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PARTY RECOVERS LIABILITY CONTRIBUTIONS IN S.423 IA 1986 PROCEEDINGS

Section 1 of the Civil Liability (Contribution) Act 1978 provides the right for any person who is found liable in respect of damage suffered by another person to recover a contribution from others who share the liability (“the 1978 Act”).

The recent case of *Dormco SICA Ltd v SBL Carlston Ltd v Mr and Mrs Munn [2021] EWHC 3209 (Ch)*, sheds light on the application of the 1978 Act in the context of a claim brought under section 423 of the Insolvency Act 1986 (“S.423”).

S.423 provides that where a transaction at an undervalue has taken place (i.e. where the consideration for the transaction is significantly less than its true value) with the intent to defraud the company’s creditors by putting assets beyond their reach or otherwise prejudicing their interests, then the court can restore the position the company would have been in, had the transaction not been entered into. Such an order may require any person that has received a benefit from the transaction to make a payment which reflects that benefit, as was ordered in *Dormco*.

In *Dormco*, SBL was held to have entered into such a transaction because the goodwill of the business, despite being worth over £2 million, was sold for a mere £1.

The Applicants argued the transaction had occurred in order to place the true value of the goodwill beyond the reach of the business’s creditors as they would be prevented from claiming this money in the liquidation.

SBL defended the claim and brought a Part 20 claim against shareholders Mr and Mrs Munn. A Part 20 claim is a third-party claim which includes, as in the case here, a Defendant seeking a contribution from another person.

SBL relied on the 1978 Act as their legal justification in seeking this contribution. They argued that by allowing *Dormco* to enter into a sale at an undervalue, Mr and Mrs Munn were also responsible for any liability that may be ordered against SBL.

Mr and Mrs Munn unsuccessfully argued that they could not be liable as they did not receive any benefit as a consequence of the transaction. The court held that Mr and Mrs Munn benefited from the undervalue as they received substantially more money for the shares they had sold because none of the purchase money had been apportioned to the goodwill.

It was therefore held that it was equitable and right for the protection of the creditors, to order a contribution from Mr and Mrs Munn pursuant to the S.423 claim for the amount of consideration paid for their shares that was attributable to the true value of the goodwill. The court did not accept Mrs Munn’s defence that she had no knowledge of the undervalue as being relevant to this decision because she had still financially benefited from the transaction. Mr Munn, by causing *Dormco* to enter into the transaction as a director, was also found to have breached his statutory and fiduciary duties under ss171-177 of the Companies Act 1986 (albeit without double counting).

Editor’s Note

S.423 continues to prove a useful weapon in an office holder’s armoury.

However a note of caution. As we have previously reported, S.423 claims cannot be issued under the Insolvency Act 1986 and so such claims attract a significant issue fee.



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