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Client Alert Commentary

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English Court Confirms Expansive Jurisdiction to Reverse Transactions to Defraud Creditors Even Outside Insolvencies

The ruling confirmed that Section 423 of the Insolvency Act 1986 has extensive international reach, and does not require a transaction at an undervalue to leave the debtor with insufficient assets.

Background

The English High Court has held that a creditor pursuing a claim under Section 423 of the Insolvency Act 1986 (s. 423) does not need to prove that the debtor has insufficient assets to meet their claim following the disputed transaction. The ruling rejected a potential "gateway" condition that would have limited the wide scope of s. 423, and confirmed its broad international reach. S. 423 remains a powerful tool for creditors to challenge transactions at an undervalue, even outside insolvencies, and even in relation to assets outside the jurisdiction of the English court.

The facts of the case[1] are complex, and the details largely unnecessary to understand the legal issues. The claimant was awarded £453 million from her husband in divorce proceedings in 2016. Subsequently, the wife alleged that her husband, assisted by their son, operated a series of dishonest schemes using his network of multinational companies involving transactions for no (or no valuable) consideration, for the purpose of transferring cash and other assets, located across multiple jurisdictions, beyond her reach. The wife sought relief under s. 423, and the court agreed.

S. 423 is a powerful and flexible tool for creditors in both solvent and insolvent situations to reverse transactions that have prejudiced their interests

Although this case concerns individuals, the ruling provides a helpful reminder to creditors that s. 423 can be used in the English court to seek financial remedies and related relief, where a debtor has an obligation to pay the claimant but enters into a "transaction at an undervalue" to put assets beyond their reach or to prejudice the creditor's interests. This judgment echoes existing case law confirming the scope of s. 423 (as highlighted in Latham's *Client Alerts* English Court Confirms International Jurisdiction to Set Aside Transactions Defrauding Creditors and UK Court of Appeal: Creditors Can Seek to Reverse Lawful Dividend Payments).

S. 423 Overview

S. 423 is a broad provision with four requirements: (1) a debtor; (2) enters into a transaction (which can include informal arrangements and procuring acts by third parties); (3) at an undervalue; (4) with the purpose of putting assets beyond the reach of or prejudicing the interests of a person with an actual or potential claim.

S. 423 applies to both individuals and companies and — in contrast to related remedies for creditors — the applicant does not need to show any of the following facts:

- The creditor has a proprietary right in the asset being disposed of, or the company was subject to a contractual obligation not to dispose of the asset.
- The debtor was or is or is about to become insolvent (meaning that s. 423 can be used outside insolvency proceedings).
- The relevant transaction was undertaken dishonestly or for fraudulent purposes.
- The transferee did not act in good faith.

Although a creditor must demonstrate that the relevant transaction was undertaken for the purpose of putting assets beyond its reach or otherwise prejudicing its interests, this does not necessarily need to be the sole or even the dominant purpose: as Knowles J put it, "*it was sufficient simply to ask whether the transaction was entered into by the debtor for the prohibited purpose*". This will be a question of fact as to the intentions of the person(s) carrying out the transactions, which may include evidence as to whether they foresaw and desired the result.

Once s. 423 is engaged, the court has wide discretion to grant whatever order it thinks fit for restoring the position and protecting the interest of victims. The fact that a transferee no longer holds assets received as part of a transaction does not provide a defence to a claim under s. 423, but may be relevant to tailoring the relief that the court may grant.

The case also confirms that s. 423 has extraterritorial effect and can be exercised notwithstanding that the debtors and/or assets are located outside England. However, the court will only exercise its power where there is a sufficient connection to the jurisdiction (which will depend upon the facts). In this case, Knowles J found such a sufficient connection based on (a) an intention to frustrate an English judgment in proceedings involving the husband; (b) the wife's status as a resident in the jurisdiction; and (c) the conduct having taken place in the jurisdiction. Importantly, the fact that none of the assets in question were located in the jurisdiction was irrelevant.

Attempt to read a Gateway into s. 423: insufficiency of assets

In advancing their defence, the respondents argued that s. 423 is subject to a gateway condition, namely that a claimant must prove that the debtor had insufficient assets following the transaction. This argument was made on the basis that the first limb of s. 423 (putting assets beyond the reach of a person who is making or may at some time make a claim against them) inherently assumed that, following the transaction, the debtor would no longer have sufficient funds to satisfy the actual or potential claim.

The respondents argued that, in the majority of reported cases, the debtor was facing financial ruin or was engaged in a course of conduct so as to diminish their assets to the point where they would be left

with less than the claim was worth; however, if the transaction left the debtor with sufficient assets to meet the liability, then the claim should fail on the analysis of the wording in s. 423.

Ruling

The judge rejected the respondents' arguments (which she found were based on a misreading of *BTI 2014 LLV v. Sequana SA*[2]) and held that claimants do *not* need to prove that the debtor has insufficient assets to meet a s. 423 claim following the disputed transaction. To rule in the alternative, the court would have been required to read into s. 423 a gateway condition that is absent from the plain wording of the statute — which would have required considerable persuasion.

In addition, requiring claimants to show that the respondent did not have sufficient assets to meet a s. 423 claim would have the effect of prejudicing creditors' interest in circumstances where the debtor's purpose was entirely consistent with s. 423 (i.e., to defraud creditors). For example, if a creditor had a claim for £5 million and the debtor had £5 million in an English bank account and £5 million in a foreign bank account where enforcement is impossible, the debtor would be entitled to transfer from the former account into a discretionary trust and the court would be unable to set aside the transaction because, even though the debtor had the intention to put assets beyond the reach of the creditor, they still had sufficient assets after the transaction in the latter account. This conclusion, the court ruled, was clearly illogical and contrary to the purpose of the statute.

In making this ruling, Knowles J applied the *dicta* of Arden LJ in *Hill v. Spread Trustee Co Ltd*[3] that the disputed transactions did not need to result in prejudice: "*prejudice or potential prejudice [is] a condition for obtaining relief. That prejudice does not have to be achieved by the purpose with which the transaction was entered into. Nor in my judgment does the purpose have to be one which by itself is capable of achieving prejudice*". In addition, the disputed transaction did not need to leave the debtor with insufficient assets to satisfy the claim: "*What [s. 423(3)] requires is that the purpose should be one which is to prejudice 'the interests' of a claimant or prospective claimant. The 'interests' of a person are wider than his rights…*"

In addition, the judge rejected suggestions that the court should not make certain orders on the basis that it would be futile because the order would be unenforceable in foreign jurisdictions. The judge did not depart from the general principle that "*the starting point is that the courts expect and assume that their orders will be obeyed*", and in particular identified utility in the wife's ability to obtain summary judgment in foreign courts and/or potentially an anti-suit injunction to prevent proceedings to frustrate the order. The judge was also unpersuaded that respondents would be at real risk of prosecution in foreign courts if they complied with the order.

The court granted the wife's claims for relief against her son and the other overseas entities that had received funds as part of the husband's schemes. The court made declarations of liability, and ordered the husband and other respondents to pay sums to the wife to meet her £453 million award, including ordering her son to pay £75 million.

Implications

The court's decision is important for what it did *not* do. By ruling against the respondents, the court refused to recognise a gateway condition whereby claimants would have to prove that the debtor had insufficient assets to meet a s. 423 claim. This condition would have introduced an additional requirement, making the test in s. 423 stricter than Parliament had intended and would severely prejudice creditors' interest when seeking relief under s. 423.

The ruling also serves as a timely reminder that s. 423 is a powerful and flexible tool that can be used by creditors in both solvent and insolvent situations to reverse transactions at an undervalue that have prejudiced their interests.

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Endnotes

[1] Akhmedova v Akhmedov and others [2021] EWHC 545 (Fam).

[2] [2016] EWHC 1686.

[3] [2006] EWCA Civ 542.