OUTER HOUSE, COURT OF SESSION

[2018] CSOH 23

P448/17

OPINION OF LORD CLARK

In the cause

BRIAN WILLIAM MILNE, LIQUIDATOR OF PREMIER HOUSEWARES (SCOTLAND) LLP

Noter

against

NAEEM RASHID

Respondent

Noter: Broome; MacRoberts LLP
Respondent: Welsh; DAC Beachcroft Scotland LLP

14 March 2018

Introduction

[1] The noter is the liquidator of Premier Housewares (Scotland) LLP ("the LLP"). The respondent was a member of the LLP. A winding-up order in respect of the LLP was made on 29 February 2016. In this case, the noter seeks an order under section 214A of the Insolvency Act 1986 ("the 1986 Act") for recovery of sums withdrawn by the respondent from the LLP in the two year period before the granting of the winding up order. Prior to winding-up, the LLP had been in administration, the administrator having been appointed on 22 December 2014.

[2] The withdrawals by the respondent which are the subject of the present claim were made monthly from March 2014 to December 2014. The total sum withdrawn was £78,259.84. The

basis for the noter's claim, in terms of section 214A of the 1986 Act, is that the respondent knew or had reasonable grounds for believing that at the time of each of the withdrawals the LLP was unable to pay its debts within the meaning of section 123 of the 1986 Act, and that he knew or ought to have concluded at the time of each withdrawal that there was no reasonable prospect that the LLP would avoid going into insolvent liquidation. The respondent denies these allegations. The case called before me for a proof before answer on the parties' averments in the Note and Answers.

The evidence

[3] The noter gave evidence, in which he explained how his appointment had come about, the investigations he had conducted and the information which he had obtained. He explained that the respondent was appointed as a member of the LLP on 17 November 2003. The other members of the LLP were Anjum Mobarik, Shokat Mobarik and Riaz Mobarik. Anjum and Shokat Mobarik are brothers and Riaz Mobarik is their father. Riaz Mobarik resigned as a member of the LLP with effect from 1 January 2005. Each member of the LLP has been, at some point, a director of LTC Distributors Limited ("LTC"), which had significant business links with the LLP. The noter explained his understanding of the financial position of the LLP at the material times and what, in his view, the respondent knew or ought to have concluded.

[4] On behalf of the respondent, evidence was led firstly from Mr Akmal Khushi. Mr Khushi is a director of and shareholder in a company which owns a major international retail business in the field of outdoor goods and sportswear. He is a respected member of the business community and has known the Mobarik family for many years. His evidence primarily concerned a meeting in July 2014 at which Heads of Agreement were reached in an effort to resolve differences between Anjum and Shokat Mobarik.

[5] Next, the respondent, who is a 53 year old chartered accountant, gave evidence about the LLP and its relations with LTC and the facts and circumstances known to him at the time of the withdrawals. His evidence included that, until December 2014, the LLP had been supported by other business interests of Anjum and Shokat Mobarik, most significantly by LTC. LTC supplied stock with the Premier Housewares brand to the LLP. Since 2003, LTC provided, year on year, long term financial support to the LLP. Until December 2014 there was no reason to believe that the trading position of the LLP would be any different going forward, so far as the financial support from LTC, as majority creditor, was concerned. The LLP would pay the invoices issued by LTC in full within 12 months from the date of issue. From knowledge obtained from attending LTC meetings and discussions with the Mobarik family there was no anticipation or expectation that any of the family members would contemplate insolvency proceedings in relation to the LLP. A 10% credit note (a rebate of 10% of the value of the total annual sales) had been issued by LTC each year up to and including 2013. It was only in December 2014, after the decision was taken to put the LLP into administration, that LTC decided that the annual credit note for the calendar year 2014 was not to be issued. Up to that point the support of LTC had been constant. The LLP had a relatively small number of creditors and debts were met by the LLP without delay, including PAYE. It was only after a family disagreement between the brothers that Shokat Mobarik decided he could no longer continue to support the running of the LLP. The brothers had been in negotiations to allow Shokat Mobarik to continue the LLP under his sole control. The expectation was that Anjum Mobarik would resign from the LLP. Only in December 2014 did things reach a stage where the working relationship was untenable. There was no reason to believe or suspect, far less conclude, that any or all of the withdrawals of money prior to and including the withdrawal in December 2014 were made in circumstances in which there was no reasonable prospect of the LLP avoiding insolvent liquidation. There were

no signs of cash-flow problems for the LLP. There were no decrees for payment sought or made against the LLP. External creditors were minimal and were being paid on time. There were no external borrowings. Additional funding facilities were available to the LLP.

[6] Finally, Shokat Mobarik gave evidence about the creation and development of the businesses, including that of the LLP and LTC, the business models, and how issues arose that led to a proposal to split the business interests of family members. He is 56 years old and now resides in Pakistan. LTC had always been the sole supplier of goods to the LLP, as it had been for the general partnership. LTC imported the goods from China, Spain and other countries. The goods were sold to the LLP at the same time as the LLP sold them on to its customers. LTC would invoice the LLP at the end of each month for all of the goods that the LLP had sold that month. The LLP would receive a significant discount from the price at which it bought the goods from LTC, enabling the LLP to cover its costs and make a profit. LTC gave the LLP a credit term of one year. The discount, or profit margin, was 28%-32%. In addition, there was a 10% rebate or credit note, given at the end of the year. In essence, the LLP was a marketing arm of LTC, although it also stored the goods. None of the directors of LTC suggested that its support for the LLP would be withdrawn. Several meetings were held to discuss the separation of business interests. The general arrangement was going to be that Anjum Mobarik would retain the cash and carry division of LTC and would resign from the LLP. Shokat Mobarik would have sole ownership of the import division of LTC and of the LLP. Shokat Mobarik intended to put more capital into the LLP and to reduce the rent and storage charges. He would have complete control of the amount of discount and rebate to be given by LTC to the LLP. He thought that the LLP would become a very viable and profitable business as a result of his restructuring efforts. By the beginning of December 2014 it was becoming apparent that Anjum was not implementing the arrangement. Shokat Mobarik had always advised the respondent that he intended to inject

more capital into the LLP following the separation of business interests, that he would also reduce the rent and storage charges and increase the discount given by LTC, and that the intention was to continue with the LLP. Had the separation of business interests occurred, that is what would have happened. The turnover of the LLP was increasing. Had these steps been taken it would have become extremely profitable. The relations between the LLP and its creditors were always excellent. There were no difficulties with payments. There were no cash flow issues and no bank or other borrowings. At no point had any creditor taken legal proceedings. It was always in LTC's interests that the LLP kept going. The stock was branded as the LLP's stock. LTC would suffer huge losses on the demise of the LLP.

[7] It is not necessary for me to rehearse at this stage the contents of the evidence in any further detail, firstly because the material parts of it upon which parties rely is noted in my summary of their respective submissions and, secondly, because, where appropriate, I have referred to relevant parts of the evidence in explaining my decision and the reasons for it.

Relevant statutory provisions

Section 214A of the Insolvency Act 1986

[8] Section 214A of the Insolvency Act 1986 (as inserted by Regulation 4 and Schedule 3 of the Limited Liability Partnerships (Scotland) Regulations 2001) is headed "Adjustment of withdrawals" and provides as follows:

> "(1) This section has effect in relation to a person who is or has been a member of a limited liability partnership where, in the course of the winding up of that limited liability partnership, it appears that subsection (2) of this section applies in relation to that person.
>
> (2) This subsection applies in relation to a person if–

(a) within the period of two years ending with the commencement of the winding up, he was a member of the limited liability partnership who withdrew property of the limited liability partnership, whether in the form of a share of profits, salary, repayment of or payment of interest on a loan to the limited liability partnership or any other withdrawal of property, and

(b) it is proved by the liquidator to the satisfaction of the court that at the time of the withdrawal he knew or had reasonable grounds for believing that the limited liability partnership–

(i) was at the time of the withdrawal unable to pay its debts within the meaning of section 123 of the Act, or

(ii) would become so unable to pay its debts after the assets of the limited liability partnership had been depleted by that withdrawal taken together with all other withdrawals (if any) made by any members contemporaneously with that withdrawal or in contemplation when that withdrawal was made.

(3) Where this section has effect in relation to any person the court, on the application of the liquidator, may declare that that person is to be liable to make such contribution (if any) to the limited liability partnership's assets as the court thinks proper.

(4) The court shall not make a declaration in relation to any person the amount of which exceeds the aggregate of the amounts or values of all the withdrawals referred to in subsection (2) made by that person within the period of 2 years referred to in that subsection.

(5) The court shall not make a declaration under this section with respect to any person unless that person knew or ought to have concluded that after each withdrawal referred to in subsection (2) there was no reasonable prospect that the limited liability partnership would avoid going into insolvent liquidation.

(6) For the purposes of subsection (5) the facts which a member ought to know or ascertain, the conclusions which he ought to reach and the steps which he ought to have taken are those which would be known or ascertained, or reached or taken, by a reasonably diligent person having both:

(a) the general knowledge, skill and experience that may reasonably be expected of a person carrying out the same functions as are carried out by that member in relation to the limited liability partnership, and

(b) the general knowledge, skill and experience that that member has.

(7) For the purposes of this section a limited liability partnership goes into insolvent liquidation if it goes into liquidation at a time when its assets are insufficient for the payment of its debts and other liabilities and the expenses of the winding up.

(8) In this section 'member' includes a shadow member.

(9) This section is without prejudice to section 214."

Sections 123(1) and 123(2) of the Insolvency Act 1986

[9] Section 123 of the 1986 Act deals with the definition of inability to pay debts. Only parts of subsection (1), and subsection (2), are relevant for present purposes and the relevant provisions are as follows:

> "(1) A company is deemed unable to pay its debts—
>
> …
>
> (e) if it is proved to the satisfaction of the court that the company is unable to pay its debts as they fall due.
>
> (2) A company is also deemed unable to pay its debts if it is proved to the satisfaction of the court that the value of the company's assets is less than the amount of its liabilities, taking into account its contingent and prospective liabilities."

Submissions for the noter

[10] The noter moved the court to grant paragraphs (iii) and (iv) of the prayer of the Note, which in essence are to declare that the respondent is liable to make a contribution of £78,259.84 to the assets of Premier Housewares (Scotland) LLP, together with interest thereon and to find that the expenses of and incidental to the Note shall be legitimate expenses in the liquidation of the LLP. The submissions of the noter in support of that motion can briefly be summarised as follows.

[11] There were three limbs to the statutory test which the noter required to meet. The first limb (as set forth in section 214A(1) and 214A(2)(a) of the 1986 Act) is that the respondent requires to have been a member of the LLP within the period of two years ending on the commencement of the winding up, who withdrew property (which includes money) from the LLP during that period. That matter was not disputed by the respondent.

[12] The second limb (in terms of section 214A(2)(b)(i)) is that it has to be proved to the satisfaction of the court that at the time of each withdrawal the respondent knew or had reasonable grounds for believing that the LLP was unable to pay its debts within the meaning of section 123 of the 1986 Act. In terms of section 123, one of the means by which a company is deemed unable to pay its debts is if it is proved to the satisfaction of the court that the value of the company's assets is less than the amount of its liabilities, taking into account its contingent and prospective liabilities (section 123(2)). That is commonly known as balance-sheet insolvency, in contradistinction to the cash-flow insolvency test provided by section 123 (1)(e).

[13] The third limb (as stated in section 214A(5)) is that the court shall not make a declaration that the respondent is liable to make such contribution unless the respondent knew or ought to have concluded that after each withdrawal of property there was no reasonable prospect that the LLP would avoid going into insolvent liquidation. The details of how this limb of the test falls to be applied are as set forth in section 214A(6).

[14] In relation to limb 2, reference was made to *Bucci* v *Carman (Liquidator of Casa Estates (UK) Ltd)* [2014] BCC 269, in which the Court of Appeal applied the decision of the Supreme Court in *BNY Corporate Trustee Services Ltd* v *Eurosail-UK 2007-3BL Plc* [2013] UKSC 28; [2013] 1 WLR 1408; [2013] BCC 397. These cases show that the court requires to make a judgment as to whether it has been established that, looking at the company's assets and making proper allowance for its prospective or contingent liabilities, it cannot reasonably be expected to meet those liabilities. If so, it will be deemed to be insolvent even if it is currently able to meet its debts as they fall due. It is counter-intuitive that a company that manages to stave off cash-flow insolvency by going deeper and deeper into long term debt is not insolvent.

[15] In relation to limb 3, analogous cases could be found in respect of alleged wrongful trading by company directors. The answer to the question of whether the respondent knew or

ought to have concluded that there was no reasonable prospect that the LLP would avoid an insolvent liquidation depends on rational expectations of what the future might hold: *Re Hawkes Hill Publishing Co Ltd (In Liquidation)* [2007] BCC 937. Liability has been held to attach where the person has been held to have no rational basis for believing that the event they hoped would save the company would come about: *Re Ralls Builders Ltd (In Liquidation)* [2016] BCC 293. Wilfully blind optimism is not sufficient, nor is a reckless belief that something might turn up when on any objective view that was groundless and forlorn: *Roberts (Liquidator of Onslow Ditchling Ltd)* [2012] BCC 407, a case in which the company was trading using credit extended to it by its suppliers. A speculative hope that it might all work out is not sufficient: *Re Kudos Business Solutions Ltd (In Liquidation)* [2012] 2 BCLC 65. The courts have been prepared to place some weight upon whether professional advice was taken: *Re Hawkes Hill Publishing Co Ltd; Re Ralls Builders Ltd*.

[16] The evidence of the noter and Mr Khushi should be accepted, but the respondent was not credible or reliable. As for Mr Mobarik, parts of his evidence should be treated with caution.

[17] It was a matter of agreement that the first limb of the test was met. In relation to limb 2, it had been proved that, at the time of each withdrawal, the respondent knew or had reasonable grounds for believing that the LLP was unable to pay its debts within the meaning of section 123 of the 1986 Act. The LLP was balance-sheet insolvent, to the respondent's knowledge, in the period March to December 2014. It had never made a profit in any year. Its balance-sheet insolvency was increasing year-on-year. There was no evidence of any properly funded plan to reverse that situation. The extended period of credit from LTC was not something which the LLP had as of right. In fact, LTC was entitled to demand payment earlier than the end of the one year period. On that basis, the LLP fell foul of the cash-flow insolvency test as well.

[18] Turning to limb 3, the evidence of the noter established that this part of the test was also met. No profit had ever been made and in the last published accounts of the LLP, for the period to 31 March 2013, its liabilities had exceeded its assets by almost £4.7 million. Emphasis had been placed by the LLP's auditors on the existence of a material uncertainty which may cast significant doubt about the LLP's ability to continue as a going concern. Further significant losses were incurred between 31 March 2013 and the entry into administration of the LLP, as shown in the administrator's estimated statement of affairs as at 29 December 2014. There was no evidence of an implementable plan, within a timescale, which would have cleared the LLP's liabilities and moved it into balance-sheet solvency.

[19] On the evidence, LTC and the LLP were not controlled in the same manner. The majority of shareholders and directors in LTC were in the camp of Anjum Mobarik. No weight should be given to Shokat Mobarik's assertion that LTC's interests involved the LLP being supported come what may. He was not in a position to obtain the outcome that he wished from LTC. LTC took no steps to stop administration or liquidation. The proposed split of business interests, referred to in the evidence led for the respondent, was conditional on Anjum Mobarik coming back to give consent, but in fact the discord remained in place and consent was never given. Any plan for the future was aspirational, undeveloped and undocumented. A reasonably diligent person in the position of the respondent would have sought details of any plan and justifications for the numbers, if any, given by Shokat Mobarik.

[20] The evidence of Shokat Mobarik, and indeed of the respondent, supported that view. LTC was not prepared to provide a larger discount to the LLP than the previously agreed figure when requested to do so. The respondent had resigned his directorship of LTC in 2012 because of concerns he had about a conflict of interest between that and his position as a member of the LLP. This clearly indicated knowledge on the part of the respondent that LTC and the LLP had

divergent positions. The noter was right to describe the accumulated liabilities of the LLP as "unassailable". The idea that a negotiated split of business interests between Anjum and Shokat Mobarik might avoid insolvent liquidation was merely a speculative hope. The negotiations lacked detail, were based on significant conditions and never reached any substantive agreement. The respondent would have been aware of the proposal to split the businesses during the first two months of 2014. But there was no evidence of any particular increase in discount, or other financial support, which would resolve the LLP's financial state. There was no rational or proper basis on which to conclude that there existed a reasonable prospect that the LLP might avoid going into insolvent liquidation. Ultimately, the respondent's evidence boiled down to little more than blind hope that the family would be able to reconcile. This flew in the face of the discord in the family, of which the respondent was aware. A reasonably diligent person would have sought knowledge of all the underlying reasons for the discord. The court should conclude that the respondent knew more about the length, basis for and degree of discord between the brothers than he was willing to admit.

[21] For these reasons, paragraphs (iii) and (iv) of the prayer of the Note should be granted.

Submissions for the respondent

[22] In brief summary, the submissions for the respondent were as follows. The respondent's second and third pleas-in-law should be sustained and the prayer of the Note should be refused. Section 123(2) of the 1986 Act is a deeming provision. It provides for a rebuttable presumption. In terms of section 214A, there were two things to bear in mind. Firstly, each payment required to be considered separately. Secondly, at each payment date the noter required to prove that limbs 2 and 3 of the test were met. In respect of limb 3, the respondent did not require to prove that he had a reasonable belief that insolvency would not happen. Rather, the noter required to

prove that the respondent knew or ought to have known that there was no reasonable prospect of the LLP avoiding insolvent liquidation.

[23] The drawings made by the respondent, which are the subject of the present proceedings, were never a matter of concern during the administration or to HMRC, nor were they the reason for the LLP being put into liquidation. Matters should not be viewed retrospectively but from the viewpoint of the respondent at the material time. The noter had little understanding of how LTC and the LLP actually operated. The evidence of Mr Khushi should be accepted in its entirety. The respondent had given up his professional career as a chartered accountant to join the business. He worked closely with the Mobarik family. He knew they would not like to lose face by the LLP going into insolvency. While not aware of the intimate details of the dispute between the brothers, he knew the general position. He was intimately involved in the running of the LLP. He was fully aware of how the family and the businesses interacted and gave reasons why he expected them to continue to do so. He was entirely credible and reliable. There was an inextricable link between the businesses. It was not in the interests of LTC for the LLP to struggle. There were no significant assets of the LLP to be distributed in any liquidation. LTC was the sole supplier of goods to the LLP and the LLP was the sole customer of LTC. There was a direct link between the import side of LTC and the business of the LLP. It was not in anyone's interest for the LLP to fail. They were owned and controlled by the same family.

[24] The LLP did not go into administration at the instance of any creditor. Rather, it was put into administration because protracted negotiations between the brothers were getting nowhere. Shokat Mobarik had become exasperated. The LLP was voluntarily put into administration. Shokat Mobarik had no personal interest in the matter before the court. He provided detailed evidence of the relationship with his brother and how it had become soured. He was intimately aware of all that was going on. On his evidence, it was clear that the respondent had a sound

basis for understanding the LLP had a future which did not involve insolvent liquidation. Immediately prior to the LLP going into administration all of the creditors were being paid on time. There was no bank debt. LTC, as the largest creditor, proceeded on the basis that its debts would continue to be paid.

[25] A deeming provision, such as section 123(2), creates a rebuttable presumption. Reference was made to: *Lafarge (Aggregates) Ltd* v *London Borough of Newham* [2005] 2 Lloyd's Rep 577; *Re Thundercrest Ltd* [1994] BCC 857; and to the judgment of the Court of Appeal in *BNY Corporate Trustee Services Ltd* v *Eurosail-UK 2007-3BL Plc* [2011] Bus LR 1359.

[26] The 12 month period of credit provided by LTC had always been the basis upon which its debts were to be paid. The absence of a written agreement on this matter was not relevant and was not required. There was an established method of trading which would have prevented LTC from recovering within the 12 months. The commercial reality was of the two aligned businesses being run by the one family and relying upon each other. The general partnership did not rely solely on the LLP and had income streams from elsewhere. The evidence of LTC's desire to keep the LLP running was strengthened by Mr Mobarik's evidence that a large amount of stock was branded with the LLP's brand. Customers were loyal to the LLP and it was not plausible to consider that they could simply be transferred to a new entity.

[27] At the time of the withdrawals, the respondent was aware of the general intention that business assets were to be divided. He understood that Shokat Mobarik would have complete control over the import side of LTC and of rental and storage charges, as well as complete control of the LLP. The result would have been that these charges and the discount and rebate given to the LLP would be controlled by Shokat Mobarik. He would have had nothing to fear by injecting capital, which he had available. With these negotiations going on, the respondent reasonably

understood at all material times that things were heading in the right direction and that insolvent liquidation was not likely to happen. The LLP was about to enter into a new phase.

[28] As was made clear in *BNY Corporate Trustee Services Ltd* v *Eurosail-UK 2007-3BL Plc* (para 44), section 123(2) is an adjunct to section 123(1), which deals with the reality of being unable to pay debts as they fall due. A company which is technically balance-sheet insolvent is not deemed to be unable to pay its debts if the reality is that it is in fact paying its debts as they fall due. The noter had provided no evidence of any debts not being met as they fell due. He accepted that the LLP was placed into administration by its members and not by any creditor. Accordingly the deeming provision was, on the evidence, overridden and section 214A could not apply. It was crucial to take into account the business model. Goods were sold on consignment, when the LLP had already agreed to sell these on. A snapshot view was misleading.

[29] In relation to limb 3, while there was discord between the brothers, there were concerted efforts to find a solution and to separate the business interests. As explained by Mr Khushi, they met and produced the Heads of Agreement. Shokat Mobarik did everything he could to try to bring about the separation, or demerger, of business interests. Had this been successful he would have controlled all three of the relevant businesses. The LLP could have returned to profit. This was exactly what Shokat Mobarik was trying to do. He explained that he would have put more capital into the LLP and reduced the rent and storage charges. He would have control of all the economic levers. There was a basis for the respondent to think there was a reasonable prospect of avoiding insolvent liquidation. Formal documentation would not be expected in a family business of this kind. It was only in December 2014 that Shokat Mobarik decided to vote to put the LLP into administration. Until then there was a genuine and reasonably held anticipation that the demerger would be successful. There was reason to believe that the LLP would be turned round and made profitable. Shokat Mobarik had a plan and had

turned the business round before. The respondent had no way of knowing that the demerger negotiations would not succeed, until December 2014.

[30] For these reasons the prayer of the Note should be refused.

Reply for the noter

[31] The submissions for the respondent had not properly engaged with the considerations in the case law. It was incorrect to say that the LLP did not have assets; the accounts showed reasonably substantial assets. There was no evidence about any amount of capital which was intended to be injected. On the administrator's estimate, more than £10m would be required. The administration in fact came about because of inability to pay debts. There was no basis for implying an agreement as to a 12 month period of credit being granted by LTC – the evidence was that the LLP had no right to that period. A new firm had been set up following the liquidation and the brand had remained the same.

Decision and reasons

The witnesses

[32] Each witness gave his evidence in an open and clear manner. All of them struck me as telling the truth and not seeking to mislead the court or to conceal any matters of relevance. The noter was quite clear as to the basis upon which he felt that the case against the respondent could be made and he explained that in his evidence. Mr Khushi was plainly a very highly-regarded businessman and he had done his best to assist in seeking to resolve the issues arising between members of the family, of whom he was a trusted and respected friend. The respondent, a qualified and experienced chartered accountant, came across as a thoughtful and honest individual. While mildly defensive on one or two points, that was perhaps not unusual in the

context of being accused of removing funds when he knew or ought to have known of impending insolvency. Shokat Mobarik came across as a very hard working and experienced businessman, who had dealt in a mature and admirable fashion with difficulties which had arisen in his wider family life. For these reasons, I have accepted as accurate the facts as spoken to by all of the witnesses. In the case of the noter, he explained what was known to him, but he was not of course privy to the full facts and circumstances which obtained at the times when the withdrawals were made. The evidence from the noter and from each of those involved at the material time was credible and reliable. I therefore reject the contentions for the noter as to any lack of credibility or reliability on the part of the witnesses for the respondent.

The tests to be applied

[33] The first part of the test ("limb 1") is dealt with in sections 214A(1) and 214A(2)(a) of the 1986 Act, and requires that the respondent had made the withdrawals which are the subject of the present claim within two years of winding up, when he was a member of the LLP. The second part of the test ("limb 2") is that it must to be proved by the liquidator to the satisfaction of the court that at the time of each of the withdrawals the respondent knew or had reasonable grounds for believing that the limited liability partnership was unable to pay its debts within the meaning of section 123 of the Act (section 214A(2)(b)). The third part of the test ("limb 3") is that the court shall not make a declaration under the section with respect to any person unless that person knew or ought to have concluded that after each withdrawal there was no reasonable prospect that the limited liability partnership would avoid going into insolvent liquidation (section 214A(5)). For the purposes of limb 3, the facts which a member ought to know or ascertain, the conclusions which he ought to reach and the steps which he ought to have taken are those which would be known or ascertained, or reached or taken, by a reasonably diligent

person having both: (a) the general knowledge, skill and experience that may reasonably be expected of a person carrying out the same functions as are carried out by that member in relation to the limited liability partnership, and (b) the general knowledge, skill and experience that that member has (section 214A(6)).

Limb 1

[34] It was undisputed that limb 1 of the test was met.

Limb 2

[35] In relation to limb 2 of the test, on behalf of the respondent it was contended that section 123 of the 1986 Act is a deeming provision, which, if satisfied, creates a rebuttable presumption. The evidence that the company was in fact paying its debts as they fell due was said to rebut the presumption. In my view, that is an incorrect characterisation of the meaning and effect of section 123.

[36] In *BNY Corporate Trustee Services Ltd* v *Eurosail-UK 2007-3BL Plc*, the Supreme Court considered the meaning and effect of section 123. Lord Walker (with whose reasoning the other Justices agreed) observed that the "cash-flow" test (in section 123(1)(e)) is concerned:

> "not simply with the petitioner's own presently-due debt, nor only with other presently-due debt owed by the company, but also with debts falling due from time to time in the reasonably near future. What is the reasonably near future, for this purpose, will depend on all the circumstances, but especially on the nature of the company's business" (para 37).

Further, in section 123(2), the express reference to assets and liabilities was:

> "a practical recognition that once the court has to move beyond the reasonably near future (the length of which depends, again, on all the circumstances) any attempt to apply a cash-flow test will become completely speculative, and a comparison of present assets with present and future liabilities (discounted for contingencies and deferment) becomes

> the only sensible test. But it is still very far from an exact test, and the burden of proof must be on the party which asserts balance-sheet insolvency"(para 37).

Lord Walker added (para 38) that whether or not the test of balance-sheet insolvency is satisfied must depend on the available evidence as to the circumstances of the particular case. He went on to refer to the observations made by Lord Neuberger in the court below (reported at [2011] 1 WLR 2524) concerning section 123(2), including the following:

> "[44] In practical terms, it would be rather extraordinary if section 123(2) was satisfied every time a company's liabilities exceeded the value of its assets. Many companies which are solvent and successful, and many companies early on in their lives, would be deemed unable to pay their debts if this was the meaning of section 123(2)…
>
> [47] More generally, I find it hard to discern any conceivable policy reason why a company should be at risk of being wound up simply because the aggregate value (however calculated) of its liabilities exceeds that of its assets. Many companies in that position are successful and creditworthy, and cannot in any way be characterised as "unable to pay [their] debts". Such a mechanistic, even artificial, reason for permitting a creditor to present a petition to wind up a company could, in my view, only be justified if the words of section 123(2) compelled that conclusion, and in my opinion they do not."

Lord Neuberger went on to use of the expression "the point of no return" as part of his analysis of the meaning and effect of the provision. Lord Walker did not endorse the use of that expression, but referred (para 42) with approval to the judgment of Toulson LJ in the Court of Appeal (at para 119):

> "…Essentially, section 123(2) requires the court to make a judgment whether it has been established that, looking at the company's assets and making proper allowance for its prospective and contingent liabilities, it cannot reasonably be expected to be able to meet those liabilities. If so, it will be deemed insolvent although it is currently able to pay its debts as they fall due. The more distant the liabilities, the harder this will be to establish."

[37] As these observations make clear, for the purposes of the definition of inability to pay debts, the fact that liabilities exceed assets at a particular point in time is not of itself conclusive. On the other hand, it does not follow from the fact that the company is currently paying its debts as they fall due that the test of inability to pay debts cannot be met. Rather, the court has to look

at the wider picture. In particular, this wider picture includes (for the purposes of section 123(1)) taking into account debts falling due in the reasonably near future and (for the purposes of section 123(2)), looking at the company's assets and making proper allowance for its prospective and contingent liabilities, to see whether it cannot reasonably be expected to meet those liabilities. Satisfaction of either sub-section, read and understood in these terms, results in a deemed inability to pay debts. It is therefore not correct to say, as the respondent contended, that the fact that a company is currently paying its debts as they fall due amounts to a rebuttal of what, in a case of balance-sheet insolvency, as described by Lord Walker, would be the deemed position in terms of section 123(2) of inability to pay debts. In short, evidence that a company is currently paying its debts as they fall due does not of itself prevent the company being deemed to be unable to pay its debts; that can still be the conclusion when one looks at the wider picture.

[38] As was also made clear in *BNY Corporate Trustee Services Ltd* v *Eurosail-UK 2007-3BL Plc*, it is of course necessary to address the particular facts and circumstances pertaining to the entity in question. I now turn to do so. While the discussion that follows at this point is in the context of limb 2 of the test, many of the facts and circumstances are also relevant for the purposes of limb 3.

[39] In the present case, the LLP was not a stand-alone trading entity. Rather, it was one of three family businesses, all having some involvement and connection with each other. In the case of LTC, that involvement and connection with the LLP was extensive and fundamental to each of their businesses, as the LLP was the sole means of selling the goods which LTC imported. The LLP had the customer base, which was understood to be unwilling to deal directly with LTC because of the cash and carry nature of part of that entity's activities. The general partnership, whose members included the Mobarik brothers, had a continuing interest in renting out premises to the LLP for storage. There was simply no evidence that the family members were willing to

allow the LLP to go into insolvent liquidation, prior to December 2014. The effect of it doing so would be to leave LTC with millions of pounds of irrecoverable debt (leaving aside any dividend from the realisation of the, relatively speaking, limited assets of the LLP). As the accounts stated, the members of the LLP were, at all material times, confident of continued support, particularly from LTC, and of the LLP's long term trading prospects.

[40] The LLP's business model was somewhat unusual. It arranged for the sale of goods which were then consigned to it by LTC. It stored the goods and paid the storage charges. Notwithstanding that the LLP received the 32% discount and the 10% rebate, it had never made a profit. In its final accounts, its trading loss was some £280,965. According to those accounts, its liabilities exceeded its assets by £4,670,060. The debt claimed by LTC following the entry of the LLP into administration was £11.79m. Yet the LLP had never been subjected to pressure from creditors, because, according to the evidence, it always paid its debts on time. It was, on Shokat Mobarik's evidence, in effect the marketing arm of LTC. The evidence on how it might have become profitable if the separation of business interests or demerger did not occur was relatively limited. On the negative side, attempts to increase the discount had been resisted by LTC's other directors. On the positive side, Shokat Mobarik's evidence was that turnover was increasing. In view of the existence of the 32% discount and the 10% annual rebate, any increase in turnover would result in the return of significant percentage of that increase to the LLP. I was not, however, shown evidence of what level of increase in turnover would be required to render the LLP profitable.

[41] LTC was, on the face of it, dependent on the LLP to generate sales and to purchase from LTC the goods to be sold. The evidence was that LTC charged the LLP the same price for the goods as that at which the LLP had agreed to sell the goods to its customers, and then the discount was applied. The financial position of LTC was not itself the subject of evidence.

[42] The noter led no evidence, and made no submissions, as to any differences in the specific facts and circumstances at the time of each withdrawal. Rather, the approach taken was that standing the financial position of the LLP during the period within which the withdrawals occurred, the respondent was liable. I do not therefore require to consider each individual withdrawal.

[43] On behalf of the noter, it was submitted that the period of credit allowed by LTC was not binding upon it, with the result that LTC could simply enforce payment of the outstanding debt at any time. Even if that is formally correct, I do not perceive it to be a material, let alone decisive, factor. In light of the evidence of the established pattern of a 12 month period of credit and of the members of the LLP understanding that the support of LTC would continue, and no suggestion of LTC ever seeking payment at an earlier point in time than 12 months, I do not regard the possibility of earlier enforcement to be something which the respondent should have had in mind. The 12 month period of credit was, on the evidence, to his knowledge implicitly accepted and adhered to at all material times.

[44] Mr Khushi explained that, at the meeting in July 2014, the Mobarik family indicated an intention to provide continuing financial support to all parts of the Mobarik businesses. There was no suggestion of anyone even considering the prospect of any of the businesses, including the LLP, being placed into administration or liquidation. The Heads of Agreement reached at the meeting recorded that the family would work together to further the earlier agreement in principle that the business interests of the brothers would be separated.

[45] The respondent's evidence included that, on the information available to him the position was as follows: (a) the LLP was repaying the debts to LTC and to external creditors on a formal and regular basis; (b) in a liquidation LTC would have been left with substantial trading losses

as it was dependent on the LLP as its only customer, the LLP having an established housewares market in the UK and abroad; and (c) the Mobarik family did not wish to incur the reputational damage occasioned by any insolvency, which would have damaged their family name in the community. The respondent's testimony was that from the outset LTC had provided, year on year, long term financial support to the LLP. There was never any reason, until December 2014, to believe that, going forward, there would be any change in the financial support from LTC, as majority creditor. The 10% rebate had been given by LTC every year and it was only in December 2014, after the decision was taken to put the LLP into administration, that LTC decided that the credit note for the calendar year 2014 was not to be issued. There was no indication in advance that this might occur. The respondent knew that the brothers had been in negotiations to allow Shokat Mobarik to continue the LLP under his sole control. The respondent also stated that the expectation was that Anjum Mobarik would resign from the LLP. Only in December 2014 did it become clear that the LLP would not be able to continue to rely on LTC's financial support. He described this as a "sudden change in circumstances" which could not have been predicted. He had been aware of differences between the brothers for some time, but only in May 2014 did he become aware of the demerger being suggested. But there was never any suggestion of insolvency or that this was something which the family members ever wanted to consider.

[46] Shokat Mobarik was able to speak authoritatively about the position of the LLP and LTC, having been, respectively, a member and a director. His evidence was that at no time was it ever intended that the relationship between the two businesses would change. In particular, none of the directors of LTC had suggested that its support for the LLP would be withdrawn. After the demerger, once Shokat Mobarik had sole ownership of the LLP and the import division of LTC, it was his intention to put more capital into the LLP and reduce the rent and storage charges.

Having complete control of the amount of discount and rebate, his position was that the LLP would become a very viable and profitable business. It was not in LTC's interests that the LLP would cease trading and go into insolvent liquidation, as that would result in "huge losses" to LTC. It was only in December 2014 that he had decided that he was unable to continue in business with his brother Anjum and at no stage before then had he advised the respondent of any intention to wind-up the LLP. As he explained, he had always advised the respondent that he intended to inject more capital into the LLP following the separation of business interests, that he would also reduce the rent and storage charges and increase the discount given by LTC, and that the intention was to continue with the LLP. Further, his unchallenged evidence was that the turnover of the LLP was increasing.

[47] I turn now to apply the limb 2 part of the test. Dealing firstly with section 123(1)(e) and applying the analysis from *BNY Corporate Trustee Services Ltd* v *Eurosail-UK 2007-3BL Plc*, as at the date of each withdrawal of sums by the respondent, the debts falling due in the reasonably near future were primarily but not exclusively the sums outstanding to LTC. These were very substantial, but were being met. In addition, there were no obvious prospective liabilities, other than those arising in the ordinary course of business, including later debts incurred to LTC, and there was no evidence of contingent liabilities. I am satisfied that, having regard to all of the information available to the respondent, he did not know, nor ought he to have concluded, that the LLP was unable to pay its debts as they fell due for the purposes of section 123(1)(e). That provision, however, is not of course the only relevant part of section 123 on the question of inability to pay debts.

[48] Turning to section 123(2), and applying the test stated by Toulson LJ and endorsed by the Supreme Court, I require to decide, having regard to the company's assets and liabilities, and

making proper allowance for its prospective and contingent liabilities, whether the respondent knew or ought to have concluded that the LLP was unable to pay its debts, in respect that it could not reasonably be expected to meet its liabilities.

[49] I accept that the extent of the LLP's balance-sheet insolvency was increasing year-on-year and indeed that further significant losses were incurred between 31 March 2013 and the entry into administration of the LLP. There was, as the noter submitted, no evidence of any properly funded and implementable plan to reverse that situation, although there was of course evidence as to the proposed demerger and its consequences. There was little evidence as to how the LLP could pay back the debt due to LTC, other than by incurring further liabilities to LTC. It might be argued that the LLP could reasonably be expected to meet these existing liabilities because of the period of credit, with the result that the debt then existing to LTC and others would have been paid off, from the proceeds of later sales of goods consigned by LTC. However, an expectation that the LLP would meet its existing liabilities, by making payment of them in return for incurring further liabilities in their place, does not in my view suffice to avoid the test in section 123(2) being met: in order to pay the existing debt to LTC, new debt to LTC to the same extent required to be incurred. On that basis, the ongoing liabilities to LTC would continue without, in reality, being extinguished or met. Another way to put it, bearing in mind Lord Walker's analysis, is that the future LTC debt falls to be taken into account as a prospective liability of the LLP. As such, it must, for the purposes of the test, form part of the liabilities which the LLP required to be reasonably expected to meet.

[50] The reality was that LTC could only begin to be reimbursed by the LLP for the extensive historic debt if the LLP began to make a profit. The means by which, and the timescale within which, that might occur were not established in evidence. In relation to the evidence about the proposed demerger and its potentially beneficial consequences, that does not in my opinion

establish that there was a reasonable expectation that the LLP would meet its liabilities (taking appropriate account of its prospective and contingent liabilities). That evidence supports the view that the LLP may very well continue in business, with the support of LTC, but it simply does not follow that the LLP would make sufficient profit to be able to eradicate its accumulated losses, within any reasonable period of time.

[51] Thus, I accept the submission of the noter that the respondent had reasonable grounds for believing that the LLP was at the time of each of the withdrawals unable to pay its debts within the meaning of section 123(2) of the Act. I stop short of concluding that he actually knew that the LLP was unable to pay its debts, because that matter is really one which involves the exercise of balance and judgment, and the evidence did not establish any such actual knowledge. But the existence of reasonable grounds for belief is sufficient. I therefore conclude that the limb 2 part of the test is satisfied.

Limb 3

[53] As I have indicated, the limb 2 element of the test, if there is no proof of actual knowledge of inability to pay debts, depends upon there being reasonable grounds for believing that the LLP was unable to pay its debts within the meaning of section 123. That requires proof that such reasonable grounds existed, to the knowledge of the respondent. It also requires proof of the elements noted in the case law, for example, if section 123(2) is relied upon, that the LLP could not reasonably have been expected to meet its liabilities.

[54] The limb 3 part of the test introduces a further requirement, that it be shown that the respondent knew or ought to have concluded that after each withdrawal that there was no reasonable prospect that the LLP would avoid going into insolvent liquidation. The criteria in section 214A(6) fall to be applied for that purpose. The fact that the LLP was, at a particular

point in time, insolvent in the sense of being unable to pay its debts, does not mean that it follows that there was no reasonable prospect of it avoiding insolvent liquidation; satisfaction of limb 2 does not mean that limb 3 is also satisfied (*Re Hawkes Hill Publishing Co Ltd (In Liquidation))*.

[55] As a matter of onus, it might be said that the noter requires to prove the absence of a basis for concluding that there was a reasonable prospect of the LLP avoiding insolvent liquidation; it is not for the respondent to prove the presence of such a reasonable prospect. But this is no more than an onus point, which flies off when the evidence has been led. Once the evidence is led, the court can conclude on whether, at the time of each withdrawal, there was or was not a reasonable prospect of the LLP avoiding insolvent liquidation. If there was no reasonable prospect, and the respondent either knew that or ought to have so concluded (having regard to the factors to be taken into account under section 214A(6)) then the limb 3 part of the test is met. It is equally plain that, if at the time of the withdrawals there existed a reasonable prospect of the LLP avoiding insolvent liquidation, of which the respondent was aware, the limb 3 part of the test cannot be met; in those circumstances the respondent could not have known, nor ought he to have concluded, that there was no such prospect.

[56] In his contentions as to the limb 3 part of the test, again the noter made no distinction between the various points in time at which the withdrawals occurred but relied upon the evidence as to the LLP's continuing financial difficulties. As I have observed earlier, there was no evidence that any creditor was dissatisfied with the timing of debt repayments, let alone that any creditor ever threatened to raise, or actually raised, any proceedings. It is true that as at December 2014, on the administrator's findings, some £1m of other debts (that is other than debts to LTC) existed, but there was no evidence of any earlier failures to pay. Nor was there any evidence that, at the time the withdrawals were made, there was any suggestion of the initiation of procedures for insolvent liquidation (whether at that point or in the future) voluntarily or by a

creditor. True it is that the plug was eventually pulled by the members of the LLP, but that does not assist in assessing the prospect of such an event as at the time of the withdrawals.

[57] Insolvent liquidation requires a process. That process is normally initiated either voluntarily or by creditors. If there is no evidence that initiation of the process voluntarily might occur and no evidence that any creditor was likely to initiate the process, that is plainly material which requires to be taken into account; insolvent liquidation will be avoided if the process will not be initiated.

[58] The evidence of the respondent about the consequences of insolvent liquidation and in particular its effects on LTC and the family was convincing. So too was his evidence, supported by that of Shokat Mobarik, of the long term financial support provided by LTC to the LLP. There was no reason for, and no indication of, any potential change, until the "sudden change in circumstances" which occurred in December 2014. I recognise that the LLP's auditors had noted the existence of a material uncertainty which, it was said, may cast significant doubt about the LLP's ability to continue as a going concern. But they also noted that the members of the LLP remained confident of the continued support of, in particular, LTC. LTC was not controlled by Shokat Mobarik, and its other directors were in the same camp as Anjum Mobarik, but that does not lead to the view that LTC had any interest or desire in the LLP being placed into insolvent liquidation. It is true that LTC took no steps to stop administration or liquidation when they occurred, but it was not really in its gift to do so.

[59] Moreover, in relation to the demerger, while it is true that at the time of the withdrawals Anjum Mobarik had not yet agreed to the terms of any split and required to take tax advice, the general thrust of the evidence supported the existence of a reasonable prospect that the demerger would occur. It was in fact the only solution on the table to the apparently irremediable discord between the brothers. Had it occurred, Shokat Mobarik would have had full control over the

links between the import side of LTC and the LLP and it is an obvious conclusion from his evidence that in those circumstances he would not have contemplated or initiated insolvent liquidation of the LLP. The reasonable prospect that the demerger would occur and its likely consequences therefore of themselves give rise, in turn, to a reasonable prospect of avoiding insolvent liquidation.

[60] I have accepted the uncontested evidence from Shokat Mobarik that turnover was increasing. It is however not possible to draw any specific conclusions from that evidence. With greater turnover, the 32% discount and the 10% rebate would result in more money returning to the LLP. But there was no evidence dealing with the point that if, say, a £10m turnover still did not cover the LLP's costs and allow a profit, how much would be needed to do so. Absent any detailed evidence of projected future profit, I can only accept the broad point that increasing turnover would have given increased returns for the LLP. Thus, the evidence about an increase in turnover does not materially assist in establishing a reasonable prospect of avoiding insolvent liquidation.

[61] I do not accept that a reasonably diligent person in the position of the respondent (applying the criteria in section 214A(6)) would, as was contended for the noter, have sought from Shokat Mobarik details of any plan, along with justifications, for the LLP moving towards profitability. The point was a broad one: he would control both entities, which relied upon each other, and on his evidence he would have ensured their survival. Precise details of the financial arrangements were not something a reasonably diligent person needed to know or should have sought to ascertain. I also reject the contention that a reasonably diligent person would have sought knowledge of all the underlying reasons for the discord between the brothers. The reasons for the discord were of much less significance than the fact of its existence and the probable effects of its continuance. The fact of its existence pointed towards a need to split the

business interests rather than towards the prospect of insolvent liquidation. Its probable effects did not include any contemplation of insolvent liquidation; rather, they included a demerger which, on Shokat Mobarik's intentions, could only benefit the financial health of the LLP.

[62] No doubt in some cases, if it is shown (as I have concluded here) that there existed reasonable grounds for believing that the relevant entity was unable to pay its debts because it could not reasonably be expected to meet its liabilities, it may be difficult to find a basis for concluding that it nonetheless had a reasonable prospect of avoiding insolvent liquidation. But the circumstances of the present case are somewhat unusual. I conclude that the noter has not established that the respondent knew, or ought to have concluded, that there was no reasonable prospect of the LLP avoiding insolvent liquidation. On the evidence, there was no suggestion of any creditor being likely to initiate an insolvency process, nor was there evidence suggesting voluntary initiation of the process. Further, there were good reasons (as explained in the evidence of the respondent and of Shokat Mobarik) why LTC and the family members would not want insolvency to occur and indeed would continue to support the LLP. The evidence on these points, taken together, suffices to establish the existence of a reasonable prospect of avoiding insolvent liquidation. The evidence concerning the discussions and proposals for a demerger of the interests of the family members, in particular of the brothers, and the consequences of such a move, also, and independently, supports the position that there was a reasonable prospect of avoiding insolvent liquidation.

[63] Turning to the cases founded upon by the noter, I accept that the concept of a reasonable prospect of avoiding insolvent liquidation requires consideration of rational expectations of what the future might hold: *Re Hawkes Hill Publishing Co Ltd (In Liquidation)*. I have no difficulty in concluding that the respondent's expectations, viewed in terms of section 214A(6), were entirely rational and satisfied that requirement. Unlike the circumstances of *Re Ralls Builders Ltd (In*

Liquidation), this is not a case where hope was placed on a specific event coming about which would save the company. There were various other factors (such as the mutual business interests and relationships and the absence of any suggestion of the initiation of insolvency) which supported the existence of a reasonable prospect of avoiding insolvent liquidation and meant that the reasonably diligent person in the position of the respondent would not have proceeded on the basis merely of the hope of some such event. But certainly from May 2014 there was separately, and in addition, a rational basis for concluding that the demerger plans would come to fruition, with helpful consequences for the future of the LLP. For the same reasons, having regard to the evidence, the present case cannot be described as one of wilfully blind optimism or reckless belief that something might turn up, which on any objective view was groundless and forlorn (*Roberts (Liquidator of Onslow Ditchling Ltd)*. Nor did the position of the respondent fall within merely a speculative hope that things might all work out (*Re Kudos Business Solutions Ltd (In Liquidation)*); it had a reasonable and rational basis. I accept that in an appropriate case some weight can be placed upon whether professional advice was taken (*Re Hawkes Hill Publishing Co Ltd; Re Ralls Builders Ltd*) but in the present case the circumstances did not create any reasonable requirement that such advice be sought.

[64] In reaching my views, I have not placed any reliance on the suggestions by the respondent that there had been an overly aggressive write down of the LLP's assets and that the losses in the balance sheet were reduced if deductions for amortisation and depreciation were added back. Rather, I have proceeded on the basis that the accounts gave the true picture.

Summary

[65] In summary, meeting liabilities which are largely to a particular creditor by replacing them with new liabilities to that creditor, in a continuing and, for the foreseeable future,

unending cycle, is not enough to stop the requirements of section 123(2) being met. The proposed demerger plans and their implementation do not support a reasonable expectation, at the material times, of liabilities being met for the purposes of section 123(2). They support the view that the business may very well continue. Profitability could result, as Shokat Mobarik intended, but equally the cycle could simply continue, albeit with a reduction in debt. Thus, the evidence on this part of the test did not give a sufficient basis for concluding that liabilities actually would be met, or indeed any timescale for so doing.

[66] However, a reasonable prospect of avoiding insolvent liquidation is established when there is no suggestion of that occurring or being likely to be initiated, whether voluntarily or by any creditor, and there are good reasons why the family members who control and have at all times financially supported the key businesses wish to avoid such a course. In respect of the withdrawals made from May 2014, the existence of that reasonable prospect is further and separately established by the evidence about the demerger and its potential consequences.

[67] Accordingly, a basis for reasonably expecting liabilities in existence at the time of the withdrawals to be met did not exist. Thus, the limb 2 part of the test which I have to apply is met. However, on the evidence which I have accepted, a reasonable prospect of avoiding insolvent liquidation was not shown by the noter to be absent. Rather, it was demonstrated to be present, on two separates bases (the second of which applied from May 2014). The limb 3 part of the test is therefore not satisfied.

Conclusion

[68] For these reasons, I refuse the prayer of the Note.