

# Insolvent Sellers And Validation Orders In The English High Court: Buyer Beware!



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In the recent case of *Wilson* (as liquidator of 375 Live Ltd) v SMC Properties Limited, the English High Court reviewed the policy behind section 127 Insolvency Act 1986 (“the Act”) and the underlying principles that apply to validation order applications. The Court considered the interaction between the requirement of good faith and the role of market value and held in this case that the purchaser’s lack of knowledge of a winding up petition presented had to be weighed against the element of undervalue when assessing the overall good faith of a transaction.

## The legislation

Section 127 of the Act provides that in a winding up by the court, any disposition of a company’s property made after the commencement of the winding up (i.e. the time of presentation of the winding up petition) is void unless the court makes a validation order in relation to the transaction. When considering retrospective validation orders, the Court is concerned to balance the interests of the buyer and those of the company’s creditors and is more inclined to validate dispositions that were made in good faith, at arm’s length terms for proper consideration and before either the company or the buyer became aware of the existence of the winding up

petition.

## **Facts**

In November 2013, SMC Properties (“SMC”) sought to sell a property which had been threatened with repossession by its mortgagee. In February 2014, a petition for the winding up of SMC was presented. SMC sold the property to the buyer in March 2014 and a winding-up order was made a month later. The buyer made a retrospective application for a validation order in relation to the transaction, asserting that it had been made in good faith, at arm’s length and had been at a fair market value. The liquidator argued the sale was at an undervalue and that as such, the transaction should not be validated.

## **The decision**

The Court stated that the purpose of s.127 was to ensure an insolvent company’s assets were distributed equally among creditors and could not be disposed of to the detriment of the company’s creditors. It accepted here that the purchaser was unaware of the presentation of the petition prior to entering into the sale agreement and that the transaction had been made in good faith and at arm’s length within the context of the mortgagee pressing for payment and threatening repossession if not paid.

The Court made it clear that it would be reluctant to validate a transaction if there was a significant reduction in the value of the company’s assets available to unsecured creditors as a result of it. Here, the liquidators had adduced evidence that the property was worth approximately £900,000 (although the evidence took no account of the limited marketing period and increased sale costs arising in a distressed sale scenario). The purchaser had paid £850,000 for the property. The Court applied a 5% margin of error to the liquidators’ valuation of £900,000 and ruled that, given the minimal difference between the liquidators’ valuation and the purchase price paid, creditors had not suffered significantly, if at all.

As such, the Court exercised its discretion to validate the transaction.

## **Summary**

This case highlights 2 issues: (1) the importance of carrying out insolvency searches against vendors when acquiring assets, to ensure that buyers do not inadvertently fall foul of section 127 and (2) the necessity of obtaining valuations to justify the value paid for an asset, particularly where a seller is in financial difficulties. Where a buyer becomes aware that a petition has been presented in the course of a transaction, they can apply immediately for a validation order and, assuming the Court is happy the transaction does not circumvent the policy behind section 127, will be able to proceed safely with the transaction with the benefit of such an order. It is better to apply in advance for an order validating a transaction with a company subject to a winding up petition (if its existence is known) given that there is a risk the court may decline to validate the transaction retrospectively if it falls foul of the policy behind section 127.

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