S423 INSOLVENCY ACT 1986: OPPORTUNITIES FOR VICTIMS

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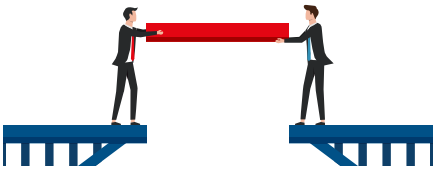
The powerful relief available under section 423 Insolvency Act 1986 (s423) is not just available to insolvency practitioners but to victims of transactions defrauding creditors too. It is increasingly being used by fraud and asset recovery practitioners, and we outline some key features below.

1. What is s423?

In brief, s423 concerns transactions at an undervalue for the purpose of putting assets beyond the reach of potential or actual creditors, or otherwise prejudicing the interests of such a person in relation to a claim which they are making or may make. Relief can include restoring the position to what it would have been had the transaction not been entered into, and protecting the interests of persons who are victims of the transaction.

2. Extra-territorial reach of s423

The court can grant permission for a claim to be served out of the jurisdiction if that claim is made under an enactment which allows proceedings to be brought and those proceedings are not covered by any of the other grounds in CPR Practice Direction 6B. Given that it was not otherwise covered by PD 6B, the question of whether s423 fell within this gateway was finally resolved in the Court of Appeal in Orexim Trading Ltd v Mahavir Port and Terminal Private Ltd[1]. Accordingly, s423 has extra-territorial effect, and can be used in relation to both evasive fraudsters and assets overseas. However, this is subject to demonstrating sufficient connection with the jurisdiction[2].



3. Is there a sufficient connection to the jurisdiction?

Whether or not there was a sufficient connection to England and Wales was one of the questions considered in Akhmedova v. Akhmedov[3], where a former husband set up a series of schemes designed to put his assets out beyond his ex-wife's reach following a divorce award, including by setting up Liechtenstein trustee companies. The former wife, Ms Akhmedova, sought to have certain transactions set aside using s423.

The respondent trustee companies denied that there was sufficient connection, relying upon SAS Institute v World Programming[4], in which the Court of Appeal had stressed the importance of not making orders with exorbitant extraterritorial effect in respect of property located abroad. The trustees argued that any order under s423 would have exorbitant extraterritorial effect, and they would be subject to a real risk of prosecution in Liechtenstein if they complied. Knowles J had little difficultly in distinguishing the SAS Institute case. The transfers made to the trusts by Mr Akhmedov or at his direction were put into effect in order to evade an English claim brought by Ms Akhmedova, an English resident. There was therefore a sufficient connection.

4. Wide ambit of 'victims' under s423

Helpfully for claimants in fraud cases, it is apparent that a wide ambit of victims have standing to bring a claim under s423.

1 [2018] EWCA Civ 1660
2 Re Paramount Airways [1992] Ch 223
3 [2021] EWHC 545 (Fam)
4 [2020] EWCA Civ 599

In Akhmedova, the Liechtenstein trustees submitted that Ms Akhmedova had no standing as a "victim" under s423. The assets in question had been held previously in Switzerland and she had not been able to enforce her order there. Following the transfer of the assets to Liechtenstein, the trustees argued that Ms Akhmedova did not and could not suffer any prejudice upon such transfer. However, the Judge held that Ms Akhmedova was a "victim" under s423 as she was a person capable of being prejudiced by the transaction, the transaction having converted the respondent from an entity at least capable of paying its liabilities to an empty shell which was hopelessly insolvent. The transactions were made with the prohibited purpose, and it was not therefore necessary to prove that enforcement had become more difficult.

5. Identity of the party to the transaction / beneficial ownership

Just as 'victims' are construed widely, there is scope to apply s423 even when the debtor is not party to the transaction complained about. This issue recently arose in Invest Bank v El-Husseini & others[5]. Here the majority of the transferred assets were held not by the individual judgment debtor, but by a company said to have been wholly owned or controlled by him. When the company then disposed of assets, did that constitute an entry by the company's owner/controller into a transaction (whether that transaction was with his company, the transferee of the assets or both)?

The court found that, without more, the company's disposal of assets could not be a transaction entered into by the debtor under s423, in light of ordinary principles of company law and the separate legal personalities involved. Nevertheless, the judge did find that such a transaction could fall within s423 if the debtor was to go beyond the steps taken by his company, for instance, if he acted on his own behalf rather than the company's. In particular, a "transaction" can extend to an agreed plan pursuant to which an asset will come to be transferred, and is not limited to the action or actions by which the transfer is made.

6. Does the asset need to be beneficially owned by the debtor?

This question arose in Invest Bank. The court found that s423 claims did not contain such a stipulation. There was no such limit in the definition of "transaction" in s436 or in the definition of the impugned purpose in s423(3). Therefore, s423 could extend to an arrangement whereby a transferee acquired at an undervalue an asset owned by a debtor's company, with a view to putting that asset beyond the (indirect) reach of the creditor.

7. Does the debtor need to have insufficient assets following the transaction to satisfy its liabilities to the creditor?

This novel question was raised by the Akhmedov respondents, who argued that s423 contained a "gateway" condition before any transaction could be set aside. However, this was not within the plain wording of the statute and was rejected by the court. Imposing such a condition would unduly prejudice creditors' interests.

8. Conclusion

These cases demonstrate that s423 is a wide-ranging and flexible means of recovery for victims of fraud, and one that should be in every FIRE practitioner's toolbox.

5 [2022] EWHC 894 (Comm)

COOKE, YOUNG & KEIDAN

COMMERCIAL DISPUTES LAWYERS

There are sure to be fireworks at our BonFIRE party for the FIREStarters community.

Date: 3 November 2022

Time: 6pm

Venue:

Cooke, Young & Keidan Offices

21, Lombard St, London EC3V 9AH

RSVP here by 28 October

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