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Case Reporter

James Morgan KC and **Zachary Kell** report on a recent corporate insolvency case

Hunt v Singh

[2023] EWHC 1784 (Ch)

INTRODUCTION

Lord Reed began his judgment in *BTI 2014 LLC v Sequana SA* [2022] UKSC 25 ('*Sequana*'), at [1], by explaining how the appeal *'raises questions of considerable importance for company law'*. That was undoubtedly true, but the decision left open a number of unresolved questions. One such question was addressed by Zacaroli J in his recent judgment in *Hunt v Singh* ('*Singh*'). In particular, how the courts will resolve the tension between (1) what is considered a contingent liability not capable of triggering the 'creditor duty' confirmed in *Sequana*; and (2) a disputed liability which should cause a director to take into account the interests of the company's creditors. In this case report, we will look at the judgment in *Singh* and what it may mean for the approach to *Sequana* going forward.

FACTUAL BACKGROUND

Marylebone Warwick Balfour Management Ltd ('the Company') provided management services to its PLC parent and other companies within the group. BDO LLP ('BDO') recommended applying a 'conditional share scheme' to allow staff to receive payments, structured as non-contractual gratuitous bonuses ('the Scheme'), designed so the Company would not incur liabilities to HMRC by way of PAYE or NIC contributions (*Singh* at [5]). The Scheme was implemented in 2002 and the Company operated it until 2010 (*Singh* at [6]). Throughout this period, BDO continued to advise the Company that the Scheme was 'robust' and no provision (as opposed to a note) should be made in its accounts (*Singh* at [29(7)]). In reliance on that advice, the Company paid out all of its profits, leaving nothing for HMRC.

HMRC's position regarding the Scheme was different. It was first notified of the Scheme in May 2003 (*Singh* at [10]) and, in June 2004, HMRC notified an enquiry into the Company's return for the period up to June 2002 and indicated that if the payments received under the Scheme were in reality earnings, then PAYE and NIC would be payable together with interest (*ibid*). In 2005, HMRC gave a market-wide offer to the participants in tax schemes, including the Company, warning that HMRC were minded to take a test case to the Special Commissioners but would not do so if the employing company agreed to pay NIC contributions together with interest (*Singh* at [12]). The Company's potential liability for NIC and interest was in excess of £3.65 million (*ibid*), but it rejected this offer (and subsequent offers) therefore from around September 2005 it was clear the matter would go to litigation.

Meanwhile, HMRC was prosecuting a case in the tax chamber of the first-tier tribunal ('the FTT') in relation to a similar scheme involving PA Holdings Ltd ('PA'). The FTT found in favour of HMRC on the NIC liability but rejected the claim for PAYE: [2009] UKFTT 95 (TC) (*Singh* at [15]). Following an appeal to the Upper Tribunal, the Court of Appeal eventually held that PA's scheme failed both in relation to NIC and PAYE: [2011] EWCA Civ 1414 (*Singh* at [17]). By this point, the Company's total liability to HMRC was in excess of £36 million (*Singh* at [18]). If account was taken of that debt, the Company was clearly insolvent and had been for some time (*Singh* at [19]-[20]). Counsel's advice following the Court of Appeal's decision in the PA case was that the Company's defence was overwhelmingly likely to fail at least in relation to the NIC element (*Singh* at [21]).

In May 2013, the Company was placed into CVL and Mr Hunt was later appointed as liquidator (*Singh* at [21]). Various claims were brought against a number of former directors of the Company. Some were settled. At trial, ICC Judge Prentis dismissed the misfeasance claim against the remaining directors *inter alia* because the creditor duty was not engaged at the time the Scheme operated, but if it had been it would have made no difference. In short, he held that the directors were entitled to rely on the advice of BDO and there was no need to make any provision for the liabilities to HMRC or to cease operating the Scheme. Mr Hunt appealed in respect of the claim against Mr Singh for monies received by him in breach of the creditor duty committed in the period from September 2005 to 2010 (*Singh* at [23]).

PRELIMINARY POINTS

Mr Singh did not take part in the appeal and was by that stage bankrupt on his own petition (*Singh* at [24]). The judge therefore did not have opposing argument.

The *obiter* comments of the justices in *Sequana* left open the question whether the trigger for the creditor duty included any requirement of knowledge on the part of the directors (*Singh* at [36]-[42]). On the basis of a concession, Zacaroli J proceeded on the assumption that it was necessary to establish some form of knowledge of insolvency (actual or constructive) on the part of the directors for the duty to arise even where the company was actually insolvent (*Singh* at [48]).

Biog box
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DISTINGUISHING *SINGH* FROM *SEQUANA*

In granting Mr Hunt's appeal, Zacaroli J stated that there '*is now no doubt that the Company was in fact insolvent (indeed substantially insolvent) throughout the relevant period*' (*Singh* at [46]) even on the NIC liability alone. From September 2005, the Company had no or negligible net assets from which it could pay HMRC the sums owed and thereafter this got '*steadily and substantially worse*' (*ibid*). In Zacaroli J's judgment the key distinction between *Singh* and the facts of *Sequana* was that (1) the Company's position against HMRC was a disputed liability (*Singh* at [47]), but (2) *Sequana* involved a long-term pollution-related contingent liability of an uncertain amount and an insurance portfolio of an uncertain value (*Sequana* at [115] per Lord Briggs JSC).

Zacaroli J applied the judgment of Richard Sheldon QC in *Integral Memory PLC v Haines Watts* [2012] EWHC 342 (Ch) at [32] where he said:

> '[…] The Claimant's liability to pay interest on the unpaid NIC to HMRC was in no relevant sense contingent. A contingent liability is a liability which, by reason of something done by the person bound, may or may not arise depending on the happening of a future event (see Re Sutherland deceased). A classic example of a contingent liability is potential liability under a policy of insurance, which will only occur if an (insured) event occurs. That was not the position in the present case. There was either an actual liability to pay NIC and interest on arrears or there was not. The existence of such liability is not contingent on HMRC succeeding or failing in a tax tribunal (or a court) […] All the tribunal or court is deciding is whether or not there is an actual liability. […]'

At [51], Zacaroli J held:

> 'In my judgment, assuming some element of knowledge is required, where a company is faced with a claim to a current liability of such a size that its solvency is dependent on successfully challenging that claim, then the creditor duty arises if the directors know or ought to know that there is at least a real prospect of the challenge failing' (emphasis added). At [52] he recognised that the language of 'real risk' of insolvency was specifically rejected by the Supreme Court in Sequana, but said that was in the different context of 'the possibility that a company, that was undoubtedly solvent at the relevant time, might become insolvent at some point in the future'. Further, that 'knowledge of a real risk that the company's challenge to a claim may fail, therefore, equates to knowledge that it is the creditors that are potentially currently being affected by the directors' actions and decisions' (at [54]).

Therefore, according to the judge, *Sequana* was a case about a company that was solvent at the relevant time. The contingent liabilities had not been triggered and *Sequana* was not even at a real risk of insolvency. In *Singh*, however, the question whether the Company was subject to existing tax liabilities to HMRC was a binary one: it either was, or it was not (*Singh* at [59]). He went on to accept Mr Hunt's case that the duty was engaged from the date when the Company was faced with a claim from HMRC (rather than from inception of the Scheme) (*Singh* at [60]).

The consequences of the creditor duty being triggered may be one on which reasonable directors, advisers and tribunals reasonably differ (*ibid*). The judge followed the nuanced approach suggested *obiter* by Lord Reed in *Sequana* at [82], namely one which is:

> '… sufficiently fact-specific to take account of differences, according to particular circumstances, in what it may be reasonable and responsible for directors to do when they find that the company is in a sufficiently weak financial situation that a conflict of interest between its creditors and its shareholders appears to arise.'

Zacaroli J noted that the judge below did not have the benefit of the Supreme Court's judgment in *Sequana* and therefore the case was remitted for reconsideration of the question of breach and the defence in s 1157, Companies Act 2006 (*Singh* at [61]-[63]).

FUTURE CONSIDERATIONS AND CONCLUSIONS

This is an important judgment in the context of the tax avoidance cases and more generally. However, it is likely to be the subject of further consideration in subsequent cases not least because the precise boundaries of what is meant by 'facing a claim' and its critical important (or otherwise) in relation to tax liabilities were not explored in the judgment.

Further and more broadly: (1) the judgment did not cite *Dickinson v NAL Realisations (Staffordshire) Ltd* [2018] BCC 506 in which HHJ David Cooke rejected a claim that the creditor duty arose when the company was facing a damages claim in environmental litigation which had a real prospect of success; (2) whilst it may be said that this was a 'contingent' claim, what about a company facing a debt claim in contract? That is surely also binary question: there is either a liability or not; and (3) these examples highlight the tension between the rejection of the 'real risk' test in *Sequana* and the judge's approach to a 'real risk' of a claim succeeding – in particular, whether there is a principled distinction between the effect of (i) tax liabilities *per se*, (ii) claims by HMRC for tax liabilities, (iii) debt claims and (iv) damages-type claims, including those considered in *Sequana* and *Dickinson*.

Prior to resolution of these questions, directors and their advisers will need to be mindful that even robust advice may ultimately be found to be erroneous especially where the dispute relates to tax liabilities. In calculating the risk when facing a substantial claim from HMRC (or another non-contingent creditor), prudence would suggest that directors should take into account the interests of creditors at an early stage. ■