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Case No: CR-2017-007029

IN THE HIGH COURT OF JUSTICE
CHANCERY DIVISION
BUSINESS AND PROPERTY COURTS
INSOLVENCY AND COMPANIES COURT

In The Matter Of C.R. AND R.A. EADE LLP (In Liquidation)
And In The Matter Of THE INSOLVENCY ACT 1986

Royal Courts of Justice
Rolls Building, 7 Fetter Lane, London

Date: 11/07/2019

Before:

INSOLVENCY AND COMPANIES COURT JUDGE JONES

- -

Between:

ANDREW McTEAR
(Liquidator of CJ & RA Eade LLP (In Liquidation)) **Applicant**
- and -
(1) CHRISTOPHER EADE
(2) RICHARD EADE **Respondents**

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- -

MR JAMES A. DAVIES (instructed by **Isadore Goldman**) for the **Applicant**
MS HANNAH THORNLEY (instructed by **Birketts LLP**) for the **Respondents**

Hearing dates: 8 - 10 April and 13 May 2019 – Final Written Submissions by 17 June 2019

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Approved Judgment

I direct that pursuant to CPR PD 39A para 6.1 no official shorthand note shall be taken of this Judgment and that copies of this version as handed down may be treated as authentic.

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INSOLVENCY AND COMPANIES COURT JUDGE JONES

I.C.C. Judge Jones:

A) Introduction

1. By an agreement made on 3 July 2009 Mr Christopher Eade ("Mr C. Eade") completed the purchase of Mr Middleton's half share in their partnership business trading as "Olympic Signs". The consideration was £320,000 combined with an indemnity by Mr C. Eade for the payment of all existing partnership debts/liabilities. The partnership had rented its business premises from the partners. Mr Middleton's 20% interest in the property was ultimately transferred in equal shares to the respective SIPPs of Mr C. Eade and his son, Mr Richard Eade ("Mr R. Eade"). The agreement provided that the transfer date for the purchase was 29 May 2009. Therefore Mr C. Eade was treated as sole proprietor from 30 May.

2. C.J. & R.A. Eade LLP ("the LLP") was incorporated on 6 July 2009. The partnership/sole trader business was transferred to the LLP shortly afterwards. Mr C. and Mr R. Eade have always been the only members and, therefore, were its designated members. There was a draft agreement ("the Draft LLP Agreement") concerning the transfer of the partnership business and operation of the LLP but it was not executed and both Mr C. and Mr R. Eade have stated that it was not binding. Mr McTear, the Liquidator, does not challenge this.

3. In those circumstances and absent any other agreed terms, the default provisions of ***Regulation 7 of the Limited Liability Partnership Regulations 2001***, SI 2001/1090 ("***the Regulations***"), which came into force on 6 April 2001, applied to the LLP and determined the mutual rights and duties of the LLP and of Mr C. and Mr R. Eade as members. The Regulations were made under ***sections 14-17 of the LLP Act 2000***.

4. The LLP used a Lloyds TSB Bank ("Lloyds Bank") account opened and remaining in the names of Mr C. and Mr R. Eade for its trading. It was into this account that a 10-year fixed term loan ("the Lloyds Bank Loan") made to Mr C. Eade and Mr R. Eade and totalling £474,700 was paid. The Lloyds Bank Loan was used to pay: (i) the £320,000 due to Mr Middleton from Mr C. Eade together with Mr C. Eade's legal costs for the purchase in the region of £18,000; (ii) capital and interest payments on the Lloyds Bank Loan; and (iii) the extant partnership liabilities which Mr C. Eade had undertaken to pay. The balance of the loan was used for the LLP's working capital.

5. Sadly, the LLP did not prosper. it entered Creditors' Voluntary Liquidation on 24 August 2011. Mr C. and Mr R. Eade have explained (in summary) that significant customers were lost to a new business established by Mr Middleton, two members of staff left and the "post-Lehmann" economic downturn had its adverse impact.

B) The Liquidator's Claim

6. The first claim in the Notice of Application of Mr McTear, as liquidator of the LLP, seeks to recover all drawings on account of anticipated profits paid to Mr C. and Mr

R. Eade between 6 July 2009 and 24 August 2011. It is alleged that each payment/receipt was a breach of the fiduciary duty each owed the LLP. It is first claimed that the LLP had no obligation to make the payments. The claim relies upon ***Regulation 7(4)***, which provides that members are not entitled to remuneration *"for acting in the business or management of a limited liability partnership"*.

7. It is also claimed that it was wrong in any event to make those drawings when the LLP was insolvent or likely to become insolvent and there were no profits. Relief is sought under ***sections 212*** (the summary remedy provision) ***and/or 238*** (transaction at an undervalue) ***and/or 239*** (preference) ***of the Insolvency Act 1986*** ("***the Insolvency Act***"). In the further alternative Mr McTear seeks compensation under ***section 214A*** (adjustment of withdrawals).

8. The Application also challenges all the payments the LLP made under the Lloyds Bank Loan from 3 August 2009 until liquidation. It is Mr McTear's claim that the LLP should have made no payment because the loan was made by Lloyds Bank to Mr C. and Mr R. Eade not the LLP. Alternatively, that the loan was capitalised in the LLP's accounts. In the further alternative that the payments were made in breach of duty by reason of insolvency and/or the statutory provisions relied upon in respect of recovery of the drawings equally apply to these payments by the LLP to Lloyds Bank.

9. The following is an introductory summary of those statutory provisions:

   a) ***Section 212*** provides a summary remedy in this case requiring Mr McTear to prove misfeasance or breach of duty owed to the LLP on the ground that its assets were misapplied by Mr C. and Mr R. Eade when making the challenged payments.

   b) ***Section 238*** requires him to prove the payments challenged were transactions at an undervalue carried out at the "relevant time", as defined in section 240, although no consequential order shall be made if the transaction was entered into by the LLP in good faith and for the purpose of carrying on its business when there were reasonable grounds for believing it would benefit the LLP.

   c) ***Section 239*** requires it to be proved the payments were made by the LLP at the "relevant time" to a creditor or a surety or guarantor of any of its debts or other liabilities with the effect of putting that person into a position which, in the event of the LLP going into insolvent liquidation, will be better than the position that person would otherwise have been in. It must also be proved that the LLP was influenced in deciding to make the payment(s) to produce that effect, although a rebuttable presumption may be relied upon for a connected person.

10. ***Section 214A of the Act*** was inserted into the Act from 6 April 2001 by **Regulation 5(2)(f), Sch. 3, para. 1 of the Regulations**. In summary, this provision applies to withdrawals of property from a limited liability partnership, including profits salary and repayment of loans and their interest, within 2 years ending with the commencement of its winding up. Mr McTear must prove that the withdrawal in issue was made when Mr C. and/or R. Eade (as appropriate) knew or had reasonable ground for believing that the LLP was unable to pay its debts within the meaning of ***section 123 of the Act*** or that this would occur as a result of the withdrawal (as further

particularised by ***subsection (b)(ii)***) In those circumstances the court may declare Mr C. and/or R. Eade liable to make such contribution to the LLP as it thinks proper.

11. However, a declaration shall not be made:

    a) Unless he knew or ought to have concluded after each relevant withdrawal that there was no reasonable prospect that the limited liability partnership would avoid going into insolvent liquidation (i.e. when its assets are insufficient for the payment of its debts and other liabilities and expenses of the winding up). For that purpose the facts he ought to have known or ascertained and the conclusions which he ought to have reached are those which would be known, ascertained, or reached by a reasonably diligent person having both:

        i) the general knowledge, skill and experience that may reasonably be expected of a person carrying out the same functions as he carried out in relation to the LLP, and

        ii) the general knowledge, skill and experience that he has.

    b) In an amount that exceeds the aggregate of the amounts or values of all the withdrawals made by him within the two-year period which are in issue

12. As to establishing knowledge of liquidation in the context of ***section 214A***, Mr McTear asserts within his evidence in chief:

    a) First, that the LLP did not have *"any reasonable prospect of avoiding insolvent liquidation by the end of September 2010"*. He relies upon the LLP's accounting records and the LLP retaining FRP Advisory LLP to advise upon insolvency and to assist to place the LLP into administration.

    b) Second, that even if it was thought in the interests of the LLP to continue business until Christmas 2010:

        > *"it ought to have been clear by the end of December 2010 that the trading between October and Christmas would not be sufficient to support the LLP through the first 5 months of the following year given the arrears and cash demands".*

    c) Third, his further alternative date is 1 April 2011. This was when:

        > *"... the Respondents approached Lloyds for a loan to meet cash-flow but ... [did not] have ... any reasonable prospects of securing funding ... [and] approved[31 July 2010] annual accounts incorporating ... [a] disputed capital account balance and on 12 April 2011 ... [made] [disputed] adjustments ... to the First Respondent's capital account ledger to bring it into a credit balance ... because the Respondents had recognised that the LLP had no reasonable prospect of avoiding insolvent liquidation or alternatively ... were sufficiently concerned to want to eliminate the overdrawn balance from the accounting records".*

    d) Fourth, Mr McTear's next date is 13 May 2011:

        > *"being the date on which the Second Respondent emailed Mr Weller confirming that Lloyds would not support the LLP and relaying the dire financial position".*

    e) Fifth, the final date is 14 July 2011 when:

> *"the Respondents confirmed in their note to [his] offices that they recognised the business could not continue".*

C) The Defences

13. The defences of Mr C. and Mr R. Eade are set out within their evidence in answer, which became their evidence in chief. That evidence will be borne in mind throughout but at this stage I will only provide a summary and throughout the judgment only refer to the defences insofar as it is appropriate and necessary to do so.

"The Lloyds Bank Loan Defence"

14. Mr C. and Mr R. Eade agreed that in return for the transfer of the former partnership/sole trader business and assets, the LLP would be responsible for repayment of the Lloyds Bank Loan, principal and interest. The LLP would also be able to use the balance of the funds as its working capital. Whilst there was no direct contractual agreement between the LLP and Lloyds Bank and the Lloyds Bank Loan remained secured on their homes, as stated in Mr R. Eade's evidence:

> *"[P]ayments made to Lloyds TSB plc in repayment of the business loan was a direct responsibility of the LLP, which would not have been entitled to enjoy the benefits of the business transferring ... as prescribed in the sale and purchase agreement dated 29 May 2009 unless it contributed financially to the purchase of that business".*

15. Accordingly, the Lloyds Bank loan was used to pay Mr Middleton for his share and Mr C. Eade's legal fees concerning the purchase, £17,313.50. It was also used to pay the extant debts and liabilities of the former partnership, the subject of Mr C. Eade's indemnity to Mr Middleton. The balance was used as working capital. The LLP also received £5,000 each from Mr C. and Mr R. Eade as capital contributions. All receipts and payments are recorded in the LLP's ledgers.

"The Drawings Defence"

16. No formal agreement concerning the operation and rights of membership of the LLP was concluded. The Draft LLP Agreement was produced but never finalised. Mr C. and Mr R. Eade worked full time for the LLP and it was their only source of income. They initially agreed to draw £1,000 per week each but from about Christmas 2009 it was reduced to £750 to assist with cash flow as a short-term requirement. Later, in some weeks nothing would be withdrawn if this was necessary to aid the LLP's cashflow. All these matters were agreed orally, informally as father and son. Two full time employees would have had to be paid at far greater cost.

17. The goodwill of the business was valued at £640,000. Whilst this valuation is identified in the 31 July 2010 financial, year-end accounts as the original asset value plus a £320,000 "revaluation", in reality this was always considered to be the value of the business transferred to the LLP. Mr Middleton had been paid £320,000 for 50% and, as stated by Mr R. Eade:

> *"The full value of £640,000 was members' debt in accordance with the Statement of Recommended Practice for Accounting by Limited Liability Partnership ... there is nothing*

> *that requires sums owed to members to be deferred to sums owed to external creditors when repaying debt to a member of an LLP".*
>
> *"[T]he statutory accounts to 31st July 2010 recorded the correct financial position of the LLP (the SAGE records used being those of the old partnership plus transactions of the LLP), [and their] drawings should be netted off/set off against my capital accounts (which were always in credit) ...".*

18. As a result, Ms Thornley submits on their behalf that:

> *"taking the capital accounts together, the Eades were always net creditors of the LLP and the current accounts which recorded the drawings were cleared off by the capital accounts when the statutory accounts were finalised ... Therefore, at all times, as a matter of law, the capital and current accounts should be netted off ... [withdrawals] can also be set off as against the monies put into the LLP and against their capital account by virtue of the principle of insolvency set off (see rule 14.25 of the Insolvency (England and Wales) Rules 2016)".*

"The End of September 2010 Trading Defence"

19. The LLP operated with the benefit of a factoring agreement with Lloyds Bank. It had no overdraft facility. From about the start of the LLP's business its turnover suffered from Mr Middleton trading in direct competition through a new limited company. During July/August 2009 two sales staff left but this loss was covered in part by remaining staff and in part by recruitment. Business was also affected by the effects of the country's post-Lehmann recession upon clients and cash flow was tight during the first year due to the Lloyds Bank Loan having been drawn to repay Mr Middleton. However, Mr C. and Mr R. Eade believed:

> *"the prospects were always good for a recovery, as the client base was a good one. At no stage in that first year did [they] believe that the business was failing or had insufficient cashflow to pay creditors".*

20. There were problems with the LLP's accountants, Granite Morgan Smith, who had previously been retained by the partnership. They were superseded by NW Consulting Limited and specifically Mr Nick Watson. He prepared the partnership's final financial year-end accounts to May 2009. Even then, difficulties were incurred obtaining information from Granite Morgan Smith and Mr Middleton to establish the LLP's opening position from the partnership's cessation accounts. The signed 31 July 2010 accounts show the true and fair position of the LLP and any assertion to the contrary is disputed.

21. Steps were taken to address the tight cash flow problem. As well as the reduction in drawings, in April 2010 employees agreed to a short-term, 10% pay reduction to help the business after the winter period. That period was traditionally a difficult time for cash flow and the partnership had previously enjoyed an overdraft facility to cover that period. This was not available to the LLP in the context of the existing factoring agreement and the Lloyds Bank Loan.

22. The business was placed for sale in May 2010 due to Mr C. Eade wanting *"to consider a retirement plan"*. Offers over £1.2 million were sort to include the freehold property, which the LLP did not own. Although the LLP remained on the market until 2011, there were no sale leads.

23. A time to pay arrangement had to be agreed with HMRC in June 2010 but *"this gave more certainty to the cash-based survival of the business"*. In July 2010 the Lloyds Bank Loan repayments increased from £4,500 to £5,330 per month. However, it was not until April 2011 that HMRC could no longer be paid current and historic liabilities. Only by letter dated 19 May 2011 did HMRC warn of distraint.

24. Nevertheless, it was appreciated in September 2010 that insolvency advice was required. A meeting with Mr Weller of FRP *"did not lead to any advice that the business needed to be liquidated"*. He advised upon *"the consequences of the different ways in which the business could be sold as well as options for arrangements with creditors"*.

"The End of Christmas 2010 Trading Defence"

25. From September 2010 cash flow improved. The LLP *"had sufficient cash to continue and did not begin to have difficulty in paying creditors until May 2011"*. A net profit in excess of £34,000 was made for September to December 2010, no creditors' payments were held back and, as mentioned, the time to pay arrangement with HMRC was met until May 2011. A large signage project from East of England Co-operative Society was *"won"* in December 2010 valued at around £32,000. It was not signed, however, and the original date for signage to be provided of January 2011 was delayed until the project was placed on indefinite hold in March 2011.

"The 1 April 2011 Trading Defence"

26. In February 2011 Mr C. and Mr R. Eade injected £20,000 each as additional capital. At the beginning of the year the LLP had engaged a freelance salesperson, Mr Piner, on a commission-based reward scheme. He would introduce major clients, whom he would bring with him from a previous business, namely Domino's Pizza and Subway Sandwiches. He raised £62,121 sales between 8 March and 6 July but it was *"conservatively estimated"* in a forecast prepared by him that sales of £200,000 to perhaps £500,000 were likely from him over 12 months. Nevertheless, and as stated in evidence by Mr R. Eade:

> *"Despite all our efforts, it became clear after the first 2 months that the sales were imminent but not going to be arriving with enough frequency to overturn the cashflow deficit … [Mr C. and Mr R. Eade] honestly anticipated that [his] sales would have rescued the LLP from being placed into liquidation had [further] support from Lloyds TSB Bank been forthcoming"*.

27. Between February and April 2011 the LLP sought further bank support and submitted a business plan. By March it was understood that assistance would be provided and *"sales enquiries were getting stronger and forecasts looked to bring an upturn"*.

"The 13 May 2011 and 14 July 2011 Trading Defences"

28. In May 2011 HMRC could no longer be paid and a letter warning of distraint was received. Two suppliers decided to no longer offer credit and required settlement of the LLP's debt. County Court judgments were obtained and enforced. Walking possession was taken on 6 July 2011 when Mr C. Eade made an initial, personal £4,200 payment. Settlement of the debt was expected by around 18 July. It was only then that it was believed *"the business would not meet its creditors' payments going forward"*.

29. Whilst it is acknowledged that the LLP *"had no prospect of continuing to trade"*, appropriate steps were taken. No further drawings were taken. Advice was sought immediately from Mr Weller and agreed procedures were followed. During the first three weeks of July Mr Weller advised there should be an administration with a pre-pack sale. Despite this, a purchase offer of £25,000 emailed by Mr R. Eade on 26 July 2011 was rejected. There was never any desire to prefer.

"The Subsequent Events Defence"

30. They decided to change advisers to McTear Williams and Wood because of *"[their] inability ... to pay the price that FRP required ... and [their information] that they had to market the business assets for sale and ... would send details to [companies owned by Mr Middleton] ... an unpalatable prospect ...*.". They were engaged on 1 August having been sent filed and management accounts together with aged debtor and creditor lists. Advice received by letter dated 12 August was relied upon to continue trading with the belief that no claims would result. The letter would indemnify them from actions claiming wrongful trading or preference. A creditors' voluntary liquidation was pursued and the creditors' meeting held on 24 August.

31. On or about 25 August 2011 the liquidators accepted £25,000 from Mr C. Eade for an asset sale to O Signs Limited, a company owned by him and Mr R. Eade. They draw attention to the fact that this company was profitable for several years and attribute that, at least in part, to the sales introduced by Mr Piner in the following years: £350,000; £532,000; £829,000; £853,000; and £1,167,000. Mr R. Eade in his evidence in chief said: *"The members honestly anticipated that these sales would have rescued the LLP from being placed into liquidation had the support of [Lloyds Bank] been forthcoming"*.

"Other Defences"

32. If necessary, ***the Limitation Act 1980*** is relied upon and/or relief sought under ***s.1157 Companies Act 2006***. In the further alternative an ***ex parte James*** defence is submitted based upon the assertion that no-one will benefit from these proceedings except for the liquidators and their lawyers. The facts relied upon will be addressed when those defences are considered.

D) Opening Issues and Closing Submissions

33. Ms Thornley on behalf of Mr C. and Mr R. Eade very sensibly raised two matters concerning the evidence before witnesses were called by Mr Davies on behalf of Mr McTear. The first, that Mr McTear's case should not be allowed to cross into areas which are covered by an extant but stayed Part 8 Claim Form seeking an account from the Mr C. and Mr R. Eade. The second, that he should not be allowed to give opinion evidence or expert evidence.

34. The Part 8 Claim Form seeks an account of sums due under clause 11 of the Draft LLP Agreement, assuming it was agreed. The clause (if contractually binding) permits drawings on account of profits with an obligation to repay any sums received in excess of a members' entitlement as established by the year end accounts. The

reason the Part 8 Claim Form seeks an account rather than a judgment sum is that the amount to be repaid cannot be determined under clause 11 until the profit and loss accounts are determined. There is only one set of annual accounts for the LLP and paragraphs 12-13 of Mr McTear's witness statement opposing a strike out application in the Part 8 Claim Form proceedings state twice that the account is needed for that determination.

35. In contrast to that claim, this Application Notice does not rely upon clause 11, accepts the agreement was not concluded and does not seek an account. The claims are brought on different bases and it follows that the stay of the Part 8 Claim does not affect this application.

36. As to the second matter, I was taken to two authorities: ***J D Wetherspoon plc v Harris and others, Practice Note*** [2013] EWHC 1088 (Ch) (albeit concerning summary judgment) and ***Kaupthing Singer & Friedlander Limited (In Liquidation) v UBS AG***, [2014] EWHC 2450 (Comm) (Mr Justice Andrew Smith). I will not of course take into consideration or will give little weight (as appropriate) to evidence from Mr McTear which crosses the boundary of admissible evidence identified within those decisions. For example, commentary and opinion. However, it was unnecessary and too late in the day to undertake the exercise of identifying such passages before cross-examination. Nor need I do so in my judgment, it being only necessary to state that I have applied both authorities.

37. The position at the beginning of the trial concerning expert evidence was more difficult. It raised the question whether parts of Mr McTear's evidence should be treated as expert evidence or whether it is evidence of fact resulting from the performance of his duties as liquidator and/or simply identifies accounting matters based upon statutory requirements under ***the Companies Act 2006*** for which the court does not need expert assistance.

38. In the end, time restraints caused me to take a pragmatic view having provided an opportunity for the parties to discuss the issue but with no outcome having been achieved. Namely, that it was inappropriate to potentially derail the trial timetable by debating admissibility of specific passages. I decided that Mr McTear's evidence should be admitted in full and cross-examination proceed accordingly. However, I left open the option for Mr McTear to be recalled and even, if necessary, for Mr C. and/or Mr R. Eade to be recalled should that prove necessary and appropriate. No request was made.

39. As to closing submissions, I have decided that it is impractical to set these out separately within this judgment. I will deal with them in context insofar as I consider it necessary but have obviously borne in mind all that has been written and said by counsel. I am grateful for their considerable work and assistance for the benefit of their respective clients.

E) The Witnesses

40. Mr McTear's evidence was inevitably limited to information derived from his role as liquidator rather than being based upon personal knowledge. Nevertheless, that can be

good evidence and I was entirely satisfied that he sought to assist the court throughout his examination. Whilst there are passages in his evidence in chief which were heavily criticised by Ms Thornley, I have not reached any adverse conclusion over his reliability as a result. It does not, of course, follow from this that his analyses, opinion and conclusions drawn from his investigations should be accepted. That is a matter for me to decide in the context of the whole of the evidence.

41. Mr R. Eade's evidence was based principally upon personal recollection. It must be remembered that his memory, as with all witnesses, will have been affected by the lapse of time and by false memories generated not least by the frequent review of the claim. It is necessary, therefore, for me to compare his oral evidence with the paper work generated and, in particular, the contemporaneous documents. However, insofar as I do not accept any of his evidence, I wish to make clear that I found him to be an honest witness who did his best to assist the court. I regret that he had to be in the witness box for so long and there is no doubt that the quality of his evidence tailed off as a result. However, I have made proper allowance for that.

42. Mr C. Eade's evidence suffered from the fact that he had plainly left the financial side and details to his son. Mr R. Eade has had informal accountancy training and it was clear during the hearing that Mr C. Eade holds him in the highest of esteem. Plainly, he is extremely grateful for all the work, effort and knowledge his son provided to the LLP.

43. I took note of Mr C. Eade's evidence concerning the arrangements involving the setting up of the LLP, the Lloyds Bank Loan and the drawings. However, when it came to his financial recollection and views, it was plain his evidence is unreliable. For example, it was unacceptable to try to justify trading on the ground that things had always worked out for the former partnership notwithstanding ups and downs. That was a different era, in different economic circumstances with different financial considerations and with different members. That does not matter to my overall assessment of the strength of the defences, however. Mr R. Eade has given the evidence required for the defences and the fact that his father's evidence does not assist will not be taken to undermine that evidence.

44. I will now set out the findings of fact which have been established before me from the oral and documentary evidence. Unless stated otherwise, the burden of proof is upon Mr McTear. The standard is the balance of probability. When considering the knowledge of Mr C and Mr R. Eade I will do so on the basis of the general knowledge, skill and experience that may reasonably be expected of a person carrying out the same functions. Although it is arguable that account should also be taken of Mr R. Eade's training and accountancy knowledge, I do not consider that will be right or fair unless it is specifically relevant. I have not found that to be the case.

F) Findings of Facts

F1) The Original LLP Agreement

45. Under the terms of the 3 July 2009 agreement with Mr Middleton, from 30 May 2009 Mr C. Eade became the sole legal owner of the business and essentially all the assets

of his former partnership with Mr Middleton. The partnership had been valued at £920,000 in March 2009 by Granite Morgan Smith. The consideration to be paid by Mr C. Eade was £320,000. Mr C. Eade also accepted an obligation to discharge all extant liabilities (as defined in the agreement) and provided an indemnity to that effect in usual terms to Mr Middleton.

46. The £320,000 consideration was paid on 3 July 2009 using the Lloyds Bank Loan, a joint and several liability of Mr C. and Mr R. Eade secured upon their homes. The loan had been credited to their joint account and was also used to pay Mr C. Eade's legal costs of the purchase, which came to £17,313.50, and in due course the extant partnership debts.

47. Whilst Mr R. Eade was not a party to the purchase, he had agreed orally with his father that the partnership business and assets would be transferred to the LLP. This is evidenced by performance. Whilst Mr C. Eade referred in evidence to this meaning in financial terms that his son would have a 25% interest in the LLP because of his 50% liability for the Lloyds Bank Loan, he accepts and never disputed that they agreed the LLP would be owned equally. This recognised his son's full-time, future involvement in the LLP's business.

48. It was also agreed that the LLP would assume liability for the Lloyd's Bank Loan. This is evidenced by the fact that the joint account into which it had been paid was effectively taken over by the LLP and used as its trading account. It paid the sums due under the terms of the Lloyds Bank Loan from this trading account. This was in accordance with their agreement and is entirely consistent with the agreement that the LLP would own the former business and assets of the partnership.

49. For the avoidance of doubt, I do not accept Mr McTear's case that there was no agreement between Mr C. and Mr R. Eade concerning the Lloyds Bank Loan and that the LLP should not have made payments to Lloyds Bank instead of Mr C. and Mr R. Eade. The facts are clear and do not require Mr C. and Mr R. Eade to recollect or identify the formulation of the agreement in terms of specific dates and/or words of offer and acceptance. They discussed matters and reached agreement in the manner to be expected of a father and son. It is plain this was their understanding and the agreement is evidenced or established by performance.

50. In practical terms:

a) There was a sub-sale to the LLP of 50% of the partnership business ultimately for the equal benefit of Mr C. and Mr R. Eade as the sole members of the LLP. This sale was achieved by the LLP assuming liability for the Lloyds Bank Loan. The balance remaining after payment of Mr Middleton, Mr C. Eade's legal fees and extant debts of the former partnership would provide working capital. The LLP started and continued trading on that basis with the agreement of its members.

b) However, Mr C. and Mr R. Eade remained personally liable to the Bank for the Lloyds Bank Loan and the bank account, whilst in practice taken over by the LLP, continued to be in their names. They lent the Lloyds Bank Loan to the LLP on the same terms as the Bank had lent to them.

c) There was no suggestion Mr C. Eade would receive consideration for his original 50% share in the partnership when the business and assets were transferred to the LLP. That would have undermined the agreement of equal ownership of the LLP.

d) Mr C. Eade was extremely grateful for his son agreeing to become involved in the LLP. As between them this would always be a 50:50 LLP. It was not intended that Mr C. Eade would be entitled to a priority return of the capital value of the business and assets as opposed to being able to share equally with his son in the value of the LLP.

51. It was agreed from the beginning of the LLP's trading that Mr R. Eade would concentrate upon the administrative side of the business, whilst his father would mostly be "on the road" bringing in business and managing the day to day projects. It is also clear from the evidence concerning the original transfer of the partnership/sole trader business and assets and by conduct that Mr C. and Mr R. Eade agreed to share the income profits equally, just as they would the capital. Even had that not been expressly agreed, default rule (1) of paragraph 7 of the Regulations would have provided that result.

52. Each needed an income from the LLP and could not await the distribution of allocated profits as shown by the profit and loss account at the end of the financial year. The LLP's ledgers record regular withdrawal of drawings on account of anticipated profits. Subject to issues of insolvency, that is a common (although perhaps not always prudent) practice both in respect of LLPs and companies. The sums received are to be treated as loans unless and until they can be and are allocated as receipts of a profit entitlement. It is unnecessary to address whether that would be because of an automatic division and payment of income profits or first require a decision to divide with the result that the profits will be attributed to members' other interests reserves.

F2) Trading to 31 July 2010

53. The £920,00 valuation would suggest the LLP had solid foundations from which to begin its initial trading even allowing for the reduction in the value attributed to Mr Middleton's share, £320,000, as at 3 July 2009. However, the oral evidence described a partnership business which had suffered from the fact that Mr C. Eade and Mr Middleton had not been speaking to each other for over a year. The partnership accounts record a reduction in turnover and profit from £1,704,249 and £384,566 respectively as at the 31 May 2007 year end to £1,358,098 and £206,279 for the period 1 June 2008 to 29 May 2009. There were net current liabilities of (£110,895) as at 31 May 2009, although this was a significant improvement upon (£201,355) as at 31 May 2008 and more in line with the figure of (£118,094) as at 31 May 2007.

54. This financial deterioration explains, at least in part, why the purchase price for Mr Middleton's partnership share was agreed at £320,000 plus the indemnity to pay extant debt. However, it is also plain from an attendance note made on 24 June 2009 that the purchase was agreed in the context of serious concerns. The note records Mr R. Eade in the presence of his father identifying his concerns that there may not be enough work from the main customer, the Co-Op, *"to ensure the business survives"*.

55. The transfer date for the sale agreement was treated as having occurred on 29 May. Between 30 May and 3 July 2009 the sole trader business transferred to the LLP on 6 July made a loss of (£47,865) during that period. The balance sheet as at 3 July 2009 values the goodwill at the price paid for Mr Middleton's half share, £320,000. Net current liabilities had improved, having reduced to (£76,677) but plainly these results will or ought to have raised the question of survival after 6 July 2009. Absent further capital injection, the LLP would need to move into profit and that task would be harder when the LLP now also had to pay the Lloyds Bank Loan's monthly repayments. These were £4,529 a month until September 2010.

56. The End of September 2010 Trading Defence recognises significant difficulties. Mr Middleton had begun trading in direct competition with the LLP through a new limited company. It is also acknowledged that there were serious trading problems resulting from the effect of the recession upon the LLP's clients. Mr C. and Mr R. Eade accept that cash flow was tight. Whilst they had a positive cash flow forecast for the period from 21 May 2010 to 1 July 2011, which had been produced during May 2010, obviously the test would be whether it could be achieved.

57. There are no subsequent forecast/actual comparisons with that cash flow forecast in the court bundles. However, the extent of the problem can be seen by comparing the customer activity summaries for the periods 7 August 2008 to 30 July 2009 (noting a slight overlap from 3 July 2009) and 4 August 2009 to 11 May 2010. A total of £226,893.29 (including VAT) for the former period had reduced to £70,414.94 for the latter. In addition, an analysis by Mr McTear leads to the conclusion that HMRC was not being paid the tax liabilities due from the early stage of trading. That applies even if the debt of £55,000 in June 2009 is excluded but it should not be. The LLP had undertaken that liability when the partnership/sole trader business was transferred to it in July and it received the benefit of the Lloyds Bank Loan as agreed with Mr C. and Mr R. Eade.

58. Mr R. Eade very fairly accepted in evidence that the business's viability going forward was an issue from its early days: *"it wasn't an easy start"*. By 12 January 2010 Mr C. and Mr R. Eade were meeting with Mr Watson to discuss accounting and taxation matters which included *"Current cash-flow issues and methods of addressing these"*. The notes of that meeting refer to the overheads' reductions not being *"enough unless circumstances took a significant turn for the better"* and to the prospect of a liquidation following a sale of assets and business to a new company being in the mind of Mr C. and Mr R. Eade. In one sense this prospect was exploratory, as Mr R. Eade emphasised during cross-examination, but it indicates and identifies the state of the business as perceived by them at this time.

59. The accuracy of that perception is evidenced by the growth in debt owed for PAYE and NIC contributions through to May 2010. By then the employees had had to accept pay cuts to avoid redundancies. Drawings on account of anticipated profits were reduced to assist. Whilst the End of September 2010 Defence refers to Mr C. Eade's retirement plans causing the business to be placed for sale in May 2010, in my judgment the primary reason was the financial position acknowledged at the 12 January meeting. Bearing in mind that financial position, the price of offers over £1.2 million was only realistic if the whole or most of that figure represented the market value of the freehold property which the LLP did not own.

60. The management accounts as at May 2010 record a loss for the year to date of (£37,485), as opposed to a budgeted profit of £73,587. However, the loss for that month was (£19,146) against a budgeted loss of (£28,947) and for the 3 months ending 31 August 2010 the loss was "only" (£2,590) against a budgeted loss of (£19,942). On the other hand, throughout the LLP's trading history, management accounts did not include payments required by the Lloyds Bank Loan or the drawings taken on account of anticipated profits; a fact which will need to be remembered whenever they are referred to, although it will be unnecessary to regularly repeat it.

61. By letter dated 9 June 2010 HMRC confirmed an arrangement to pay part of the total outstanding PAYE/NIC of just over £107,000 by instalments: £2,000 in June and July, £4,000 in August and £10,000 in September when the arrangement would be reviewed. Current liabilities had to be paid as required by law.

62. It is stated within the ***s.98 Insolvency Act***, creditors' report that:

> *"In the first 13 months of trading losses of £27,175 were reported before partner's drawings on sales some £150,000 less than forecast. Through this period it became apparent that costs would need to be reduced and efforts were made to reduce staff costs and a pay reduction was agreed by all staff and partners to assist with cashflow".*

63. The LLP's accounts for the period ended 31 July 2010 are unaudited but signed by NW Consultants Limited on 1 April 2011. They were approved by Mr C. and Mr R. Eade on the same day. Although serious issues arise because of their content, I do not find it proven that they were concocted by the auditors and Mr C. and Mr R. Eade to deceive or to be creative (in a derogatory sense) as the case of Mr McTear suggests. For example, I do not consider that to be a fair construction of or inference from the email from Mr Watson sent to Mr R. Eade on 5 February 2011. It would also be contrary to my assessment of Mr C. and Mr R. Eade as witnesses. That does not mean, however, that the accounts do not give rise to difficulties, as will appear later when considering whether the debt attributable to the Lloyds Bank Loan was capitalised.

64. The accounts include the following information:

    a) A turnover of just above £1 million produced a gross profit of about three-quarters of a million pounds but an operating loss of £27,175.

    b) The LLP's fixed assets consisted of the value in the business described as its good will and fixtures and equipment and motor vehicles. The good will was revalued from £320,000 to £640,000.

    c) Current assets stood at £200,112 (work in progress: £23,200; debtors £173,623; and £3,289 cash) as against creditors falling due within one-year totalling (£449,799).

    d) Trade creditors stood at (£87,155) and it is to be noted that the aged creditor analysis within the evidence before me identified as at 31 July: £19,882.57 current debt; £31,375.64 period 1; £9,920.72 period 2 £9,550.66; period 3 and

£16,558.97 older. Whilst Mr R. Eade referred to some of that debt being disputed, the total is consistent with the trade creditor figure in the accounts.

e) Creditors also included amounts owed *"to group undertakings and undertakings in which the company has a participating interest"*: £137,948, which Mr R. Eade could not explain what this referred to.

f) Debt owed to HMRC totalled £157,512, although some £107,000 odd was subject to an arrangement to pay and further review on 20 September 2010 identified within a letter from HMRC dated 9 June 2010. Current months payment was required together with: £2,000 on 19 June and 19 July; £4,000 on 19 August and £10,000 on 19 September 2010.

g) The sum owed to creditors falling due after 1 year was small. Net assets totalled £481,668.

h) Members' capital consisted of:

£327, 216 plus the revaluation reserve of £320,000

less

liabilities of £27,175 and £138,373 for remuneration charged as an expense and drawings respectively.

I accept the evidence of Mr McTear, which is factual, that the £327,216 is the product of:

The balance owed to Lloyds Bank as shown in the LLP's nominal ledger as a liability of the LLP, £435,130.03 plus the balances on Mr C. and Mr R. Eade's capital accounts, £10,953.94 and £5,000)

less

The balance on "R Middleton capital account", (£75,020) and the sole trader loss (£48,847.42).

65. Trading problems are apparent from the face of those accounts. Whilst appreciating that this is a "one-day snap shot" and that any analysis must be subject to consideration of ongoing trading, the obvious question was or ought to have been for Mr C. and Mr R. Eade: how will the LLP be able to pay the creditors falling due within one year when it has net current liabilities totalling (£249,687)?

66. The tangible assets are fixtures and fittings and motor vehicles and, therefore, overall of relatively little value in this context. The good will revaluation was plainly unjustified in the light of those results. In any event Mr R. Eade rightly accepted that the intangible assets (the good will) would not provide a source for raising funds in circumstances of the existing Lloyds Bank Loan. As a result, as he said in answer to questions from me, the LLP's future was dependent upon improvements in the business.

F3) Trading to 30 September 2010

67. The VAT returns for August and September 2010 show sales reasonably consistent with the LLP's previous trading. The overall aged debt as at 30 September 2010 remained similar in total if compared with 31 July but with higher current debt and less for periods 1-3 and older debt: £44,560.69 current; £27,887.77 period 1; £9,309.79 period 2; £75.01 period 3 and £6,347.32 older. The balances (rounded down) were: £93,000; and £104,000.

68. Management accounts record a £5,980.53 net profit in August (compared with a loss of £17,412.75 for August 2009) and a net profit of £11,732.98 in September (compared with a profit of £3,386.73 in 2009). This produced an aggregate trading profit of £17,713.51 over those two months.

69. Those figures provide a possible indicator of what might have been in the minds of Mr C. and Mr R. Eade when considering the LLP's financial position as at 30 September 2010 pending the availability of the September management accounts. So too do the figures for October to December (albeit that hindsight is not to and will not be used against them). They subsequently showed profits of £10,435.40 and £27,014.33 followed by a loss of (£2,483.49) with an aggregate profit for the 5 months of £52,679.75.

70. However as mentioned, the profit figure does not include the continuing requirement to make the Lloyds Bank Loan payments. In July 2010 the Lloyds Bank Loan repayments increased from £4,500 to £5,330 per month. I note there is a sum for "bank loan interest" in the accounts but for the months from August to December 2010 it was either about £2,250 or £2,400 odd. The LLP did not have an overdraft and, therefore, this figure may be attributable to the factoring agreement. Mr C. and Mr R. Eade did not know. Even if not, it was still only half the sum required for the monthly Lloyds Bank Loan payments.

71. Therefore, the results for August to September and the potentially foreseeable profits from October to November offered Mr C. and Mr R. Eade, relatively, an improved outlook for the short-term future of the Company. But there was still an extremely long way to go before they might be able to contemplate answering the question resulting from the 30 July 2010 balance sheet positively. In that context it is to be noted that the budget for the 3 months ended 31 August 2010 had anticipated a net profit of £19,493, whereas the actual profit was only £2,590.

72. There was also the problem that drawings were not included in the management accounts. Ledgers for August 2010 record withdrawals totalling £3,860 and for September £7,860. It was or ought to have been apparent to Mr C. and Mr R. Eade that the drawings were not supported by profits either as at 31 July 2010 or 30 September 2010.

73. On 19 September 2010 the LLP failed to pay HMRC the £10,000 agreed instalment which was due in part payment of the historic debt. This and all the difficulties previously identified explain why on 27 September 2010 Mr C. and Mr R. Eade signed FRP Advisory LLP's letter of engagement dated 17 September. The services to be provided were specifically concerned with urgently selling the business and the

appointment of administrators. This is apparent from the content of the letter including its description of services.

74. It is to be concluded from the financial information available to Mr C. and Mr R. Eade at the time, as summarised above, that this would be an exit resulting in an insolvent liquidation following a pre-pack sale of the business and that they appreciated that. As Mr R. Eade said under cross-examination, the LLP's financial position was such that they needed to pursue this potential exit.

75. An e-mail sent on 30 September 2010 by Mr Weller of FRP to the LLP's solicitor, Mr Perry, refers to: (i) the LLP having apparently written to its creditors to inform them that *"a new entity would be meeting all existing liabilities"*; (ii) an exchange of information with HMRC; and (iii) *"Pressure ... starting to mount from both HMRC & Lloyds so we are mindful of resolving this quickly"*. During cross-examination Mr R. Eade accepted they had concluded the LLP was insolvent and this was the only rescue plan. There is no evidence to sustain the proposal that all existing liabilities will be met by a new entity.

F4) 1 October to 31 December 2010

76. An attendance note of a meeting Mr C. and Mr R. Eade had on 5 October 2010 with Mr Weller of FRP starts with the following reference to the LLP: *"Attention then turned to the plight of the LLP, which had significant debt and little funds"*. The note identifies estimated current debts of £103,000 owed to HMRC and £100,000 to suppliers which fell to be addressed within the context of also having to pay £45,000 rent arrears and the Lloyds Bank Loan payments. Debt under the factoring agreement secured on book debts totalled £152,000.

77. The possibility of a pre-pack administration remained but was described in the note as *"becoming more problematic due to o/d current accounts and the lack of certainty over goodwill and asset purchases"*. When the need for pre-sale advertisement was mentioned, Mr C. and Mr R. Eade raised concern that it might provide the opportunity for Mr Middleton to outbid them.

78. A short, post-meeting discussion between Mr Weller and Mr R. Eade concerning a new company's future trading prospects led Mr Eade to point out that:

> *"to secure the future certain assumptions needed to be fruitful outcomes in that a rent review would be required, [Lloyds bank] would need to offer a capital repayment holiday and the staff costs would need to be controlled to manageable levels [potentially resulting in redundancies because staff costs could not be covered in low turnover periods]"*.

79. A different attendance note of the main meeting records the meeting having considered the possibility of using anticipated sale proceeds from Mr C. Eade's property in Portugal to pay *"PAYE [due] from the old company [referring to the former partnership] of about £60,000 and a claim for personal tax of about £160,000 ... [with potentially] a short term IVA paying 100 pence in the pound"*. It is recorded that CVA and Administration were discussed for the LLP and that:

> *"There is also a question over [Mr R. Eade's] position. [He] has taken drawings out of about £50,000 which is not supported by profit. There is, accordingly, a potential negative Partners Loan Account ... [which] is obviously problematic"*.

80. An email sent to Mr Weller by Mr R. Eade on 6 October 2010 refers to two cheques totalling some £11,000 having been sent to HMRC following a telephone call chasing for payment. Its content also discloses that wrongful trading had been previously discussed and a decision had been made by Mr R. Eade to send a cheque for £4,900 to the LLP's aluminium supplier for their August account (terms 30 days) which *"will not alert them to any problems and show that we had every intention of trading properly with them"*. The conclusion was: *"there is no clear solution/outcome available to us and we must all continue to explore the possibilities"*.

81. By 20 October 2010 *"[C]VA [was considered by Mr Weller] to be unlikely and administration ... appears to be the most likely route forward"* as recorded in the solicitor, Mr Perry's attendance note for that day. The possibility of a CVA has not featured in the trial as a defence and the reality is that administration was the only serious route.

82. It is unclear precisely when Mr C. and Mr R. Eade decided not to pursue the proposed administration, if there was a specific date rather the decision being the outcome of a progression of events. There is a paucity of documentary evidence concerning the LLP's continued trading during October – December. It appears that contact with FRP ceased by the beginning of November. Much of the correspondence before me between September and December concerns a dispute with Mr Middleton and the partnership's accountants over the partnership's accounts which were relevant to the LLP to the extent that it required opening balances for its first accounts. The main evidence for this period is to be found in the End of Christmas 2010 Trading Defence.

83. However, on the balance of probability I am satisfied from the evidence above and having taken into consideration the answers in cross-examination that all the problems previously mentioned surrounding the practicalities and possible outcomes of an administration will have been relevant to their decision. I am also satisfied that at least during September and October, Mr C. and Mr R. Eade were concerned about and took account of their personal positions. In particular, the problems for them of raising the funds required for a pre-pack, the risk of Mr Middleton purchasing the business and the potential adverse financial consequence of the repayment of drawings by Mr R. Eade.

84. Nevertheless, Mr R. Eade was resolute in his evidence that there was an up-turn in the following months, that cash flow improved and that they were right to continue the LLP's trading. He described the LLP as profitable, albeit accepting that the profits appeared inadequate to cover the upcoming quieter months of trading over winter. I will need to consider that further when reaching my decision.

85. As mentioned above, the management accounts for October – December record net profits of £10,435.40 and £27,014.33 followed by a net loss of (£2,483.49) in December. This certainly came nowhere near to resolving the LLP's financial problems but it meant the LLP had an aggregate profit for the year to date of £52,679.75. However, this figure is not "as good" as it first appears.:

a) First because the Lloyds Bank Loan repayments and drawings have to be taken into account.

b) Second because the evidence established that profits needed to be built up by December to provide cash flow cover for the leaner months. To some extent December and certainly the first few months of a new year were always quiet for the industry. Historically the former partnership had relied upon an overdraft facility but this was not available to the LLP.

86. The position with HMRC during those months is far from clear: PAYE and NIC ledgers record payments towards current liabilities during October and November plus £3,847.07 and two payments of £4,000 towards PAYE arrears. A letter dated 12 November 2010 from HMRC refers to cancellation of the time to pay arrangement and to a decision to distrain. The ledgers record a further £4,000 paid in December but this is a relatively small reduction in the total arrears previously over £100,000 and potentially at odds with HMRC's 9 June 2010 letter. It required current liabilities to be paid and £2,000 on 19 June and 19 July; £4,000 on 19 August and £10,000 on 19 September 2010 towards arrears. On the other hand, there was no attempt to levy distress during 2010.

87. During cross-examination Mr R. Eade stated his belief that there was a further agreement with HMRC permitting payment of debt by instalments providing ongoing liabilities were paid. If so, the agreement is not documented but there is evidence to support his recollection. An HMRC letter dated 19 May 2011 refers to a previous time to pay agreement conditional on prompt payment and to their records showing the LLP failed to comply with its terms. The letter cancelled that agreement in respect of arrears totalling £85,273.65.

88. Whether the cancelled agreement was a continuation of the 9 June 2010 agreement or a new one negotiated after 12 November 2010 is unclear. However, the LLP's nominal ledger records £4,000 continuing to be paid in the months of January-March 2011. The oral evidence is that by April the LLP could no longer pay HMRC as agreed.

89. Between October and December 2010 the LLP's aged debt moved: (i) for current debt from £43,044.56 to £31,855.03; (ii) for period 1 from £33,382.64 to £30,719.79; (iii) for period 2 from £11,474.76 to £8,243.42; (iv) for period 3 from £3,688.99 to £11,456.49; and (v) for older from £15,881.91 to £7,911.52. The balances for those 3 months being (rounded down): £107,000; £[not stated]; and £90,000.

90. The proposed administration did not proceed and the LLP continued to trade without creditors apparently taking steps to obtain/enforce judgments or place it into liquidation. Mr R. Eade's evidence described the year ending with optimism based upon the East of England Co-operative Society signage project relied upon under the End of Christmas 2010 Trading Defence. He also stated that optimism arose from discussions with Mr Piner, who is referred to under the 1 April 2011 Trading Defence. Mr R. Eade recollected that they were first in contact about Mr Piner being engaged by the LLP around Christmas.

F5) Trading 1 January to April 2011

91. Mr R. Eade's evidence was that the prospects to be expected from Mr Piner's involvement were at the forefront of their minds because of his contacts and ability to obtain work from substantial suppliers, "Dominos Pizza" and "Subway Sandwiches". It was suggested by Mr R. Eade in evidence that there had been sales of £62,000 by Mr Piner over the first four months of his engagement but he accepted that this might lead at best to no more than £4,000 a month (odd) gross profit. He accepted that Mr Piner's involvement was too late in the day for the LLP. The 1 April 2010 Trading Defence is significantly undermined by this fact.

92. Management accounts (in their unaltered template and, therefore, excluding drawings as loans and repayment of the Lloyds Bank Loan) for January to April record net losses of: (£31,284.44); (£6,618.81); (£8,215.69); and (£22,020.57). Whereas between September and December sales had been: £101,457.41; £88,924.45; £120,439.15; and £71,530.72, during January to April they were: £58,596.11; £59,747.55; £72,679.66; and £45,974.48. Around this time Mr C. and Mr R. Eade agreed to postponement of the LLP's rent liability. Mr C. and Mr R. Eade invested £20,000 each during February 2011 as additional capital. It is apparent that was essential for the LLP.

93. A 5-year, £40,000 loan was requested from Lloyds Bank *"to aid the business through [its] current cash flow shortage"*. That shortage is illustrated by the fact that the report had to explain that a redundancy package for a production director of £26,000 was unaffordable without that support.

94. A business plan (potentially revised) dated March 2011 was presented on the basis that:

> *"In February 2011, the partners carried out an in depth review of the business and re-assessed the viability and recognised that sales generation beyond their current levels is required in order to trade up to the potential ... The early estimates are that [because of Mr Piner's engagement and contacts] this business will yield a minimum of £200,000 additional sales per annum with expectations that this will rise to nearer £500,000".*

95. Mr R. Eade's evidence was that the plan was not produced by the accountants. He said the Bank was initially impressed and they expected to receive this additional funding. On the other hand, he could not explain during cross-examination why there was nothing in writing from the Bank to that effect. In an email sent to Lloyds Bank on 14 April 2011 he drew attention to cash flow difficulties and to a payment due to be made to Barclaycard which would not be covered by the LLP's cleared balance. He asked, *"On an aside, have you had a chance to consider the loan application?"*. There is no response in the papers. FRP was contacted again.

96. The business plan was heavily criticised during cross-examination for containing a balance sheet which for the period ending 31 July 2010 incorrectly included fixed assets to produce the net current asset balance. Plainly that was an error and an important one to appreciate when analysing the financial position. However, I do not find it to have been more than a mistake.

97. The plan included a forecast balance sheet and a profit and loss account. There was also a positive cash flow forecast which included payment of drawings and the Lloyds Bank Loan repayments. Net profits of £19,807, £24,411 and £17,610 were forecast

for May to July. In contrast and to assess reliability (but remembering hindsight must be avoided when assessing the position at the time), the actual figures within management accounts, which excluded drawings as loans and the Lloyds Bank Loan repayments, record losses of: (£2,829.29); (£13,153.42); and (£22,423.11). There was no explanation for this distinction.

98. Aged debt fluctuated during this period but did not alter significantly from previous months. For example, January and April can be compared as follows: Current: £50,334.47 v £54,778.93; Period 1: £25,210.79 v £21,650.43; Period 2: £21,188.20 v £20,024.58; Period 3: £7,198.90 v £13,957.68; and Older: £12,777.80 v £16,546.07. The balances for all 4 months being (rounded down): £116,000; £105,000; £126,000; and £128,000.

99. On 12 April 2010 Mr C. Eade's capital account was adjusted to include a credit of £320,000 against a balancing entry to goodwill.

100. In an email sent to Mr Weller of FRP on 15 April, Mr R. Eade wrote:

> *"The current cash flow ... is at its tightest since we first discussed our options with you ... our sales have fallen below the minimum required to keep up to date with our cash demands. Chris and I have injected a further £40,000 into the business to remain afloat ... Our concerns remain that by you continuing to act for us will drain cash flow further and as no viable solution to our plight has been possible, we cannot continue to casually incur expense. Further overhead cuts have been instigated and we have realised assets to improve cash flow temporarily. I have drafted a revised business plan and have requested from Lloyds a facility to cover our current working capital shortfall, which they are considering. The positive is that we have secured new clients and prospects for the summer look likely to improve, subject to the goodwill of our creditors. I am not in a position to settle any fees to you currently, my main concern is to ensure the VAT and PAYE get paid this month to prevent HMRC returning to [distrain] ... as they have threatened before".*

F6) May Onwards

101. An email from Mr R. Eade to Mr Weller sent on 13 May 2011 following discussions with Lloyds Bank and the accountants caused him to conclude:

> *"that without further bank support, which has been declined, the cashflow position is such that unless we enter into CVA* [a CVA option had apparently been produced offering £0.50 in the £ over 5 years], *the business will be forced into administration or liquidation by the first brave creditor to take action".*

102. An email sent on 21 November 2011 from Mr Weller to the liquidators explains that although FRP had been formally instructed to place the LLP into administration in September 2010, matters did not progress until May 2011 from when:

> *"Discussions continued ... on whether to place the business into administration/[C]VA or liquidation. Creditor pressure mounted & it was felt administration would provide the protection required. In July our report went to [the Bank] for their approval. I left the case with a colleague ... the main sticking point ... was the value ... to comply with SIPP 16. On my return ... my colleague advised that this information was not forthcoming. Shortly after, [the Bank] advised that they had received a new notice of intention to appoint [McTear Williams Wood] administrators".*

103. HMRC wrote their above-mentioned distraint warning letter dated 19 May 2011. It was sent by Mr R. Eade to Mr Weller on 25 May with the comment: *"content inevitable"*. A letter dated 20 May identifies VAT arrears totalling £14,859.57 to be added to the £85,273.05, PAYE payment plan arrears.

104. By 26 May, as evidenced by an email sent that day by Mr R. Eade to Mr Weller, Mr C. and Mr R. Eade were speaking to National Westminster Bank plc to raise working capital for a new company to which the business of the LLP would be transferred. The figure of £25,000 is identified as a potential unsecured loan.

105. On 8 June 2011 Mr Weller emailed Mr R. Eade to advise him about a CVA, a pre-pack administration, plain administration or a liquidation. Mr R. Eade emailed Mr Weller the next day to inform him that he was:

> *"still working through cash flows ... testing the CVA etc"* and that *"... Chris and I are of the belief that we might as well try for a CVA with one outcome being to buy time to establish the new Ltd company and funds, as the SIPP even if it agrees to release funds will take time"*.

106. It is plain Mr C. and Mr R. Eade intended to establish a phoenix company to purchase the business but were not yet financially able to raise the funds. The CVA was not pursued. Mr R. Eade explained in cross-examination that the proposed offer was based upon an example of a successful CVA proposal provided by Mr Weller. It was not communicated to creditors. It is clear from the evidence and I find that it was never considered to be a realistic solution.

107. On 6 July a court officer took walking possession with Mr C. Eade paying £4,200 personally to prevent execution to enforce suppliers' judgments. Sale of the apartment in Portugal completed on 11 July. No further capital was injected.

108. The LLP sought further advice from Mr Weller and by 8 July the process was started to achieve an administration. However, a £25,000 offer for the business emailed by Mr R. Eade on 26 July 2011 was rejected. This caused them to decide to change advisers to McTear Williams and Wood. As stated in their evidence this was because of:

> *"[their] inability ... to pay the price that FRP required ... and [their information] that they had to market the business assets for sale and ... would send details to [companies owned by Mr Middleton] ... an unpalatable prospect ....*".

109. The 13 May and 14 July Trading Defences contend that appropriate steps were taken by Mr C. and Mr R. Eade at this stage. However, they did not take the step of placing the LLP into administration or initiate any alternative insolvency remedy. Instead they delayed in reliance upon considerations which were not in the interests of creditors but met their personal aims.

110. Management accounts for the period 1 August 2010 to 30 April 2011 record a net loss of £9,970.11 based on a turnover of £692,021.15. The balance sheet records total net assets of (£27,710.11). The year to date figures record the same profit and loss figures but £18,435.52 total net assets. The capital accounts are recorded as: Mr C. Eade – £160,341.52 - £89,458.84 drawings; with a miscellaneous figure of (£25,000); Mr R. Eade - £25,000.

111. McTear Williams and Wood were engaged on 1 August having been sent filed and management accounts together with aged debtor and creditor lists. By letter dated 12 August 2011 within general insolvency advice, they advised that the LLP could continue trading whilst the prospects of future trading were being established. This is relied upon within the Subsequent Events Defence as an indemnity against wrongful trading and preference claims. However, that is a misreading of the letter. That initial advice was subject to important conditions in reasonably standard form, aimed to ensure the trading would not be detrimental to existing creditors and their preferential or *pari passu* rights. The recommendation was a creditors' voluntary liquidation.

112. The liquidation commenced on 24 August 2011. On or about 25 August 2011 the liquidators accepted £25,000 from Mr C. Eade for an asset sale to O Signs Limited, a company owned by him and Mr R. Eade.

113. During the LLP's trading the following sums were paid to Mr C. and Mr R. Eade on account of drawings:

Date	Mr C. Eade	Mr R. Eade	Total
01/08/09 to 31/07/2010	£56,719	£42,048	£98,767
01/08/10 to Liquidation but with no payments being received from 16 July 2011	£42,990 including £36,270 from 1 October 2010; £24,690 from 1 January 2011; £13,360 from 1 April 2011; £9,250 from 16 May 2011.	£35,250 including £30,250 from 1 October 2010 £21,250 from 1 January 2011; £12,500 from 1 April 2011; £9,250 from 16 May 2011.	£78,240

114. Between 1 October 2010 and liquidation the LLP paid £63,969 in respect of the Lloyds Bank Loan. That sum included: £47,967 from 1 January 2011; £31,984 from 1 April 2011; £21,923 from 16 May 2011; and £10,661 from 16 July 2011. When asked why the LLP continued to make these payments despite its financial position, Mr R. Eade explained that Lloyds Bank would have withdrawn its banking facilities had payments been missed. That will be considered further below.

115. The statement of affairs as at 24 August 2011 records an estimated deficiency of £370,000. Whilst the book value for goodwill was £640,000 producing estimated total assets of £690,000, the value given for estimated realisation was £3,000 and £21,000 respectively. Based on book value, trade creditors stood at £144,000 and HMRC £140,000. The landlord was owed £60,000 with employees claim for pay in lieu of notice and redundancy being £47,000.

G) Decision

G1) The Lloyds Bank Loan Payments – The Starting Point

116. The starting point for the claims for repayment of the LLP's Lloyds Bank Loan payments is the finding of fact that Mr C. and Mr R. Eade agreed for good consideration that the LLP would assume that liability. In return the LLP received the assets and business of the former partnership purchased by Mr C. Eade from Mr Middleton and the use as working capital of the balance of the Lloyds Bank Loan. It does not matter that this agreement with the LLP was reached informally between father and son whilst wearing their hats as designated members. The company law, *"Duomatic"* principle applies to LLPs unless the members otherwise agree (***In re Duomatic Ltd*** [1969] 2 Ch 365).

117. Therefore, the payments to Lloyds Bank fulfilled that contractual obligation. They did not depend upon a direct contractual relationship between Lloyds Bank and the LLP. That means there are only two circumstances in which the payments to Lloyds Bank can be successfully challenged. The first is if Mr C. and Mr R. Eade capitalised their loan to the LLP. The second is if the LLP was insolvent at the time of a payment and Mr McTear can establish that a payment was made in breach of a common law/equitable duty and/or is susceptible to a statutory remedy under ***sections 239 or 214A of the Insolvency Act***. It is plain from the findings of fact that ***section 238*** will not apply. The payments were not a gift or a transaction at an undervalue but made pursuant to an oral agreement for good consideration.

118. The issue of capitalisation has caused difficulty and it is convenient here to set out the following basic principles relevant to matters raised during submissions. The context is that whilst a member who has lent money unsecured to an LLP ranks together with all other unsecured creditors in a liquidation and can rely upon the same rights of set off:

a) Members' capital, the working funds provided as equity, is an investment upon terms which leave the member at risk of loss. A member cannot set off capital as though it is debt whether within or without an insolvency. Capital will be recovered in a liquidation only if there are funds available after payment of the costs, expenses, debts and obligations of the LLP. That results from the fundamental nature of capital and its distinction from debt. It is also expressly provided within ***section 107 of the Insolvency Act***, which applies to LLPs.

b) It has been drawn to my attention in support of the submission that capital can be set off against debt that ***section 74(2)(f) of the Insolvency Act*** has not been applied to LLPs. Instead ***Schedule 3 of the Regulations*** provides a substituted ***section 74*** provision for LLPs. However, that has no effect upon the principles summarised in sub-paragraph (a) above. The provisions of ***section 74*** concern the liability of members to contribute to the assets of the company/LLP upon winding up and ***sect116-ion 74(2)(f)*** allows members' claims to be taken into account upon the final adjustment of the rights between members. Whilst ***section 74(2)(f)*** also expressly provides that a sum due to a member in that capacity cannot be ranked as a creditor's debt, the omission of those words

within the substituted LLP provision cannot lead to the conclusion that the opposite is intended for LLPs. Such conclusion would need an express provision and would be contrary to ***section 107*** (above).

G2) Was the LLP's Liability for the Lloyds Bank Loan Capitalised?

119. Whether funds have been lent or provided as capital is a matter of fact based upon the intention of the members. It is submitted on behalf of Mr McTear that the accounts filed for the financial year ending 31 July 2010 are consistent with capitalisation, they have been approved by Mr C. and Mr R. Eade and they are bound by them.

120. Whilst I have not been referred to authority on that proposition of law, as a matter of general principle it is plainly correct. For example, in the case of ***Re Singh Bros Contractors (Northwest) Limited, Sukhpaul Sing v Satpaul Singh*** [2014] EWA Civ 103, Lord Justice Vos when dismissing a renewed application for permission to appeal explained:

> *"... the purpose of the filing of companies' accounts is to represent to the world the true state of the company's affairs ... The company ... when it finalises its accounts, signed or not signed, as between itself and its shareholders and as between itself and its directors, is to be taken as filing accounts that show a true and fair view of the company's affairs ...".*

121. It matters not that this statement of law was made in the different context of a derivative claim. The now Chancellor decided that the company could not bring a claim for dividends to be declared illegal because dividend waivers had been procured by undue influence or misrepresentation. Applying his decision to this case, Mr. C. and Mr R. Eade will normally be bound by their approval of accounts recording capitalisation of a loan if they did so. The accounts are a record of their intention.

122. It should be a straightforward task to decide from the 30 July 2010 accounts if the debt was capitalised. They should comply with ***The Small Limited Liability Partnership (Accounts) Regulations 2008*** (SI 2008/1912) ("the Accounts Regulations"), which then applied to small LLPs. Unfortunately, the Company's 31 July 2010 accounts do not contain any of the information required by ***Regulation 46***. Amongst their deficiencies they do not give the aggregate amount of loans and other debts due to members as at the date of the beginning of the financial year or the aggregate amounts contributed by members during the financial year.

123. Put simply, they do not obviously distinguish members' capital classified as a liability from members' capital classified as equity. Whilst *"members' capital"* appears under the heading *"Loans and other debts due to members"*, there is no heading for equity despite the £10,000 undoubtedly injected by Mr C. and Mr R. Eade as equity when the LLP started. That means the figure given for members' capital, £327,216, needs to be investigated and a note within the accounts that *"Members' capital is classified as a liability under Financial Reporting Standard 25"* needs to be applied in that context.

124. The accounts are drafted from the basis that the LLP is a continuation of the former partnership/sole trader business/funds rather than having started afresh with the purchase/injection of the business. That followed the Sage, management accounting

records. As a result, Mr R. Eade's capital account ledger for the period to 31 July 2010 is only credited with his initial £5,000 capital injection. This despite Mr R. Eade having provided 50% of the purchase price of Mr Middleton's partnership share through the loan to the LLP of the Lloyds Bank Loan.

125. Mr C. Eade's capital account ledger continues his former partnership/sole trader business ledger (including period end losses) and along with the other day to day credits and debits includes: (i) a debit of (£147,429.24) representing the merger into his ledger of Mr Middleton's capital account ledger; and (ii) £320,000 posted on 12 April 2011 for 31 July 2010 to represent goodwill.

126. Mr McTear's starting point is the revaluation of intangible assets, the good will, from £320,000 to £640,000. It is submitted on behalf of Mr McTear that the "revaluation" is a *"crude attempt to suggest that capital ... was debt ... and ... Designed to make the Accounts opaque"*. That is not my conclusion based upon my assessment of Mr C and Mr R. Eade as witnesses except I agree entirely with the word "opaque".

127. Whilst £320,000 may have represented the value of the business by reference only to Mr Middleton's previous 50% share upon its purchase by the LLP on 3 July 2009, the decision as at 31 July 2010 to double its value is not only opaque but unjustifiable in the light of the financial decline. Its inclusion undermines the fair presentation of the accounts. Its addition to Mr C. Eade's capital account within the Sage management accounts is simply wrong.

128. However, as Mr McTear recognises, the increase was treated as a revaluation reserve in the 31 July 2010 financial year-end accounts under the heading of *"loans and other debts due to members"*. That is plainly the correct treatment (assuming revaluation was justified). It is not treated as a credit to a member's capital account and does not affect the debt converted to capital debate.

129. Mr McTear's case relies upon his work, which I have accepted, identifying how the £327,216 was calculated (see paragraph 64(h) above). He contends that this entry establishes capitalisation. It is submitted that the Lloyds Bank Loan does not appear in the accounts because full credit has been given for the introduction of the sole trader business by Mr C. Eade. In a final written submission it is proposed in the alternative that the payments towards the Lloyds Bank Loan should be treated as drawings.

130. As previously explained, I must approach this claim without the benefit of expert evidence and my decision is to be reached without trespassing into areas which would be covered by such evidence. Whilst this is potentially a fine line when the ***Companies Act 2006*** prescribes the contents of the accounts, the conclusions I can reach are these:

a) The £327,216 is the product of the valuation of Mr Middleton's 50% interest in the former partnership, the capital accounts transferred from that partnership and the £10,000 specifically injected by both Mr C. Eade and Mr R. Eade. It also includes the net sum of cash injected from the balance of the Lloyds Bank Loan after deduction of the liabilities transferred from the partnership.

b) The accounts when recording that figure should have distinguished equity from debt within the heading of members' capital but failed to do so. The

failure to classify the £10,000 injection as equity plainly establishes that conclusion.

c) Instead the accounts refer to the £327,216 as *"loans and other debts"*. That is plainly incorrect insofar as, for example, the £10,000 is concerned. That cannot mean, however, that the classification is necessarily wholly inaccurate and that the whole of the £327,216 should be read as members' equity not debt.

d) The part of the £327,216 attributable to the finance received via the Lloyds Bank Loan (directly in cash by taking over the bank account or indirectly by receiving the 50% interest in the business it purchased and assuming the liability) can be correctly included as *"loans and other debts"* if that was the intention of Mr C. and Mr R. Eade.

e) The evidence concerning and terms of the agreement creating the LLP's liability for the Lloyds Bank Loan payments and the payments made pursuant to that agreement up to the date the accounts were approved, 1 April 2011, is evidence of an intention to create and maintain that liability as debt.

f) Whilst what occurred after the accounts were approved will not be evidence of the intention/agreement as at 1 April 2011, the continuing payments by the LLP in respect of the Lloyds Bank Loan are also consistent with that conclusion.

g) Whilst the Sage management capital accounts present the potential for a different analysis, they are not approved accounts. They provide potential evidence of the intention of the designated members but the evidence referred to in sub-paragraph (e) with or without the support from the evidence in sub-paragraph (f) is overwhelming.

131. Therefore, the capitalisation claim has not been established on the balance of probability. That means Mr McTear's claim in respect of the Lloyds Bank Loan payments must depend upon establishing that a payment was made in breach of a common law/equitable duty and/or is susceptible to a statutory remedy under ***sections 239 or 214A of the Insolvency Act***.

132. Those matters overlap issues concerning the claims for recovery of the payments on account of anticipated profits. Therefore, it is convenient to next identify the starting point for those claims.

G3) The Payments On Account Of Anticipated Profits – The Starting Point

133. It is a finding of fact that Mr C. and Mr R. Eade agreed that money could be withdrawn on account of anticipated profits. This is the starting point. Mr C. and Mr R. Eade cannot argue in those circumstances that the money should be treated as their remuneration or claim a *quantum meruit* for the following reasons:

(1) That agreement was the basis on which the LLP paid and they received that money. They cannot change that fact. The payments were correctly entered in the books as withdrawals on account of profits and in the filed accounts evidencing their binding decision.

(2) Further, the agreement resulted from the fact that they were members of the LLP entitled to a share in the profits. They were not employee members. A person cannot be a member of an LLP entitled to share in the profits and be an "employee" or "worker" at the same time under English law (see ***section 4(4) of the Limited Liability Partnership Act*** 2000, as construed in by Warren J. in ***Reinhard v Ondra LLP and others*** [2015] EWHC 26 (Ch), [2015] EWHC 1869, [2016] 2 B.C.L.C. 571, applying the Court of Appeal decisions in ***Tiffin v Lester Aldridge LLP*** [2012] EWCA Civ 35, [2012] 2 All ER 1113, [2012] 1 WLR 1887 and ***Bates van Winkelhof v Clyde & Co LLP*** [2012] EWCA Civ 1207, [2013] 1 All ER 844 in the light of the decision of the Supreme Court on the appeal of the latter decision, [2014] UKSC 32, [2014] 3 All ER 225, [2014] 1 WLR 2047).

(3) In ***Reinhard v Ondra LLP and others*** (above) Mr Justice Warren decided that the only possible routes forward for a member to obtain agreed "remuneration" would be: (i) for the agreement to establish that the member was not entitled to share profits but was in fact an employee member; or (ii) to confer the rights agreed between the members through their incorporation as terms of the LLP members' agreement, oral or in writing, so far as possible.

(4) The first route obviously does not apply on these facts. The second cannot be used to avoid the law identified in sub-paragraphs (1) and (2) above. The membership construction approach will seek in this case to ensure that the same "remuneration" is received as a member through the profit share calculations. That will only entitle payments on account of anticipated profits not payments of remuneration.

(5) There can be no *quantum meruit* when the payments cannot be re-characterised as payments for services which the LLP could lawfully make (cf ***Global Corporate Ltd v Hale*** [2018] EWCA Civ 2618).

134. That means payments to Mr C. and Mr R. Eade must be treated as loans to be repaid on demand if there are no or insufficient year end profits unless Mr C. and Mr R. Eade can establish a set off. They claim to be entitled to set off the LLP's liability to them to repay the Lloyds Bank Loan.

135. That gives rise to two issues now that the third, whether Mr C. and Mr R. Eade capitalised their loan to the LLP preventing set off, must be ruled out. Namely, whether (i) the LLP's claim to recover sums paid to members on account of anticipated profits can be set off against a members' claim as creditors of the LLP; and/or (ii) the payment involved misfeasance with the result that there will be no right of set off. The second depends upon whether a payment was made in breach of a common law/equitable duty as alleged and/or is susceptible to a statutory remedy under ***sections 239 or 214A of the Insolvency Act***.

G4) Payments On Account - Set Off Against Debts Owed to Members

136. The answer to the first of those issues is that there can be no set off. The loans by the LLP of the sums paid on account of anticipated profits were loans to Mr C. and Mr R. Eade in their capacities as members. As a result, they cannot be set off against the LLP's liability to them as creditors. To do so would be contrary to ***section 107 of the Insolvency Act*** and the judgment at paragraph 118 above equally applies.

137. I turn next to the breach of duty/statutory claims and as a result also to the second set off issue. If there has been misfeasance, there will be no set off.

G5) Insolvency and The Duties of Designated Members – The Law

138. Insolvency is to be assessed by reference to the phrase *"a company is unable to pay its debts"* found within ***section 122(f) of the Insolvency Act***. That phrase is defined in sections ***123(1)(e) and s.123(2)***. Their meaning has been explained by the Supreme Court in ***BNY Corporate Trustee Services Ltd and others v Eurosail-UK 2007-3BL plc and others*** [2013] UKSC 28, [2013] 3 All ER 271, [2013] 1 WLR 1408 (***"Eurosail"***) as follows:

    a) An inability to pay debts as they fall due includes present and *"depending on all the circumstances, but especially on the nature of the company's business, the reasonably near future"* but to cease considering the future past that point because the *"test would become completely speculative"*.

    b) A balance sheet insolvency test looking at *"the company's assets and [making] proper allowance for its prospective and contingent liabilities, asking whether it could not reasonably be expected to be able to meet those liabilities; but that the more distant the liabilities, the harder it would be to deem insolvent a company that was currently able to pay its debts as they fell due"*.

139. The law concerning duties of a company director has been codified by ***sections 170-187 of the Companies Act 2006***. Whilst this code has not been extended to or adopted for members of LLP, whether designated members or not, there is no doubt that members are potentially subject to the same common law and equitable duties upon which the code is founded. Those duties are not displaced by the code except by mirroring.

140. Application of those duties will depend upon each member's role but in this case Mr C. and Mr R. Eade as designated members were effectively the LLP's directors. Therefore, it is appropriate to refer to the law specifically applying to the duties of directors as though it referred to members unless the context clearly provides otherwise.

141. A director's statutory and common law/equitable duties alter in the event of insolvency because the director must then have regard to the interests of creditors. This duty *"might be triggered when a company's circumstances fell short of actual or established insolvency. The duty arose when the directors knew or should have known*

that the company was or was likely (meaning probable) to become insolvent" (see ***BTI 2014 LLC v Sequana SA and others*** ("Sequana") [2019] EWCACiv 112, [2019] 2 All ER 784).

142. This judgment needs to be considered further to identify the application of that duty to this case. The Court of Appeal rejected the significantly lower threshold of a test of *"a real (as opposed to a remote) risk of insolvency"*. Lord Justice David Richards (with whom Lord Justices Longmore and Henderson agreed) explained [216-222]:

> *I have, however, concluded that the duty may be triggered when a company's circumstances fall short of actual, established insolvency ... The precise moment at which a company becomes insolvent is often difficult to pinpoint. Insolvency may occur suddenly but equally the descent into insolvency may be more gradual. The qualified way in which judges have expressed the trigger (and I am among them; see Burnden Holdings (UK) Ltd (in liq) v Fielding [2016] EWCA Civ 557, [2017] 1 WLR 39 at [18]) reflects that the directors may often not know, nor be expected to know, that the company is actually insolvent until some time after it has occurred. For this reason, among others, a test falling short of established insolvency is justified.*
>
> *I consider there to be a problem with formulations ... such as being on the verge of insolvency, because they suggest a temporal test. If the test is that insolvency is 'imminent', or if similar words are used, it suggests that actual insolvency will be established within a very short time. That may well describe many situations in which the duty is triggered, but it does not or may not cover the situation where, although the company may be able to pay its debts as they fall due for some time, perhaps a considerable time, to come, insolvency is nonetheless likely to occur and decisions taken now may prejudice creditors when the likely insolvency occurs.*
>
> *[220] Judicial statements should never be treated and construed as if they were statutes but, in my judgment, the formulation used by Sir Andrew Morritt C and Patten LJ in Bilta v Nazir, and by judges in other cases, that the duty arises when the directors know or should know that the company is or is likely to become insolvent accurately encapsulates the trigger. In this context, 'likely' means probable, not some lower test ...".*

143. An underlying reason for this duty is that the company/LLP will be operating with or will be likely to have insufficient assets to pay creditors. As a result, the creditors rather than the members will be directly affected by the outcome for the company of the directors' decisions. Put simply, those decisions will affect how much money there will be to pay the creditors, as opposed to how much the company/the value of its shares will benefit having paid all the creditors.

144. In those circumstances the normal duty to act for the benefit of members by promoting the success of the company/LLP is superseded by the duty to have regard to the interests of creditors when promoting success, at least to the extent that it is the creditors' money which is at risk from the decisions taken by the directors (as codified within ***section 172***). As Lord Justice David Richards said in ***Sequana***:

> *"I hesitate to attempt to formulate a general test of the degree of financial instability which would impose upon directors an obligation to consider the interests of creditors. For present purposes, it is not necessary to draw upon Nicholson v Permakraft as authority for any more than the proposition that the duty arises when a company is insolvent inasmuch as it is the creditors' money which is at risk, in contrast to the shareholders proprietary interests. It needs to be borne in mind that to some extent the degree of financial instability and the degree of risk to the creditors are interrelated. Courts have traditionally and properly been cautious indeed in entering boardrooms and pronouncing upon the commercial justification of particular executive decisions. Wholly differing value considerations might enter into an adjudication upon the justification for a particular decision by a speculative mining company*

> *of doubtful stability on the one hand, and, on the other hand, by a company engaged in a more conservative business in a state of comparable financial instability. Moreover, the plainer it is that it is the creditors' money that is at risk, the lower may be the risk to which the directors, regardless of the unanimous support of all of the shareholders, can justifiably expose the company."*

145. Examples of a failure to have regard to the interests of creditors whilst the duty was triggered referred to in the Court of Appeal's decision include ***Re Horsley & Weight Ltd*** [1982] Ch 442, CA. The Court of Appeal found a breach of duty when directors granted a pension although the company could not afford the payment having regard to problems of cash flow and the payment threatened the existence of the company (see the judgment of Templeman LJ) or caused loss to the creditors (see the judgment of Cumming-Bruce LJ) instead of waiting until the financial position was assured.

146. In ***Sequana*** Lord Justice David Richards adopted the approach of those Lord Justices by accepting an objective test for breach of duty asking whether the directors *"should have appreciated"* or *"ought to have known"* that the payment in question *"was likely to cause loss to creditors or threatened the continued existence of the company"*.

147. That leads to a further question for this case, namely whether the interests of the creditors are to be treated as paramount or decisive. Lord Justice David Richards said this [222]:

> *... an important issue is whether, once the creditors' interests duty is engaged, their interests are paramount or are to be considered without being decisive. This is not straightforward, and there has been a good deal of discussion about it in some of the cases and in the academic literature. It is not an issue that arises on the facts of this case and, in my view, it should be addressed on the facts of cases where it must be decided. I therefore express no view on it, save to say that where the directors know or ought to know that the company is presently and actually insolvent, it is hard to see that creditors' interests could be anything but paramount."*

The stated exception to expressing "no view" provides a very strong steer and guidance which should be followed by me.

148. It is also to be noted that a theme of Lord Justice David Richards' judgment concerning directors' duties is pragmatism recognising that the legal test is to be applied within a working environment and context taking into consideration all the circumstances faced by the directors at the time of their decision. I will approach my decision and apply the test identified in ***Sequana*** with the assistance of the guidance within the judgment of Lord Justice Richards accordingly.

G6) Breach of Duty

G6.1) The Duty to have Regard to the Interests of Creditors

149. The conclusion to be drawn from the findings of fact is that Mr C. and Mr R. Eade knew the LLP had serious financial problems from the commencement of trading. The LLP's trading had to alter the pattern of falling turnover and reduced profit experienced during the last years of the former partnership and continued with the loss incurred by the sole trader business. Yet the customer activity summaries for August through to May 2010 evidence a continuing fall in turnover.

150. Taking that into account together with the HMRC liability from the beginning of its trading and the aged debt figures, Mr C. Eade and Mr R. Eade knew or ought to have known the LLP was or was likely to become insolvent. The duty to have regard to creditors was triggered from the beginning of the LLP's trading.

151. In any event Mr C. and Mr R. Eade knew or should have known that the LLP was insolvent at the latest by January 2010 and from then until 30 September 2010 (inclusive). They were required to have regard to the interests of creditors throughout that period. That conclusion is evident from the following, additional findings of fact (amongst others):

a) The notes of the 12 January 2010 meeting with Mr Watson record Mr C. and Mr R. Eade's understanding that the business would have to be sold and liquidation result unless *"circumstances took a significant turn for the better"*(see paragraph 58 above). Trading was not improving and competition from Mr Middleton's new company was marked.

b) In April 2010 employees sustained a 10% pay reduction to avert redundancies.

c) The business was placed on the market in May 2010 because of the adverse financial position.

d) The LLP's management accounts to May 2010 recorded a loss. Mr C. and Mr R. Eade appreciated (or ought to have done) that the financial deterioration continued and that those results did not include the Lloyds Bank Loan payments or distributions on account of anticipated profits. They would or ought also to have contrasted them with the unattained, budgeted figures. The inability to pay HMRC during this period would or should also have spoken volumes.

e) The 31 July 2010 financial year-end accounts were unavailable but the the problem of an overwhelming amount of creditors' debt (net current liabilities of just under £250,000) would or should have been evident to them from the management accounts (see paragraphs 64-66 above).

f) The aged debt through to and including 30 September 2010 would or should have demonstrated to Mr C. and Mr R. Eade the LLP's inability to pay debts as they fell due.

g) The signing of FRP's engagement letter on 17 September for services in connection with the urgent sale of the business and appointment of administrators. There is no suggestion that a sale would be for a purpose other than to achieve a better result for creditors than would be likely if the LLP was wound up.

h) Mr R. Eade accepted they had concluded insolvency by 30 September 2010. The position is highlighted by the 5 October 2010 attendance note for the meeting of Mr Weller which states: *"Attention then turned to the plight of the LLP, which had significant debt and little funds"*(see paragraph 76 above).

152. The End of September 2010 Trading Defence relies upon anticipated improvement to justify continuation of the LLP's business and payments of the Lloyds Bank Loan liabilities and/or the drawings on account of anticipated profits. However, the above-mentioned *"significant turn for the better"* Mr R. Eade recognised was required did not occur even though the LLP moved into net profit from August to October (noting the management accounts recording this did not take account of the Lloyds Bank Loan payments or withdrawals of payments on account of anticipated profits).

153. The improvement was far too small to alter the position. Mr C. and Mr R. Eade continued to know or should have known that the LLP was insolvent. HMRC were not paid their £10,000 instalment on 19 September 2010. An administration was being considered and the need to resolve the position quickly was recognised. The LLP had *"significant debt and little funds"* (see paragraphs 76 and 151(h) above). The duty to have regard to the interests of creditors continued through to the end of September 2010.

154. Plainly that duty also continued through October and by the 20th Mr Weller advised that administration was the most likely route forward. The fact that it was not pursued does not alter the position. The duty to have regard to creditors continued notwithstanding October and November's profits. First because they were insufficient to alter the knowledge of insolvency giving rise to that duty and second because Mr C. and Mr R. Eade knew that the accrued profits would be needed to help cover the seasonal downturn which would occur from/after December.

155. The End of Christmas 2010 Trading Defence is over-optimistic in its reliance upon the East of England Co-Operative signage project. Not only was a contract never signed but it did not offer nearly enough profit to lift the fact of insolvency. The anticipated seasonal decline occurred, as evidenced by the loss in December and the reductions in actual sales between January and April when compared with September to December. Whilst those figures introduce hindsight and are not relied upon as such, Mr C. and Mr R. Eade anticipated the seasonal downturn, as they should have done. There was nothing to suggest anything other than losses for the first two months of 2011. It cannot be suggested that there was not a duty to have regard to creditors or that this duty did not continue into the new year.

156. The £40,000 capital injection was required and provided but it was reasonably foreseeable that it would only cover the losses for those first two months as evidenced by the need to obtain further bank finance in the sum of another £40,000.

157. Moving, therefore, to the March/April period, the 1 April 2011 Trading Defence relies upon the engagement of Mr Piner and/or further bank support. However, the evidence has established that Mr Piner's involvement was too late in the day. As stated in the 15 April e-mail to Mr Weller, the future was dependent on the good will of creditors but there is no evidence of that good will being expressed. Whilst Mr R. Eade recollected that the business plan was well received, there is no contemporaneous evidence from the Bank, certainly no decision to lend and the 14 April e-mail asking whether the application had been considered has no answer in the papers for me.

158. By 13 May 2011 the bank had declined the request for additional finance. Mr Eade's email to Mr Weller of that date acknowledged the absence of a future if the support was declined. HMRC's letter of distraint is dated 19 May. Turnover was significantly

reduced and losses continued. As did the duty to have regard to creditors until the LLP was placed into liquidation. This need not be expanded upon because it is obvious from the facts. It was or should have been obvious to Mr C. and Mr R. Eade without any element of hindsight. By 26 May they were seeking funds for a new company from National Westminster Bank plc. There can be no other conclusion that that the duty to have regard to the interests of creditors continued until the LLP's liquidation.

159. In those circumstances by March/April 2011 the conclusion Mr C. and Mr R. Eade ought to have drawn having regard to the interests of creditors is that the LLP should only continue trading if an insolvency remedy was to be pursued with reasonable prospects of imminent achievement and the LLP's continuing losses would not be detrimental to creditors when weighed against the anticipated results of that remedy.

G6.2) The Duty and the Lloyds Bank Loan Payments

160. It follows that all the LLP's payments in respect of the Lloyds Bank Loan were made during the period Mr C. and Mr R. Eade had to have regard to the interests of creditors in the performance of their duties. Although paid to the Bank, the contractual arrangement means that the question is whether it was a breach of duty to repay the contractual debt owed to Mr C. and Mr R. Eade.

161. Absent a statutory remedy, which claims are not being considered at this stage, it is not a breach of duty to pay a creditor simply because the creditor is a member of the LLP. Those payments fulfilled the LLP's contractual obligation. They were necessary payments. In my judgment payments in respect of the Lloyds Bank Loan would only be in breach of duty if Mr C. and Mr R. Eade ought to have decided having regard to the interests of creditors that the LLP should stop trading.

162. The move into monthly trading profit during August and September would have provided support for a more favourable assessment of trading until the end of the year. It is reasonable to assume that the profit which occurred in October and November was sufficiently foreseeable as at 30 September for the directors acting in accordance with that duty to conclude that although insolvent, it would be in the interests of creditors if the LLP continued trading at a profit. That was because it was reasonable to conclude that the LLP's value should be maintained or improved and this period would allow time for an administration or even for a revision of the assessment of future prospects.

163. There is an issue whether that remained the case once the possibility of a pre-pack became *"problematic"* as noted at the 5 October 2010 meeting with Mr Weller. The business had been on the market since May 2010 without an offer and Mr C. and Mr R. Eade were taking into consideration their personal positions (see paragraph 83 above). That is of concern but there is no evidence that a sale was lost as a result of that approach and the practical reality is that the improvement in trading meant they could review the position in December.

164. In my judgment the improvement in trading through to December 2010, an aggregate profit for the financial year to date of £52,679.75, justified their decision to continue

trading until that year end having regard to the interests of creditors. The results are sufficiently adequate even after deducting the Lloyds Bank Loan payments.

165. Whether it was in the interests of creditors to continue trading subsequently, however, had to depend upon the outcome reasonably foreseeable for that trading in contrast to cessation by liquidation at the beginning of January 2011. Mr C. and Mr R. Eade rely upon three possible routes forward, individually or combined. The first is an injection of £40,000 capital. The second is the intended role for Mr Piner. The third, raising further finance from the bank based upon a business plan for future trading. The first two were reasonably foreseeable as at 31 December 2010, whilst the latter was in embryonic form at most.

166. Assuming, which it is right to do, results similar to those achieved between January and April were foreseeable during December 2010, the £40,000 injection justified continued trading for the first two/three months of the new year having regard to the interests of creditors (even allowing for those management results excluding the Lloyds Bank Loan payments and the drawings). It effectively covered the trading losses, even though it did not alter the insolvency. The Lloyds Bank Loan payments remained justifiable in that circumstance.

167. Moving, therefore, to the March/April period, the 1 April 2011 Trading Defence relies upon the engagement of Mr Piner and/or further bank support. However, the evidence has established that Mr Piner's involvement was too late in the day. This is also relevant to business plan presented to the bank because the plan depended upon the business he would generate in due course. In the circumstance of Mr Piner's belated introduction, a key question for Mr C. and Mr R. Eade when having regard to the interests of creditors was whether it was realistic to expect the Bank to lend a further £40,000 to cover the *"current cash flow shortage"* until that involvement would prove productive.

168. Their evidence is that they were positive about the outcome but that must be questioned when there is no evidence to justify the plan's May to July net profit forecast. Losses for each month through to and including April were incurred in 2011. Turnover was significantly reduced. Mr Piner would not provide the solution in time. By April the LLP could no longer pay HMRC as agreed. There is no evidence of good will from creditors being expressed. Whilst Mr R. Eade recollected that the business plan was well received, there is no contemporaneous evidence from the Bank to that effect. The 14 April e-mail does not have a reply. In my judgment the May to July net profit forecast was obviously unrealistic and it was unreasonable to continue trading on the presumption of expected further finance.

169. In all those circumstances by March/April 2011 the conclusion Mr C. and Mr R. Eade ought to have drawn having regard to the interests of creditors is that the LLP should only continue trading if an insolvency remedy was to be pursued with reasonable prospects of imminent achievement. No such steps were taken during that period.

170. In that context Mr C. and Mr R. Eade should have asked whether the continuing payments of the Lloyds Bank Loan were in the interests of the LLP having regard to the interests of creditors. The result of those payments during March and April was that money which should have been available for an insolvency procedure were used to pay creditors for a debt which had no direct impact on the LLP's trading.

171. There is an argument that the LLP's business would have had to cease if there was default by the LLP of its obligations to Mr C. and Mr R. Eade. It is reasonable to conclude that default would have caused the bank to exercise commercial pressure by proposing withdrawal of its facilities from the LLP. This means Mr C. and Mr R. Eade were entitled to consider and should have considered whether continued trading for a further short period the Lloyds Bank Loan payments continuing was nevertheless in the interests of creditors to avoid there being little to sell within an insolvency procedure.

172. In my judgment this overlaps a causation argument. Namely, that Mr C. and Mr R. Eade should be credited with or allowed the time required to achieve the appropriate insolvency remedy at this stage. There is an inherent reluctance to follow either argument because the liquidation was delayed until August. However, the continued payments enabled the LLP's business to be sold in the liquidation, albeit for only £25,000. That would not have been the case if the Lloyds Bank Loan payments ceased in March/April.

173. In my judgment covering both arguments, it was not a breach of duty to continue the Lloyds Bank Loan payments from March 2011 until about the end of April. That means, of course, that this argument of time credit/allowance cannot be repeated. The liquidator should have been holding the realised value of the business by the end of April with no more Lloyds Bank Loan payments being made.

174. On 13 May 2011 Lloyds Bank declined the request for additional finance. Mr R. Eade's email to Mr Weller of that date acknowledged the absence of a future if the support was declined. HMRC's letter of distraint is dated 19 May. The continuing payments of the Lloyds Bank Loan could not be justified.

175. They were not in the interests of the LLP having regard to the interests of creditors. The months of March and April should have been used to implement the appropriate insolvency remedy, whether administration or liquidation. There is no evidence to suggest a company voluntary arrangement was realistic. It cannot be argued that further time was required for an insolvency procedure and that the payments "held the ring". That argument has already been used.

176. Instead from May to July (inclusive) they tried raise funds to establish a phoenix company to enter into a pre-pack without taking and, indeed, seeking to avoid the steps required to market the business (see paragraphs 104-109 above). Mr C. and Mr R. Eade knew or ought to have known that the payments would reduce the assets available for creditors and would cause loss to them. Creditors' interests were paramount but they were instead concerned with how best to purchase the LLP's remaining business for the price they could afford. The Lloyds Bank Loan payments from May 2011 until liquidation were authorised in breach of fiduciary duty.

G6.3) The Duty and the Payments on Account

177. It is unnecessary in the absence in any event of a right of set off to decide whether Mr C. and Mr R. Eade acted in breach of duty by failing to have regard to the interests of creditors when causing the LLP to pay the drawings on account of anticipated profits.

However, the answer to whether there was a breach of duty and, therefore, misfeasance can be readily recorded. Plainly it was a breach of duty throughout the period that breach of duty is claimed when the facts establish there was no reasonable cause for such anticipation.

178. It was a misfeasance. A set off cannot exist in an insolvency if the company's claim is based upon the member's wrongdoing (see ***Manson v Smith (liquidator of Thomas Christy Ltd*** (1997) 1 B.C.L.C. 161).

G7) The Limitation Period Defences

179. The payments on account of anticipated profits and the Lloyds Bank payments in breach of duty were a misuse of the LLP's money by those entrusted with its stewardship. That was a breach of fiduciary duty. ***Section 21(1)(b) of the Limitation Act 1980*** disapplies the limitation period for claims of breach of fiduciary duty brought against directors because they were entrusted with the stewardship of a limited company's property and owed fiduciary duties to it as the beneficiary of the property subject to that stewardship (see ***Burnden Holdings (UK) Ltd v Fielding*** [2018] UKSC 14, [2018] AC 857). That reasoning applies to members of LLPs responsible for payments made in breach of duty such as these.

180. Mr McTear can also rely upon the decision of the Court of Appeal in ***Burnden Holdings (UK) Ltd v Fielding*** ([2016] EWCA Civ 557, [2017] 1 WLR 39 (not the subject of appeal to the Supreme Court) that equitable compensation is an appropriate remedy for an action falling within ***section 21(1)(b)***. This was expressed at [38] in the judgment of David Richards LJ as follows:

> *"Mr Chivers also objected that an account of profits is not within section 21(**1**)(b). I am inclined to agree, but the remedies sought by the claimant include equitable compensation and that appears to me to be an appropriate remedy falling within section 21(**1**)(b), particularly where, as in the case of Mrs Fielding, the trustee's indirect interest in the trust asset has been converted to the use of the trustee."*

181. Therefore, subject to consideration of ***ex parte James*** and to ***s.1157 Companies Act 2006***, to be considered further below, compensation equal to the sums received on account of anticipated drawings should be repaid. An amount equal to the Lloyds Bank Loan payments made from May 2011 to the commencement of the liquidation are also recoverable as compensation for breach of the fiduciary duty owed to the LLP. **Section 212 of the Insolvency Act** applies and it is just that the total amount should be contributed to the LLP's assets by way of compensation.

G8) *Section 214A of the Insolvency Act*

182. The decision to date means that Mr McTear's claim in respect of the sums paid towards the Lloyds Bank Loan before May 2011 depends upon ***section 214A of the Insolvency Act*** or his case that the payments can be challenged as a preference. I will consider each claim in turn.

G8.1 Section 214A – The Law

183. There does not appear to be reported authority upon ***section 214A of the Insolvency Act 1986***. Plainly it is analogous to wrongful trading for which ***section 214*** provides the court with a power to order a director to pay compensation if:

> *"at some time before the commencement of the winding up of the company, that person knew or ought to have concluded that there was no reasonable prospect that the company would avoid going into insolvent liquidation or entering insolvent administration"* subject to a defence that the director *"took every step with a view to minimising the potential loss to the company's creditors as (on the assumption that he had [such knowledge]) he ought to have taken"*.

184. However, there are the following differences in drafting in that ***section 214A***:

a) Applies to a member who makes a specific withdrawal of property from the limited liability partnership within the 2 year period *"whether in the form of a share of profits, salary, repayment of or payment of interest on a loan to the limited liability partnership or any other withdrawal of property"*;

b) Only refers to knowledge after each withdrawal of an insolvent liquidation not to *"entering insolvent administration"*. ***Section 214A*** reads: "*knew or ought to have concluded that after each withdrawal ... there was no reasonable prospect that the limited liability partnership would avoid going into insolvent liquidation"*.

c) Provides for a maximum liability by reference to the aggregate amount or value of all the withdrawals made in the relevant period;

d) Does not include an *"every step"* to minimise loss defence.

185. The second, identified difference should not have a significant impact upon the application of ***section 214A*** to this claim. That is because a member considering administration will need to address its purpose. Legal issues may arise from the difference if the purpose of the administration was to rescue the LLP as a going concern. In this case, however, the purpose was always a sale of the business to achieve a better realisation. Creditors would not be paid in full and in those circumstances a member who knew or ought to have known that there was no reasonable prospect that the limited liability partnership would avoid going into administration would also know there was no reasonable prospect of subsequently avoiding insolvent liquidation.

186. The similarities between the two statutory provisions mean the principles concerning knowledge identified in paragraphs [168 – 179] of the ***section 214*** decision of Mr Justice Snowden in ***Re Ralls Builders Ltd, Grant v Ralls*** [2016] EWHC 243 (Ch). [2016] B.C.C. 293 are to be applied to ***section 214A*** subject to the drafting differences identified above. Those valued paragraphs should be treated as being read into this judgment. Attention is also drawn to the following words of Chadwick J. in ***Re C S Holidays Ltd; Secretary of State for Trade and Industry v Gash*** [1997] 1 WLR 407 at p.414; [1997] B.C.C. 172 concerning the fact that there is no duty to ensure a company/limited liability partnership does not trade while insolvent:

> *'The companies legislation does not impose on directors a statutory duty to ensure that their company does not trade while insolvent; nor does that legislation impose an obligation to ensure that the company does not trade at a loss. Those propositions need only to be stated to be recognised as self-evident. Directors may properly take the view that it is in the interests of the company and of its creditors that, although insolvent, the company should continue to trade out of its difficulties. They may properly take the view that it is in the interests of the company and its creditors that some loss-making trade should be accepted in anticipation of future profitability. They are not to be criticised if they give effect to such view.'"*

187. There is an issue whether the same approach should be taken to quantification of compensation as Mr Justice Snowden decided applied to ***section 214*** bearing in mind the difference identified at paragraph 185(a) above.

188. In ***Re Ralls Builders Ltd*** at **[219-251]** Mr Justice Snowden decided that the contribution to be awarded for wrongful trading should not be measured by loss to individual creditors resulting from the fact that their debts had been incurred during the period of wrongful trading. Compensation should focus upon loss to the company caused by continued trading excluding losses which would have been incurred in any event because of entry into insolvent liquidation. Therefore, the quantification of any contribution should be measured by whether there had been any increase in the net deficiency of the company as regards its general body of unsecured creditors during that period.

189. This conclusion followed from the fact that the contribution would be distributed *parri passu* amongst the unsecured creditors (applying the decision of the Court of Appeal in ***Re Oasis Merchandising Services Ltd*** [1998] Ch 170; [1997] B.C.C. 282). It would not provide differential redress for individual creditors depending upon the extent of their individual loss.

190. That analysis did not rely upon the separate, minimising loss defence which:

> *"requires a director who wishes to take advantage of the defence offered by that subsection to demonstrate not only that continued trading was intended to reduce the net deficiency of the company, but also that it was designed appropriately so as to minimise the risk of loss to individual creditors".*

191. It follows that the absence of a minimising loss defence within ***section 214A*** does not affect the potential relevance of Mr Justice Snowden's reasoning and conclusion upon the focus of compensation for ***section 214*** claims. Compensation under ***section 214A*** will also be paid to the limited liability partnership in liquidation and be available (subject to liquidation costs and expenses) for *parri passu* distribution amongst the unsecured creditors not to individual creditors.

192. However, there is the important difference that ***section 214A*** is concerned with specific withdrawals. The starting point for causation and compensation must be intended by Parliament to be the amount or value withdrawn not the consequential effect upon the net deficiency. This is confirmed by the maximum compensation provision within ***subsection (4)***.

193. In my judgment that does not mean the analysis of Mr Justice Snowden does not apply to ***section 214A***. The decision to declare compensation is still discretionary and there is no fetter upon the exercise of judicial discretion subject to the statutory context. As a result, in an appropriate case it will still be relevant at the discretionary

stage to take into consideration arguments that continued trading did not result in an increase in the net deficiency or that compensation should not exceed any increase. In those circumstances the judgment of Mr Justice Snowden remains of great assistance as guidance.

194. That approach ends any argument of construction that ***section 214A*** is only concerned with events at the time of the relevant withdrawal preventing the court from considering whether subsequent events affect causation and quantification. That it does supports the decision.

G8.2 Section 214A – The Decision

195. The liquidation commencing on 24 August 2011, the two-year period to which ***section 214A*** can apply started on 25 August 2009. During that period the LLP withdrew property in the form of a share of profits (the drawings on account) and in repayment of and payment of interest on a loan. The claim in respect of those payments under ***section 214A*** starts from 1 October 2010.

196. The previous findings and decisions make clear that the ***section 214A*** *"unable to pay debts"* knowledge test is satisfied from that date. That means there is a discretionary power to declare Mr C. and Mr R. Eade liable to make such contribution to the LLP's assets as the court thinks fit unless the knowledge of insolvent liquidation test is not satisfied.

197. The previous findings and decisions also lead to the conclusion that Mr C. and Mr R. Eade knew or ought to have known after each withdrawal of anticipated profits and Lloyds Bank Loan payment from 1 October 2010 that there was no reasonable prospect of the LLP avoiding insolvent liquidation. In particular:

a) The engagement of FRP in September 2010 was on the basis that there would have to be a sale of the business and it cannot be suggested that the creditors would be paid in full as a result taking into consideration (amongst other matters) the 31 July 2010 accounts. Insolvent liquidation would follow.

b) That position did not alter. The improvement in trading between October and December 2010 was insufficient in itself and also taking into account the need to cover the seasonal downturn during/after December.

c) The £40,000 capital injection held the ring for the first two months but the route of administration had to be followed. A route which would inevitably not result in payment of the creditors in full. Insolvent liquidation was inevitable even if a sale was achieved.

d) The involvement of Mr Piner and the application for further funding from Lloyds Bank did not alter that. The first was too late. The second relied on unrealistic projections but in any event was refused.

198. The question, therefore, is whether the discretion should take into consideration the findings made when deciding whether there was a breach of duty in the context of the

Lloyds Bank Loan payments. The drawings should not have been paid in any event. They were unjustifiable for all the reasons previously provided.

199. The underlying feature of those findings is that between October 2010 and February 2011 the LLP traded profitably or had its losses covered by the capital injections. The period March to April gave rise to losses but these occurred during the period required to place the LLP into a pre-pack administration as previously explained. Whilst that time might be slightly generous, the monthly boundaries are not absolute and pragmatism is required. In the exercise of the statutory discretion, it is right and fair for the decision to remain: compensation should not be paid in respect of the Lloyds Bank Loan payments except for those from May 2011 to liquidation (inclusive) unless any other payment can be challenged as a preference.

G9 Preference

200. All the elements of ***section 239 of the Insolvency Act*** summarised in paragraph 9(c) above are satisfied in respect of the Lloyds Bank Loan payments except for considering the requirement of a *"desire to prefer"*. Mr C. and Mr R. Eade are connected persons and the two-year period ending with the liquidation applies. The *"unable to pay debts"* requirement is met, as previously explained. Each payment put Mr C. and Mr R. Eade into a better position than they would have been as unsecured creditors in a liquidation.

201. Mr C. and Mr R. Eade must rebut the presumption of a desire which exists because they are connected persons. They must satisfy the court that the payments to Lloyds Bank were not made because they positively wished to improve their positions as creditors in the event of an insolvent liquidation when deciding to make the respective payment. As Mr Justice Millett said in ***MC Bacon Ltd (No1)*** [1990] B.C.L.C. 324 at [335e-336d] (without reference to the presumption):

> *"It is no longer necessary to establish a dominant intention to prefer. It is sufficient that the decision was influenced by the requisite [to improve the position] desire. That is the first change. The second is that it is no longer sufficient to establish an intention to prefer. There must be a desire to produce the effect mentioned in the subsection ... Intention is objective, desire is subjective. A man can choose the lesser of two evils without desiring either.*
>
> *It will still be possible to provide assistance to a company in financial difficulties provided that the company is actuated only by proper commercial considerations. Under the new regime a transaction will not be set aside as a voidable preference unless the company positively wished to improve the creditor's position in the event of its own insolvent liquidation.*
>
> *But the mere presence of the requisite desire will not be sufficient by itself. It must have influenced the decision to enter into the transaction. ... That requirement is satisfied if it was one of the factors which operated on the minds of those who made the decision. It need not have been the only factor or even the decisive one. In my judgment, it is not necessary to prove that, if the requisite desire had not been present, the company would not have entered into the transaction. That would be too high a test.*

202. In my judgment the evidence of Mr R. Eade firmly established that the Lloyds Bank Loan payments being considered were made to ensure the LLP continued trading and/or its business was sold within an administration under a pre-pack agreement.

Nothing in the evidence suggested that they had in mind improving their position in a liquidation when making those payments. The fact that at times they decided in their own interests to continue trading rather than pursue an administration does not establish a desire relevant to this statutory provision because those decisions were not directed at the relevant payments. The presumption is rebutted.

G10) *Ex parte James* and *s.1157 Companies Act 2006*

203. I can find no basis for the application of either the principle in ***ex parte James*** or the power to grant relief under ***s.1157 Companies Act 2006***. The findings above and equitable approach taken justify that conclusion. This is a claim Mr McTear was entitled to pursue and for which he had to retain lawyers. Whether their fees are reasonable and proportionate is a matter for the creditors to consider not for this hearing except to the extent that it is to be considered within any order for costs.

H) Conclusion

204. The decisions above result in Mr C. and Mr R. Eade being liable to pay to the LLP the sum equal to all the drawings taken from the LLP on account of profits and the payments made by the LLP towards the Lloyds Bank Loan from May 2011 to the date of liquidation (inclusive). That liability arises under ***sections 212 and 214A of the Insolvency Act.*** There is no right of set off and no limitation period defence. The claims in respect of the other payments made by the LLP towards the Lloyds Bank Loan are unsuccessful.

Order Accordingly