Introduction

On 28 July 2016, the English Court of Appeal delivered its decision in *Express Electrical Distributors Ltd v Beavis and others* [2016] EWCA Civ 765, which considered whether a validation order should be granted in respect of a payment that had been made for pre-liquidation supplies at a time when neither party was aware of the winding-up petition. The judgment is important as it clarifies the principles of granting a validation order.

Background

Express Electrical Distributors Ltd ("Express") is a company which trades in the wholesale supply of electrical goods. Edge Electrical Limited ("Edge") was in the business of installing electrical equipment in high value properties. In about 2011, Edge became a customer of Express and purchased significant quantities of goods from Express every month or so. In order to utilize the maximum credit to which Edge was entitled, Edge generally paid for the supplies on the last available payment date allowed under Express’s terms and conditions. However, from November 2012, Edge started to pay late. On 29 May 2013, in response to a number of attempts by Express to contact Edge, Edge made a payment of £30,000 to Express in respect of goods already supplied.

In the meantime, unknown to both Express and Edge, Mr. Graham Cook, another creditor of Edge, issued a winding-up petition against Edge on 22 May 2013. A winding-up order was subsequently made over Edge on 15 July 2013, with effect from the date of the petition. The liquidators of Edge demanded the repayment of the £30,000 from Express. Express then made an application seeking a validation order under section 127 of the Insolvency Act 1986, which is equivalent to section 182 of the Companies (Winding-Up and Miscellaneous Provisions) Ordinance (Cap 32). Section 127 renders void, except where court permission has been granted, any disposition of company property made after the commencement of the winding-up. The application was dismissed by the District Judge and on appeal to the High Court. Express appealed to the Court of Appeal.

Court of Appeal’s Decision

The Court of Appeal considered that the applicable principles in deciding whether a validation order should be made are contained in the leading English decision of *Re Gray’s Inn Construction Co Ltd* [1980] 1 WLR 711. In this landmark decision, Buckley LJ explained
and emphasised that it is a fundamental principle of insolvency law that the free assets of the insolvent at the commencement of the liquidation shall be distributed rateably amongst the unsecured creditors as at that date. Therefore, it must be shown that special circumstances exist which makes a particular transaction one in the interests of the creditors as a whole before a validation order will be made to override the usual application of the *pari passu* principle. Special circumstances include cases where, for instance, the creditor concerned has since the presentation of the petition helped to keep the company afloat, or has otherwise swollen the company’s assets, salvage cases and that sort of thing: *In re J. Leslie Engineers Co. Ltd* [1976] 1 WLR 292.

On the facts, the Court found that the goods to which the £30,000 payment related had all been supplied by Express on credit prior to the making of that payment and were already available for use in Edge’s business regardless of whether that payment was made or not. Further, it was found that following the payment, Express only supplied goods worth £13,000 and by supply in the ordinary way, rather than on any specially advantageous terms. Moreover, there is no evidence to suggest that those supplies were made in order to secure completion by Edge of particularly profitable contracts so as to achieve a better overall result for the general body of creditors than would otherwise have been the case. On the contrary, the evidence only indicates that Edge wanted the goods to be supplied in order to continue to carry on its business generally in its ordinary course for as long as possible in the hope that its position might improve, and without there being any objective of the sale of the business as a going concern in view. In light of these findings, the Court came to the view that it was not in the interests of the general body of creditors that Express should receive the £30,000 for the goods supplied, in breach of the *pari passu* principle.

Express then sought to rely on a passage in the judgment of Buckley LJ in *Re Gray’s Inn Construction* which contains the dicta that “a disposition carried out in good faith in the ordinary course of business at a time when the parties are unaware that a petition has been presented may normally be validated by the court.” The Court found it not easy to square this proposition with the emphasis his Lordship gave elsewhere in his judgment to the importance of the *pari passu* principle. This proposition, the Court concluded, is too flimsy to constitute a clear judicial direction that the principle of *pari passu* should be set aside in cases involving the parties’ good faith and ignorance of the relevant winding-up petition. Thus, the Court concluded that the statement by Buckley LJ, i.e. it is presumed that a validation order in cases apparently involving good faith payments made in ignorance of an outstanding winding-up petition, cannot be taken at face value and applied as a rule in itself. The true position is that, a validation order should only be made in relation to dispositions occurring after presentation of a winding-up petition if there is some special circumstance which shows
that the disposition in question will be or has been for the benefit of the general body of unsecured creditors, such that it is appropriate to override the usual *pari passu* principle.

**Conclusion**

The judgment is important as it brings clarification to the oft-cited presumption that the court will grant a validation order in cases apparently involving good faith payments made in ignorance of an outstanding winding-up petition.

The outcome of the case appears to be a little harsh, which might result from the finding of the Court that the payment was probably not made in good faith, as it was made much more quickly than in previous months. It is perhaps arguable that the further supply of the goods did benefit the general body of creditors in a negative sense in that it minimised the exposure of Edge to damages for breach of other contracts: *Re Luen Cheong Tai Construction Co Ltd* [2004] 1 HKLRD 735. In any event, the judgment serves as a reminder that those seeking validation orders to continue trading or for specific creditors to be paid must produce clear and credible evidence that the payment will or did produce a benefit to the general body of creditors.

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**Important**: The law and procedure on this subject are very specialised and complicated. This article is just a very general outline for reference and cannot be relied upon as legal advice in any individual case. If any advice or assistance is needed, please contact our solicitors.

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