wholly objective; this is an important consideration.

Analysis of the present transaction

Critical facts

[27] In applying the foregoing principles to the sale that is now under challenge, the sale of the property in East Kilbride by Grampian to the defenders, certain of the facts appearing in the opinion of the commercial judge and in the agreed documents appear to us to be of importance. First, Grampian was in severe financial difficulties by July 2014. These are recorded by the commercial judge. After he took over Grampian, Mr Quinn realized that the company could not meet its obligation to make loan repayments to NatWest, which amounted to approximately £4,600 per month. NatWest indicated that it was not prepared to continue financial support, and no alternative source of funding appeared to be available, at least in the short term. At about the same time the finance company that provided invoice finance to Grampian withdrew their factoring facility. Factoring and invoice discounting are

in practice important sources of finance, and it is clear that the loss of this facility had serious effects on Grampian's cash flow. Mr Quinn concluded that no alternative source of invoice finance was available, at least in the short term. That plainly had a major effect on the company's working capital, which in itself would make the continuation of the business difficult.

[28] Secondly, on the facts recorded by the commercial judge it is apparent that Grampian was insolvent, on a balance sheet test, by the time of the sale. It owed £473,604.68 to NatWest, which was paid off following the sale, and it owed an equivalent or slightly greater sum to HMRC; by the time of the winding up proceedings in September 2014 this debt amounted to approximately £550,000. Grampian's trucks (which were worth little in any event) had been sold off, but the proceeds of sale provided a minimal benefit to the company. In view of the size of Grampian's debts, we are of opinion that on an objective assessment it must have been apparent to a reasonable person in Mr Quinn's position that Grampian was insolvent. In his witness statement Mr Quinn stated that he had throughout tried to do the best that he could, which may well be correct, but objectively it seems to us to be clear that Grampian's financial situation was very poor indeed.

[29] Thirdly, Mr Quinn arranged for the sale of Grampian's trucks, which had been held under hire purchase contracts. This had the advantage of reducing outgoings, but it did relatively little to raise funds for Grampian. More importantly, the fact that the trucks had been sold obviously made it extremely difficult for Grampian to continue its business, which consisted of a distribution service throughout Scotland and further afield. No doubt some sort of subcontracting arrangement could have been used, but that would involve a major change to Grampian's business model. Fourthly, the sale of the premises in East Kilbride deprived the company of its principal place of business and depot. That too would make it

very difficult for Grampian to continue its business, and any attempt to continue the business in those circumstances would certainly involve a major change in the business model.

Application of section 242

[30] The four factors that we have described, the severe practical financial difficulties faced by Grampian, its probable insolvency on a balance sheet test, the sale of its trucks and the sale of its premises, must in our opinion be considered together. Moreover, their implications must be determined on an objective basis. When that is done, the inevitable inference is in our opinion that there was no realistic prospect that Grampian's business could continue in existence. The company's principal place of business was being alienated, and it faced severe financial problems. Consequently we are of opinion that this is not a case where it is possible to assert that achieving a quick sale will save the company's business; the business was already beyond saving, for a number of important reasons. On that basis there was no reason for Grampian, or Mr Quinn as its managing director, to proceed to a sale within three months or six months. Instead, in view of the fundamental policy described by Bell which underlies section 242, the interests of the general creditors should have been put first, and an attempt should have been made to sell the property for its full market value, assuming a willing buyer and a willing seller and without any time constraints. That is of course what would happen in the event of winding up. In that way, by obtaining full value without the constraints of a sale, the interests of the general creditors are put first.

[31] It follows that the lower value spoken to by the two expert surveyors, £550,000, was not relevant in the circumstances of the present case, as that valuation proceeded on the

basis that a sale had to be concluded within three months or six months. The material valuations were therefore the higher valuations spoken to by the two surveyors, £820,000 and £740,000. These are substantially above the consideration of £550,000 that was paid by the defenders for the sale of the property. On that basis we conclude that the defenders had failed to establish that they paid adequate consideration for the property.

[32] The disposition of the property in favour of the defenders accordingly falls to be reduced in terms of section 242(4) of the Insolvency Act 1986. This is subject to one further consideration, however. Under the proviso to section 242(4), the subsection is declared to be without prejudice to any right or interest acquired in good faith and for value from or through the transferee in the alienation. A similar result might well have been reached under the common law, because reduction is an equitable remedy and an onerous transferee in good faith may be entitled to protection against the effects of any decree of reduction. The statutory proviso is clear by itself, however. In the present case, the defenders obtained a loan from the Bank of Scotland and in security of the loan granted a standard security over the property. The Bank of Scotland has not entered the present process. They may be entitled to claim a degree of protection in the liquidation of Grampian, but that is not a matter for this court and we express no opinion upon the matter.

[33] Finally, although the foregoing reasons are sufficient to justify decree of reduction, we should note a number of other factors that were referred to by the parties and by the commercial judge in his opinion. Mr Quinn and Mr Gaffney, although not "associates" for the purposes of section 242, had had a long business relationship, and three months prior to the date of sale the defenders, under Mr Gaffney's direction, had expressed an interest in acquiring the property at a price of £950,000. These are factors that justify a close scrutiny of the transaction, as the commercial judge held. Nevertheless they are not decisive by

themselves. The same is true of the fact that the amount actually paid by the defenders for the property (£473,604.68) was the precise sum owed by Grampian to NatWest. This coincidence is somewhat curious. If it was deliberate, it suggests that the intention was to pay Grampian's bankers but to ignore its very extensive tax liabilities. It is not, however, necessary to consider these matters in greater detail because the fundamental assumption, that a sale of the property had to be effected quickly, is not substantiated. Finally, reference was made to a company known as Bullet Express, which had indicated a short time before the sale that they might be interested in acquiring the property at a price of £900,000. We consider that the higher figures spoken to by the two expert witnesses are sufficient to establish a sale at an undervalue, and it is accordingly unnecessary to examine in detail the possibility of a sale to Bullet Express.

Conclusion

[34] For the foregoing reasons we will allow the reclaiming motion and recall the first part of the commercial judge's interlocutor of 26 January 2017. We will sustain the second and third pleas in law for the pursuers, which are to the effect that the transfer of the property was a gratuitous alienation in favour of the defenders, with consequential entitlement to decree of reduction. We will repel the whole of the defenders' pleas in law. Finally we will pronounce decree of reduction in terms of the first conclusion of the summons. The commercial judge found the defenders liable to the pursuers in respect of the expenses of process, notwithstanding the defenders' success, for reasons that are specified in a supplementary note. The defenders had indicated to the pursuers in May 2016 that they would pay the shortfall between the figures of £550,000 and £473,604.68, but had failed to do so before the start of the proof; the sum was in fact paid after the proof diet. Furthermore,

the defenders did not lodge their expert surveyor's report until seven months after the action was raised. On that basis he concluded that the liquidators were justified in raising the present action and awarded them the expenses of process. We consider that such a course was justified, and that part of the commercial judge's interlocutor will stand. So far as the expenses of the proceedings in the Inner House are concerned, the pursuers have been successful and are accordingly entitled to their expenses.

[35] In conclusion, we should note that, although we are reversing the decision of the commercial judge, we have derived considerable assistance from his discussion of the issues in the case. Moreover, the focus of the parties' arguments changed significantly, from an emphasis on the evidence of the two expert surveyors to a more nuanced consideration of the fundamental policy questions that underlie this area of law. It is perhaps worth emphasizing that, especially in technical areas such as insolvency law, detailed analysis of the relevant legal provisions and their underlying policy is of the greatest importance, even in cases where most of the time in court is taken up with the leading of evidence.