

## GUIDE

# What is a Validation Order?

If your company has received a winding up petition and its bank account has been frozen as a result, our team of experts can assist. A Validation Order can unfreeze the company's bank account allowing you to continue trading and significantly reduce the risk of personal liability as a result of trading the business whilst subject to a winding up petition.

Essentially, a Validation Order is a court order which authorises a company to continue trading notwithstanding being subject to a creditor's winding up petition. A Validation Order is usually required to unfreeze a company's bank account and effectively authorises (i.e. 'validates') payments and other dispositions that the company is required to make as part of its business operations.

The payments can include:

- payments out of the company's business bank account in the usual course of its business such as payments to key suppliers, HMRC, trade creditors, rent and utilities and employees
- disposing of tangible and intangible assets owned by the company (for example, shares and other property assets)
- any other payments or dispositions that the company is required to make in the ordinary course of its business.

It is very important to appreciate that the court will only grant a Validation Order if it is satisfied that doing so will not prejudice or make worse the interest of the company's unsecured creditors as a whole. For example, a Validation Order application for a specific transaction that would have the effect of reducing the company's assets available to creditors in a proposed insolvency process is unlikely to be permitted by the court.

### Why do I need a Validation Order?

Section 127(1) of the Insolvency Act 1986 (IA 1986) provides:

*"In a winding up by the court, any disposition of the company's property, and any transfer of shares, or alteration in the status of the company's members, made after the commencement of the winding up is, unless the court otherwise orders, void."*

In this context, the commencement of the winding up is the date when the winding up petition is presented to the court and before any winding up order is made. Therefore, after a winding up petition has been presented against a company, any transactions made by the company are potentially **void**.

This means that if the company continues trading and/or disposes of any of its assets whilst subject to a winding up petition, any subsequently appointed liquidator (i.e. the Official Receiver or a licensed Insolvency Practitioner) can seek to reverse the transaction(s) for the benefit of creditors.

The reasons for the rules on void dispositions are to:

- preserve the assets of the company for the benefit of its creditors in a compulsory liquidation process
- protect against the risk of one unsecured creditor being paid before another, protecting the pari passu principle of asset distribution in a compulsory liquidation.

A Validation Order can also help reduce the risk of directors being held personally liable for the company's debts and being ordered to contribute to the company's assets in a prospective liquidation.



### How can I obtain a Validation Order?

In order to obtain a Validation Order from the court, the company will need to:

- file an Application Notice with the court stating that a Validation Order is sought under Section 127(1) of the Insolvency Act 1986
- include a detailed witness statement setting out the reasons why a Validation Order is required
- include a draft order detailing the company's bank account(s) which is/are required to be unfrozen and/or details of the specific transaction or disposition the company is seeking to validate.

The witness statement in support of the application for a Validation Order should normally be made by a director of the company (or someone authorised to act on the directors' behalf) who is involved in the company's business operations and affairs. If appropriate, supporting evidence in the form of a witness statement from the company's accountant should be produced.

The type of information and supporting evidence required will vary according to each company and the particular circumstances of each case, however, the following evidence should be included in the application.

### Evidence in support of a Validation Order

The Insolvency Practice Direction provides that the following information should be included as far as possible in an application for a Validation Order:

- when and to whom notice has been given
- the company's registered office
- the company's nominal and paid-up capital
- brief details of the circumstances leading to the presentation of the winding up petition
- how the company became aware of the presentation of the petition
- where the petition debt is admitted or disputed and, if the latter, brief details of the basis on which it is disputed
- full details of the company's financial position, including details of its assets (including details of any security and the amount(s) secured) and liabilities, which should be supported, as far as possible, by documentary evidence, eg the latest filed accounts, any draft audited accounts, management accounts or estimated statement of affairs
- a cash flow forecast and profit and loss projection for the period for which the order is sought
- details of the dispositions or payments in respect of which the order is sought
- the reasons relied on in support of the need for such dispositions or payments to be made any other information relevant to the exercise of the court's discretion

- details of any consents obtained from the persons mentioned above (supported by documentary evidence where appropriate)
- details of any relevant bank account, including its number and the address and sort code of the bank at which such account is held and the amount of the credit or debit balance on such account at the time of making the application
- where an application is made urgently to enable payments to be made which are essential to continued trading (e.g. wages) and it is not possible to assemble all the evidence listed above, the Court may consider granting limited relief for a short period, but there should be sufficient evidence to satisfy the Court that the interests of creditors are unlikely to be prejudiced by the grant of limited relief.

Where the Validation Order application involves a disposition of property, the Court will need details of the property (including its title number if the property is land) and to be satisfied that any proposed disposal will be at a proper value. Accordingly, an independent valuation should be obtained and exhibited to the evidence.

The Court will need to be satisfied by credible evidence either that the company is solvent and able to pay its debts as they fall due or that a particular transaction or series of transactions in respect of which the order is sought will be beneficial to or will not prejudice the interests of all the unsecured creditors as a class.

A draft of the Validation Order sought should be attached to the application.

Similar considerations to those set out above are likely to apply to applications seeking ratification of a transaction or payment after the making of a winding up order.

### Who do I need to serve with the Validation Order application?

A Validation Order application should be served on the following persons:

- the petitioning creditor
- any person entitled to receive a copy of the winding up petition
- any creditor who has given notice to the petitioner of their intention appear on the hearing of the petition
- any creditor who has been substituted as the petitioner.

It is important to ensure that the Validation Order Application has been properly served as failure to do so could lead to the application being adjourned or dismissed.

It should be served as soon as reasonably practicable after it is filed and, in any event, no later than 14 days before the hearing date.



### What court do you apply to for a Validation Order?

When applying for a Validation Order, the application should be made to the same court that is dealing with the winding up petition. For example, a County Court or the High Court.

If the application is made in the High Court, it will normally be heard by a specialist Insolvency and Companies Court Judge.

### When should a Validation Order application be made?

The application for a Validation Order is normally made after the company has been served with a winding up petition, however, it can be made before a winding up petition has been issued.

Where the Validation Order application is made before the disposition of assets has occurred, the court will grant an *antecedent* Validation Order only if it is satisfied that one of the following apply:

- the company is solvent and able to pay its debts as they fall due
- the transaction or transactions to be validated will be beneficial to, or will not prejudice, the interests of all the unsecured creditors as a class.

If the company continues to trade or otherwise disposes of assets without first obtaining a Validation Order it may be possible to obtain a retrospective Validation Order authorising the transaction(s) or disposition(s) at issue.

On an application for a retrospective Validation Order, the court will try to balance the interests of the recipient of the property or transaction at issue with the interests of the company's creditors. However, it is not possible to guarantee that a retrospective Validation Order will be made and the court will need to find special circumstances that justify the overriding of the principle of *pari passu* payment of unsecured creditors.

### When will the Validation Order application be heard?

If the Validation Order application is presented to the High Court, it will normally be heard in the interim applications list in the Business and Property Courts, which takes place on Thursdays, Fridays and every second Monday.

Urgent applications for a Validation Order typically require a Certificate of Urgency certifying that the matter is urgent and cannot await a hearing before the judge in its due turn and specifying the reasons why. This can include the need to pay staff wages, the petition debt and/or other key suppliers and creditors of the company.

### When will the court grant a Validation Order?

Validation Order applications are at the discretion of the court.

As a general rule however, a Validation Order will only be granted if the court is satisfied that doing so is likely to improve the position of the company's creditors – particularly its unsecured creditors.

Where a Validation Order is sought to validate the sale of a specific asset, for example, the court will need to be satisfied that the proposed sale will be a proper value. The asset should therefore be sufficiently identifiable and an independent valuation provided in support of the application.

### What might happen if I do not obtain a Validation Order?

If your company is subject to a winding up petition and you dispose of any company assets without obtaining a Validation Order and the company is ultimately wound up, the directors could be found personally liable for the company's debts. In these circumstances, a liquidator could decide to issue proceedings against the directors for causing the company to trade or enter into void transactions where the court could order the directors to contribute to the company's assets by way of compensation.

Often when a company disputes the winding up petition, it will want to continue trading between the date of presentation of the petition and the hearing. Therefore, once directors become aware that a petition has been presented, it is important to obtain a Validation Order in respect of all transactions and dispositions that are required to be made by the company.

### Costs of a Validation Order application

The costs of a Validation order application are awarded at the court's discretion. Where the Validation Order application is unopposed by the petitioning creditor and a Validation Order is granted, the court could order that the costs of the application be "In the petition". This means that if the winding up petition is dismissed, the petitioner could be ordered to pay the costs of the application for a Validation Order.

Alternatively, if the petition debt is not disputed and the company requires a Validation Order to pay the petition debt, the court may grant a Validation Order on a no order as to costs basis.

Edwin Coe has many years of experience in assisting businesses obtaining Validation Orders and unfreezing bank accounts allowing businesses to continue trading, despite being subject to winding up petitions. If your company has been served with a winding up petition and you need to continue trading in the meantime, please call our experts. →



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