

Dispositions of Company Property in UK Insolvency: Are You “Special” Enough to be Validated?

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The presumption that courts normally validate dispositions by a company subject to a winding up petition if such dispositions are made in good faith and in the ordinary course of business has been called into question in the recent case of *Express Electrical Distributors Ltd v Beavis and others* [2016]. Whilst the court has discretion to validate a disposition, it was considered that the court must balance the interests of the recipient of the company’s property with the company’s other creditors and unless there are special circumstances justifying validation of a transaction, the *pari passu* principle must not be overridden.

The Legislation

Section 127 of the Insolvency Act 1986 (“the Act”) provides that any disposition of a company’s property made after the commencement of a winding up (i.e. after the date of presentation of a winding up petition) is void unless a validation order is made in respect of that transaction. This is to ensure the preservation of assets for the benefit of all the company’s creditors and to guard against the risk of preference of creditors, ensuring all unsecured creditors are treated equally and paid *pari passu*.

The Facts

Edge Electrical Limited (“Edge”) regularly received electrical goods from its supplier Express Electrical Distributors Limited (“Express”). Payment was due on the last day of the calendar month immediately following the calendar month in which delivery took place. Edge generally paid for goods on the last permissible date under terms agreed between the parties, utilising the maximum credit to which it was entitled. From November 2012, however, Edge began to pay late and this pattern continued for several months. Following supplies made in April 2013 and after several attempts made by Express to contact Edge, a payment of £30,000 was made by Edge to Express on 29 May 2013. Although at this date Express had supplied goods to Edge with a value in excess of £30,000, strictly speaking, nothing was due from Edge to Express until 2 days after the payment was made (i.e. on 31st May). Even then, invoices totalling only circa £25,000 were contractually due for payment – the balance of circa £5,000 was not due for payment until 30 June 2013.

On 22 May 2013, seven days prior to the payment being made to Express, another creditor of Edge had presented a winding up petition against it. Edge's directors claimed not to have known about the petition at the time of making payment to Express. A winding up order was ultimately made against Edge on 15 July 2013 and in accordance with s.129(2) of the Act, the winding up was deemed to have occurred on 22 May 2013.

The key question on the facts of this case was whether there should be validation of the payment of the £30,000 on the basis that such payment was necessary to secure the continued supply of goods from Express to Edge after 29 May 2013.

The Decision

The Court of Appeal upheld the decision of the District Judge not to grant a validation order in respect of all or part of the £30,000 payment. The court scrutinised the scope of its discretion to make a retrospective validation order and concluded that there needs to be "special circumstances" showing a benefit to the general body of creditors to justify overriding the pari passu principle. Special circumstances may include, for example:

1. A payment to secure the continued supply of goods necessary for completion of a profitable contract; or
2. a transaction in the ordinary course of business that would assist in ultimately achieving a sale of the business as a going concern for the benefit of creditors.

It should not be presumed that a validation order will normally be made even in respect of a disposition made in good faith in the ordinary course of business without knowledge of the outstanding winding up petition.

The facts of the case that can be distinguished on the basis that here, the petitioner had made numerous references to the possibility that he might present a winding up petition and as such, it was difficult to accept that Edge's directors had no idea that a winding up petition had been served. Furthermore, on the facts, there was evidence that the payment may not have been made in good faith and could have been an attempt to prefer because:

1. payment was made much more quickly than in the months immediately preceding the payment and earlier than strictly required by the supply contracts (two days earlier in respect of circa £25,000 and one month and one day earlier in respect of circa £5,000);
2. the goods to which the payment related had already been supplied and as such, the payment did nothing more than put Express in a better position than Edge's other pre-petition creditors; and
3. the benefit of making the payment had not been fully explained by Express or Edge.

Comment

This case highlights the need for companies in financial difficulty to monitor closely any creditor threats and treat these with more care than they may have done previously. Proceeding with transactions (even in the ordinary course of business) in ignorance of such threats, spurious or genuine, risks transactions becoming void if a winding up order is made at a later date. Any parties entering into contracts with companies in distress may also wish to carry out regular insolvency checks against those companies. Special circumstances should be demonstrated that benefit creditors and justify a departure from the pari passu principle – for example, that the payment was

to ensure continued supply of goods to the Company which:

1. ultimately led to a going concern sale of the Company rather than a forced sale; or
2. led to the completion of a profitable contract; or
3. resulted in the position of the unsecured creditors improving.

Ultimately, parties transact at their own risk where a winding up petition is outstanding.

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