

# Award in company law fundamentals

Lecture Title: The *Price Club* judgement

Lecturer: Dr Malcolm Falzon

Date: 6 December 2022



Diploma in Law (Malta)



CAMILLERI PREZIOSI

ADVOCATES

# Fraudulent Trading – Article 315

- *“If in the course of the winding up of a company, whether by the court or voluntarily, it appears that any business of the company has been carried on **with intent to defraud** creditors of the company or creditors of any other person or for any fraudulent purpose, the court on the application of **the official receiver, or the liquidator or any creditor or contributory of the company**, may, if it thinks proper so to do, declare that **any persons** who were knowingly parties to the carrying on of the business in the manner aforesaid be personally responsible, **without any limitation of liability for all or any of the debts or other liabilities of the company as the court may direct.**”*



# Fraudulent Trading – Article 315

*“Where the business of a company is carried on with such intent or for such purposes as is mentioned in [sub-article (1)], every person who was knowingly a party in the carrying on of the business in the manner aforesaid, shall be guilty of an offence and liable on conviction to a fine (multa) of not more than two hundred and thirty-two thousand and nine hundred and thirty-seven euro and thirty-four cents (232,937.34) or imprisonment for a term not exceeding five years, or to both such fine and imprisonment.”*



# Main elements (fraudulent trading)

- ✓ In the course of the winding up of the company
- ✓ Business carried out with fraudulent intent
- ✓ Application of the liquidator/official receiver/creditor/contributory
- ✓ Declare those persons knowingly carrying on such business
- ✓ To be held personally and unlimitedly liable for all/any debts and liabilities of the company
- ✓ Multa up to €232,937.34 and, or up to 5 years imprisonment



# Wrongful Trading – Article 316

1) *“The provisions of this article shall apply where a company has been dissolved and is insolvent and it appears that a person who was a **director** of the company knew, or ought to have known prior to the dissolution of the company that there was **no reasonable prospect that the company would avoid being dissolved due to its insolvency.**”*

2) *“The court, on the application of the **liquidator** of a company to which this article applies, may declare the person who was a director referred to in subarticle (1) liable to make a payment towards the company’s assets as the court thinks fit.”*



# Wrongful Trading – Article 316

- 3) *“The court shall not grant an application under this article if it is satisfied that the person who was a director knew that there was no reasonable prospect that the company would avoid being dissolved due to its insolvency and **accordingly took every step he ought to have taken with a view to minimizing the potential loss to the company’s creditors.**”*
- 4) *“For the purposes of subarticles (2) and (3), the facts which a director of a company ought to know or ascertain, the conclusions which he ought to reach and the steps which he ought to take, are those which would be known or ascertained, or reached or taken, by a reasonable diligent person having both –*
- a) the knowledge, skill and experience that may reasonable be expected of a person carrying out the same functions as are carried out by or entrusted to that director in relation to the company; and*
  - a) the knowledge, skill and experience that the director has.*



# Main elements (wrongful trading)

- ✓ An insolvent dissolution
- ✓ Director knew or ought to have known
- ✓ No reasonable prospect that the company avoids insolvent dissolution
- ✓ Contribution towards the company's assets
- ✓ Brought by the liquidator
- ✓ Defence where despite there being knowledge of no reasonable prospect, such director took every step he ought to have taken with a view to minimizing the potential loss to the company's creditors



# FRAUDULENT TRADING VS. WRONGFUL TRADING

During winding up (any type)

Fraudulent intent

Any person involved

Personal & unlimited liability

Application by liquidator/official receiver/creditor/contributory

During insolvent dissolution

No need to prove fraud

Directors only

Contribution to assets

Application by liquidator



# *Silver-lining defence*

The English Courts have developed the so-called silver lining or sunshine defence, formulated in the landmark judgement of *White v. Osmond* ,

*In my judgment there is nothing wrong in the fact that directors incur credit at a time when, to their knowledge, the company is not able to meet all its liabilities as they fall due. What is manifestly wrong is if directors allow a company to incur credit at a time when the business is being carried on in such circumstances that it is clear that the company will never be able to satisfy its creditors. However, there is nothing to say that directors who genuinely believe that the clouds will roll away and the sunshine of prosperity will shine upon them again and disperse the fog of their depression are not entitled to incur credit to help them to get over the bad time*



# The Price Club Case

*Dr Andrew Borg Cardona noe vs Victor Zammit et [Court of Appeal] 14 May 2010.*



# Group structure

A company that operated a chain of supermarkets by the name of Price Club Operators Limited, was burdened with debts and loans sustained by other group companies, where the suppliers were put in a perilous situation due to the created state of affairs, which most of the time were found to be to the benefit of the directors' personal interests.

The structure of the group of companies was as follows:



# Key facts:

- The Price Club business (as it stood at the time) was acquired by Price Club group in 1998
- 3 supermarkets, increasing to 8 in a short period of time
- Ceased operating towards the end of 2001
- The operations of the Group were carried out as follows: PCH was a Holding Company having 100% interest in PCO and various property-owning companies (leased out to PCO as operator)
- The group was structured in a way that PCO would assume all the debts of the Group (this was not prima facie illegal since a corporate group may be formed in a way as to minimise liabilities). However, PCO was undercapitalised – it had huge debts, no realisable assets and no immovable property and very low capital. There was no company in the Group which assumed responsibility for PCO's debts (i.e. guarantees were not granted in favour of creditors).



# Key findings

- The structure was evidence of the directors' dishonest intent, from the outset, to avoid the company's assets being made available to creditors
- No realisable assets, huge debts and a low capital - thinly capitalised company
- Directors' report – true and fair view of the business? / true and correct picture of the financial position of the company?
- Just a short term cash flow problem?
- The Directors argued that there was never the intention to defraud creditors with the structure of a holding/operating companies, and that this structure is often used.



# Decision

- The Court concluded that fraudulent intent had been proven and found the directors liable for fraudulent trading.
- The Court of Appeal upheld the decision of the first court that there was an intent to defraud creditors - the company continued to operate with an operating deficit and without a strong capital base and the directors continued to trade in the knowledge that this was to the detriment of creditors.
- ***From the beginning, the directors sought to protect their own interests at the risk of the creditors.***
- The directors were found liable for fraudulent trading in solidum for all the debts of the company.



# Conclusions of the Judgement



Ultimately, the Court reached the conclusion that the directors had the intent to enrich themselves at the expense of the creditors at every stage of PCO's trading activity. The Price Club directors did not merely fail to show the required duties of care, skill and diligence expected of them, but they did this with the clear intention of causing undue prejudice to creditors.

The Court chose to conclude that the actions of the directors, which, although considered individually may not be prima facie evidence of fraudulent intent, when considered as a whole, constituted fraud and not merely negligence and mismanagement.

# Legislative update

On the 20<sup>th</sup> of September 2022, the **Commercial Code (Amendment) Act 2022 (“Bill 11”)**, the **Pre-Insolvency Act, 2022 (“Bill 12”)**, and the **Insolvency Practitioners Act, 2022 (“Bill 13”)**, were published.

Collectively, the bills are aimed at enhancing Malta’s bankruptcy and insolvency regimes, and partially transpose certain provisions of the EU’s Directive on preventive restructuring frameworks, on discharge of debt and disqualifications, and on measures to increase the efficiency of procedures concerning restructuring, insolvency and debt (Directive (EU) 2019/1023), with a view to strengthening the existing legal framework.



# Reform

- Pre-Restructuring Act
- Insolvency Practitioners Act
- Commercial Code (Amendment) Act
- Companies Act (Amendment) Act
- Secondary legislation intended to regulate certain technical aspects
- Guidelines for involved parties
- Public awareness campaign strategy
- Training campaign strategy
- Consolidation of insolvency laws into INSOLVENCY ACT



# Bill 11 - new concepts to look out for

- Bankruptcy trustee
- Inventory and debt register
- Bankruptcy estate
- Debt agreement vs bankruptcy order
- Income payment plan
- Fraudulent bankruptcy



# Bill 12 - new concepts to look out for

- Pre-Insolvency Act
- Pre-restructuring procedures
- Early warning tools (EWT)
- Preventive restructuring procedure (PRP)
  - Standard PRP
  - Pre-formulated PRP
  - Pre-approved PRP
- Best-interest-of-creditors test (BOIC)
- Essential executory contracts (EEC)
- Restructuring plan
- Cross-class cram-down
- Affected parties
- Stay (temporary) of individual enforcement actions
- Insolvency Practitioners Act
- Insolvency and receivership Service - amendment to the Malta Business Registry (Establishment as an Agency Order) (S.L.595.27)



# Bill 13 - new concepts to look out for

- Insolvency Practitioners Act
- Insolvency and receivership Service
- Insolvency practitioners
- Registered firms
- Breach of professional duty
- Appeals before the Administrative Review Tribunal





**Diploma in Law (Malta)**



CAMILLERI PREZIOSI

ADVOCATES