KEY POINTS

- Until recently contractual payments to counterparties that had decided to cease trading by reason of their insolvency could be treated as being held on constructive trust by the payee for the benefit of the payer. This provided a degree of protection to the payer in any subsequent competition with the wider body of creditors for the paid sum. *Angove's Pty Ltd v Bailey and another* has recently removed, or at least significantly reduced, that measure of protection.
- The paying party still has a number of potential steps it may take to protect its position in such circumstances.

Feature

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Counterparty insolvency after *Angove v Bailey*

Angove's Pty Ltd v Bailey and another [2016] 1 W.L.R. 3179 held that payments made to a counterparty at a time when it had decided to cease trading as a result of its insolvency are not held on constructive trust for the paying party by that reason alone. The case alters the balance of insolvency risk that the paying counterparty must now consider in its business arrangements. In this article the author considers some of the steps the paying party may take in light of the prospective insolvency of its counterparty.

INTRODUCTION

In *Angove's Pty Ltd v Bailey and another* [2016] 1 W.L.R. 3179, the Supreme Court considered whether the receipt of money at a time when the recipient payee knew that imminent insolvency would prevent it from performing the corresponding contractual obligation, could give rise to a constructive trust in favour of the payer. The Supreme Court found that the answer to this question was no. In so doing the Supreme Court overruled the long established, if controversial case, *Nest Oy v Lloyd's Bank plc* [1983] 2 Lloyd's Rep 658.

ANGOVE'S PTY LTD v BAILEY AND ANOTHER: THE FACTS IN BRIEF

Angove, an Australian winemaker, had entered into an agreement with D&D Wines International Ltd entitled the Agency and Distribution Agreement (ADA). D&D, as Angove's agent and distributor under the ADA, purchased wines from Angove in its own right. It also sold wines on Angove's behalf to UK customers, generally retailers. The ADA was terminable by either side on six months' notice or by notice with immediate effect on the occurrence of certain events, which included the appointment of a liquidator or administrator.

D&D entered into administration (and shortly thereafter into creditors' voluntary liquidation). At the commencement of the administration, it was owed around A$874,928 representing the price of wine which it had sold to two UK wine retailers (the UK retailers). Two days after the commencement of D&D's administration, Angove gave notice terminating the ADA with immediate effect and sought to terminate any authority of D&D to collect the price from the UK retailers. The notice also declared that Angove proposed to collect the price directly from the UK retailers (under the terms of the ADA) and would account separately to D&D for their commission.

D&D's liquidators objected to Angove's proposed course. They argued that they were entitled to collect the price, deduct commission due to D&D, and leave Angove to prove in the winding up for the rest of the price. They contended that the relationship between D&D and Angove was as buyer/seller and not as agent/principal. As such, they argued, D&D's debt to Angove at the commencement of the administration was a simple debt for goods sold and delivered.

Angove argued that D&D would collect the outstanding amounts from the UK Winemakers as its agent under the ADA. It argued that the price should be paid over to it since D&D's liquidators' right to collect the money had been revoked by the termination notice. In the alternative, Angove also argued that any moneys held by D&D for its account were held on trust for Angove.

After the termination of the ADA, the price was collected and placed into an escrow account pending the determination of the dispute.

THE DECISION AT FIRST INSTANCE

At first instance (reported at [2013] EWHC 215 (Ch)) the judge held that the relevant relationship between Angove and D&D was as principal and agent and that D&D's authority to collect the price from customers came to an end upon the service of Angove's termination notice. In the circumstances, the judge held that Angove was entitled to the moneys in dispute. The judge, however, rejected Angove's alternative argument that the moneys in dispute were held on trust for Angove.

THE DECISION IN THE COURT OF APPEAL

In the Court of Appeal (reported at [2014] EWCA Civ 215) D&D's liquidators did not challenge the judge's finding that D&D acted as agents. They argued that D&D's authority to collect the price of the wine that it had sold on Angove's behalf survived termination of the ADA because it needed such (irrevocable) authority in order to recover its commission. The Court of Appeal accepted this argument and allowed the appeal on that basis. In the circumstances, the Court of Appeal held that D&D was entitled to the moneys in dispute. The Court of Appeal also rejected Angove's alternative case that the moneys in dispute were held on trust for Angove but for different reasons from those of the judge.

THE DECISION IN THE SUPREME COURT

The Supreme Court (Lord Sumption delivering the unanimous decision of the court) reversed the Court of Appeal's

decision. The Supreme Court accepted that an agent's authority to collect payment could, in principle, be irrevocable where:

- the contract expressly or impliedly provided that such authority was irrevocable; and
- such authority had been given to secure a "relevant interest" of an agent.

However, the Supreme Court found on the true construction of its terms, the ADA did *not* provide that:

- D&D had an irrevocable authority to collect payment on behalf of Angove; and
- D&D's right to collect moneys from customers existed in order to protect its interest.

As such, the Supreme Court found in favour of Angove.

In such circumstances, the Supreme Court did not have to consider Angove's alternative case, namely, that D&D held the moneys in dispute on constructive trust for Angove's benefit. However, in view of the general importance of the point raised, the Supreme Court proceeded to decide the constructive trust point in any event. Strictly speaking, therefore, this part of the decision might be considered *obiter dicta* and, as such, only persuasive. However, in light of the unanimous nature of the decision and the extensive legal argument on the point before the Supreme Court, it is highly likely that it will be treated as binding authority going forward.

THE CONSTRUCTIVE TRUST ARGUMENT

In short, the Supreme Court held that if the issue of a constructive trust had been relevant then Angove would have failed on that basis.

In the Court of Appeal, Angove had relied on the case of *Nest Oy v Lloyd's Bank plc* [1983] 2 Lloyd's Rep 658. It submitted that D&D held the moneys in dispute on constructive trust for Angove. The Supreme Court rejected the submission and in doing so overruled *Nest Oy*.

Nest Oy was concerned with a bank's right to combine accounts of an insolvent shipping agent, PSL, which had been authorised to settle certain third party service-provider debts of its principal, a shipowner, Nest Oy. Nest Oy put PSL in funds from time to time. Sometimes it paid PSL funds in advance; sometimes the payments simply reimbursed PSL for moneys it had paid to third-party service providers on behalf of Nest Oy. PSL entered into insolvency. At this time, it held the unspent balance of six payments that Nest Oy had paid into its (PSL's) general account. On the particular facts of the case the Judge (Bingham J) rejected Nest Oy's argument that the first five of the six payments were held on trust by reason of a principal/agent relationship or on the basis of a special purpose (or *Quistclose*) trust. Bingham J did hold, however, that PSL held the sixth payment on constructive trust for Nest Oy. It was found as a matter of fact that PSL had received the sixth payment after its directors had concluded that their company was insolvent but before PSL had in fact entered into formal insolvency. Bingham J considered that equity demanded that the sixth instalment be repaid to the shipowner since "it would have seemed contrary to any ordinary notion of fairness that the general body of creditors should profit *from the accident of a payment made at a time when there was bound to be a total failure of consideration*:" at p 666 of the law report [emphasis supplied]. That is, there was no prospect of PSL paying the sixth payment on to the third-party service-providers. Since on the findings of fact the bank had been put "on enquiry" of the constructive trust, Bingham J held that the sixth payment was not subject to the bank's right of combination.

The Supreme Court held that *Nest Oy* was wrongly decided. In order to show a constructive trust it was a necessary, but not necessarily a sufficient, condition to show that "… where money is paid with the intention of transferring the entire beneficial interest to the payee, the least that must be shown in order to establish a constructive trust is (i) that the intention was vitiated, for example, because the money was paid as a result of a fundamental mistake or pursuant to a contract which has been rescinded, or (ii) that irrespective of the intentions of the payer, in the eyes of equity the money has come into the wrong hands, as where it represents the fruits of a fraud, theft, or breach of trust or fiduciary duty against a third party" p 3193A-C of the law report. The Supreme Court observed that neither of the necessary conditions applied in *Nest Oy*. Lord Sumption noted that the *prospect* of a total failure of consideration was not a circumstance that could be said to "vitiate" the payer's intention so as to give rise to a constructive trust. This was *a fortiori* in light of the fact that an *actual* failure of consideration could not give rise to such a constructive trust. Moreover, Lord Sumption observed that it could not be unconscionable for a party to receive moneys to which it was contractually entitled in any event. Applying this analysis to *Angove* itself, Lord Sumption held that there would have been no such constructive trust in favour of Angove as contended for by Angove.

The Supreme Court considered that a potentially better basis for the decision in *Nest Oy* would have been mistake; namely, that the shipowner had paid the agent in the mistaken belief that the agent was in a position to disburse the payments to the third party service-providers. Lord Sumption expressed no firm view on the point stating in respect of the matter that:

> "Whether that is correct is not a question that arises on this appeal" p 3193F of the law report.

Lord Sumption noted that on the footing on which Angove's alternative constructive trust case was considered by the Supreme Court (namely, that D&D had the relevant authority to collect the proceeds of the invoice) the UK retailers' belief was not mistaken. The UK retailers had paid the moneys to D&D in the belief that D&D was authorised to collect the proceeds of the invoice.

THE COMMERCIAL CONSEQUENCES OF *ANGOVE*

Payment to a prospectively insolvent counterparty made at a time when there is bound to be a total failure of consideration by its non-performance of its obligations will no longer, in itself, give rise to a constructive trust over the paid amount. Of course, a

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constructive trust may arise in respect of such payment on some other basis, eg by reason of a special purpose trust or (possibly) by reason of mistake. However, assuming no other basis exists, the paying party now faces a greater insolvency risk than perhaps was hitherto thought to be the case.

SOME POTENTIAL WAYS TO ADDRESS THE INCREASED RISK

While each case must be considered on its facts there are some practical and strategic measures that a party should consider taking in order to protect its position when making payments to a party that may be on the cusp of insolvency.

Early warning-signs/first-mover advantage

It is important that vigilance is maintained for any early warning signs of a prospective counterparty's insolvency including the non or late payment of debt; legal proceedings or judgments against the counterparty, and the late filing of statutory accounts. Regular credit checks, *via* credit reference agencies, of counterparties are of course highly advisable. First-mover advantage, whether in the exercise of contractual rights or other remedies, may often minimise, or extinguish, the insolvency risk. If Angove had exercised its right to direct payment from the UK retailers under the ADA before, or immediately after, the ADA's termination, the litigation could possibly have been avoided.

Check the existing contract

There may be provisions in the contractual documentation to provide that moneys are paid directly to a party down the contractual chain effectively cutting out the prospectively insolvent party. Conversely, there may be contractual provisions for a party to intervene and collect monies owed it directly from a party up the contractual chain (again cutting out the prospectively insolvent party from receiving the moneys at all). Without entering into the fierce controversy as to the true legal or equitable nature of sub-freight liens in maritime charterparties, the right of intervention of a shipowner to collect freight directly from a sub-charterer might be considered an example of such a right of intervention. In any event, in order to achieve effectiveness any such contractual remedies will likely have to be exercised promptly upon learning of the prospective insolvency of the counterparty.

Security/quasi-security

There is always the option of considering taking security or quasi-security to secure the repayment of sums paid to a prospectively insolvent counterparty. Security taken from a counterparty shortly before its insolvency will, however, almost certainly come under the scrutiny of the insolvent counterparty's liquidator/administrator under the claw back/set aside provisions of the Insolvency Act 1986 to the extent English law applies.

Use of insolvency set-off where it is available

Insolvency set-off provides that mutual debts are automatically set-off against each other on the commencement of liquidation or administration so that only the balance due to the solvent party is provable in the insolvency. Upon the discovery of an impending insolvency of a counterparty, the solvent counterparty should consider whether he can give or take assignments of debts from any associated or group company so as to reduce the risk of exposure on the insolvency of the counterparty. So take, as an example, an instance where A and B are associated parties and C is a prospective insolvent party who has contractual dealings with both A and B. If A is owed £100 by C; and B owes C £100, then on C going into liquidation:

- B would have to pay C's liquidator £100; and
- A would have to prove in C's liquidation (possibly for a few, if any, pennies in the pound).

If, however, *before* C going into liquidation, A assigned the £100 debt to B, then B could set-off the credit against its own £100 debt to C thus extinguishing in effect its debt. Meanwhile, A would not be left as an unsecured creditor in C's liquidation.

However, in order to take advantage of insolvency set-off, any assignment must generally occur *before* the insolvency.[1] In the circumstances, it is even more important that vigilance is maintained for any early warning signs of a prospective counterparty insolvency.

CONCLUSION

Angove has increased the risk of parties making payments to counterparties that may be on the cusp of insolvency. Prudent commercial parties would be well advised to review and revise (as necessary):

- their contractual documentation; and
- their current strategy in mitigating such risks.

1 The position may be different where there is a cross-border insolvency element. If the prospectively insolvent counterparty enters into insolvency outside of Great Britain and subsequently has its insolvency recognised in Great Britain under the Cross-Border Insolvency Regulations 2006, it is an open point whether for the purposes of insolvency set-off, the relevant date is: (i) the date of the foreign insolvency; or (ii) the date of recognition in Great Britain of the foreign insolvency: *Larsen v Navios* [2012] Bus LR 1124 at 1130F.

Further Reading:

- A case of wine leaves insolvent agent with a hangover: irrevocable authority and remedial constructive trusts (2017) 1 CRI 6.
- Middleman down: the consequences of an agent's insolvency (2016) 9 JIBFL 552.