Cripps

Court of appeal provides guidance on phoenix syndrome

In a judgment published this month, the Court of Appeal considered the provisions of sections 216 and 217 of the Insolvency Act 1986 which address what is commonly known as the 'phoenix syndrome'. As the line from Shakespeare's play 'Henry VIII' goes, *"The bird of wonder dies, the maiden phoenix, her ashes new create another heir."*

These sections are designed to protect the public from being misled into dealing with a new business when in fact it has been liquidated. Depending on which side of the fence you sit, the case is a timely reminder that the corporate veil can be pierced, and a director can be made personally liable for the debts of a company because the law does not distinguish between good and bad phoenix situations or between honest and unscrupulous traders.

The Phoenix Syndrome

The "phoenix" problem results from the continuance of the activities of a failed company by those responsible for the failure, using the vehicle of a new company. Commonly, the new company trades under the same or a similar name as the old company and uses the assets of the failed company, often acquired at an undervalue, thereby exploiting any remaining goodwill of the old company and its business opportunities. Meanwhile, the creditors of the old company are left to recover what they can from what is often as not a valueless shell whilst the management of the new company conceal their previous failure from the public.

Strict liability with far-reaching consequences

Directors of companies should be very alive to the phoenix syndrome and its consequences. Acting in contravention of section 216 is a criminal offence which may result in a fine or imprisonment, confiscation proceedings, disqualification as a company director, and personal liability for all debts incurred by the new company during the infringement.

The offence is triggered by a person where:

- a company has gone into insolvent liquidation (the "liquidating company").
- the person was a director or shadow director of the liquidating company at any time within the 12 months before it went into liquidation.
- the person is concerned directly or indirectly in carrying on the business using a "prohibited name" for a period of 5 years from the liquidation of the liquidated company.
- a prohibited name is one which is either the same or so similar to the name of the liquidating company as to suggest an association with that company.

There are three statutory exceptions to section 216 all of which provide a defence to a person who would otherwise have committed an offence. The three exceptions variously relate to notice being given to creditors, the court granting leave to re-use the prohibited name and considerations around how long the new business has been known by a prohibited name.

The facts in PSV 1982 Ltd v Sean Langdon

In early 2017 Sean Langdon through his business then known as Tradewinds Marine Limited became the owner and director of a group of companies which manufactured and sold high-end yachts. Tradewinds Marine Limited became known as Discovery Yachts Group Limited ("DYGL") after April 2017 when it acquired the shares in Discovery Yachts Sales Limited ("DYSL") and the business and assets of Discovery Yachts Limited (DYL"). DYL was placed into insolvent liquidation on 12 October 2017 when, unknown to Mr Langdon at the time, "Discovery Yachts" became a prohibited name. None of the three statutory exceptions applied to rescue Mr Langdon from his impending predicament.

In October 2015 Discovery Yachts had sold a luxury yacht named "Elusive" to a buyer who subsequently complained of a number of alleged defects. In September 2017 DYGL and the buyer entered into an agreement concerning the repair of Elusive which the buyer alleged was breached by DYGL in January 2018. The buyer issued a claim against DYGL in April 2018 which DYGL initially defended but, before the trial, DYGL entered administration. In December 2019 the trial continued in the defendant's absence when a judgment plus costs and interest of circa £800,000 was granted to the buyer. Shortly after the judgment was made DYGL entered into liquidation meaning the buyer was merely an unsecured creditor unable to enforce its judgment.

The Court of Appeal's findings

The buyer's claims were assigned to PSV 1982 Ltd ("PSV") in 2020 who had shrewdly spotted Mr Langdon's contravention of section 216. PSV issued a claim against Mr Langdon on the basis that he was liable to personally pay the judgment debt granted against DYGL (which by then had grown to £1.2m because of the costs awarded). PSV successfully obtained a judgment against Mr Langdon in the High Court, but the Court of Appeal was tasked to consider two grounds of appeal.The first was Mr Langdon's argument that the statutory provisions did not

intend to deprive a director of his right to defend himself from being personally liable for a company debt which he disputes, even where that liability has previously been established against the company (by way of a judgment). Mr Langdon argued that he should be entitled to begin with a clean sheet and that the creditor must prove the debt against him, personally. On this ground, the Court of Appeal disagreed, finding that a creditor should not be 'penalised' by the costs of proving its claim twice when the purpose of the section was to protect creditors and widen the pool of people from whom the creditor may recover a debt. Therefore, PSV was entitled to rely on the judgment as conclusive evidence of the debt.

The second was Mr Langdon's argument about when a relevant debt is incurred to trigger section 216. His argument was that the debt was incurred when DYGL entered into the agreement to repair Elusive, which was in September 2017, not when it was breached in January 2018. If he was right, he would not be personally liable to PSV because his offence was triggered afterwards when DYL went into liquidation in October 2017. The court disagreed once again, finding that the contract was only the source of the obligation to pay monetary compensation, but the obligation to pay only arises upon a breach. Unfortunately for Mr Langdon that meant he was personally liable to PSV.

Our view

It's normally the end of the road for a creditor who holds a judgment against a debtor company in administration or liquidation. It makes little sense to throw good money after bad by taking steps to enforce the judgment, except to the extent that a creditor will file a proof of debt in the company's insolvent estate and take their chances in receiving a dividend payment which is usually pennies in the Pound, if anything at all. However, this case shows that it may well be worth investigating the records of the directors of the company which are publicly available at Companies House. You may just discover a windfall opportunity to recover your debt from another source.

Interestingly, the Court commented that where a creditor relied upon a debt based on an invoice (as something less certain than a court judgment), and the director disputed the company's debt, it would probably be necessary for the proceedings brought by the creditor against the director to determine what the company's debt was, if any. In other words, this position would be less certain and more arduous in effort and cost than that of a creditor who already holds a judgment.

How can we help?

If you would like to learn more about how we can help then please contact Justin McConville or any member of the insolvency and commercial disputes team**.**

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