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Mamutse, BC (2018) Balancing unequal trading relationships: transaction avoidance precepts as a route to a new end? Journal of Business Law, 6. ISSN 0021-9460

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BALANCING UNEQUAL TRADING RELATIONSHIPS: TRANSACTION AVOIDANCE PRECEPTS AS A ROUTE TO A NEW END?

Blanca Mamutse

Abstract

In the field of insolvency law, the transaction avoidance regime protects creditors from improper actions of insolvent debtors. There is however increasing public awareness that the solvency of small business creditors may be stretched by actions of their larger debtors. This undermines governmental measures to support small businesses. It also has negative implications for the transaction avoidance regime, which has undergone expansion through the Small Business, Enterprise and Employment Act 2015 reforms. The value of these reforms is deflated where small businesses have entered administration/liquidation because their finances have been overborne by the trading practices of larger partners, **and** established insolvency law remedies for overturning transactions cannot be invoked to return any lost value to the estate. The absence of such remedies, together with the weakness of other mechanisms relied on for the protection of smaller businesses, lead this paper to propose that tenets of transaction avoidance law offer a route to discerning circumstances in which contractual arrangements with large counterparties should be unravelled in the interests of strengthening the protection of small businesses.

A. Introduction

United Kingdom news headlines between 2013-2016 carried several stories exposing pressurised relationships between large manufacturing/retail organisations and suppliers. These revelations coincided with legislative developments aimed at providing a boost for small businesses. These legislative developments, in turn, emerged contemporaneously with measures enhancing the insolvency law regime's capacity to challenge misconduct by directors and overturn improper transactions. The insolvency reforms do not form part of the agenda to support small businesses, but revelations regarding the tribulations experienced by small businesses in relation to larger trading partners strike a chord with the transaction avoidance regime's goal to promote commercial morality¹ by 'discouraging inappropriate behaviour'.² This convergence of developments also raises questions regarding whether commercial morality can be extended beyond the insolvency context into the full range of dealings by market actors, as a means of addressing the imbalance in relationships between small businesses and larger trading partners.

Key reasons for exploring this possibility are that controlling the behaviour of dominant market actors could prevent small business insolvencies: as discussed below, powerful trading partners can exert pressure on small business creditors in ways that trigger the latter's financial distress and reduce funds available for distribution to their own creditors in insolvency proceedings. Secondly, whereas transaction avoidance law corrects distortions brought about by colourable transactions entered into

¹ *Insolvency Law and Practice: Report of the Review Committee* Cmnd 8558 (1982) – paragraphs 235, 238.

² D. Milman, 'Transactional Avoidance: Disrupting Unsound Corporate Dealings' 2010 C.L.N. 1, 2.

by an insolvent company prior to its collapse,³ if widespread conduct that erodes the value of a company's estate cannot be challenged through existing transaction avoidance mechanisms in the event of the company's collapse, the role of the transaction avoidance regime is undermined. Consequently, reforms introduced by the Small Business, Enterprise and Employment Act 2015 ('SBEEA') to facilitate greater use of certain transaction avoidance remedies⁴ would have a limited impact in practice. Moreover, as seen below, traditional techniques including the regulation of late payments are incapable of providing a comprehensive solution to any self-serving practices,⁵ and thus do not constitute an effective alternative means of protection. In light of the increased attention drawn to the transaction avoidance regime by SBEEA reforms, this paper considers whether there is room for devising standards that are useful in determining the propriety of arrangements between small businesses and large counterparties, by analogy with concepts associated with this area of law. This would minimise insolvency risks connected with trading challenges of the nature considered below, and signal instances in which a powerful trading partner should curb its practices to avoid (i) threatening the survival of a smaller business and (ii) 'a lowering of business standards'⁶.

This paper therefore examines the context in which concern regarding difficulties experienced by smaller businesses has gained attention (Sections B, C, D), and the extent to which the transaction avoidance framework is capable of shielding small businesses from controversial practices (Section E). It highlights respects in which a set of standards that demarcates the boundaries of stronger parties' exercise of their commercial might, can be formulated with reference to considerations attached to current transaction avoidance remedies (Sections F, G). It draws conclusions regarding the benefits, of establishing a more cohesive relationship between protection of small businesses and the role of the transaction avoidance regime (Section H).

B. Background

In 2014, news articles revealed that a major food producer had requested 'investment payments' from suppliers in exchange for continued custom, failing which they would be 'nominated for de-list'.⁷ Payment amounts were as high as £70,000, with the company's receipts totalling low millions.⁸ The suppliers' reaction is captured in comments 'They know you can't afford solicitors to fight them', 'It's like a gun held to your head'.⁹

Such 'pay and stay' practices are not uncommon in manufacturing and retail,¹⁰ as illustrated by an investigation by the Groceries Code Adjudicator ('GCA'¹¹) into allegations of that one of the largest UK supermarket chains had requested lump sum payments from suppliers. The GCA found that only some of this organisation's demands stemmed from contractual agreements between itself and its

³ *Re Paramount Airways Ltd* [1993] Ch. 223, 230.

⁴ s.118 SBEEA (2462D Insolvency Act 1986).

⁵ C. Cowton and L. San-Jose, 'On the Ethics of Trade Credit: Understanding Good Payment Practice in the Supply Chain' (2016) J.B.E. 673, 675-676.

⁶ Cork Report (n.1), paragraph 238.

⁷ L. Kuenssberg, 'Premier Foods accused over "pay and stay" practice' BBC (05/12/14).

⁸ *Ibid.*

⁹ *Ibid.*

¹⁰ *Ibid.*

¹¹ <https://www.gov.uk/government/organisations/groceries-code-adjudicator>

suppliers, and many requests for payments ‘were made with an implication of detriment if any supplier declined to contribute’.¹² The GCA concluded that lump sum payments pertaining to future business between a supplier and a retailer, which had not been agreed to explicitly in the supply contracts, ‘were potentially an attempt by the retailer to vary the Supply Agreement’ without invoking any of its contractual rights to effectuate a unilateral variation of the terms of the agreement.¹³

A detailed example is provided by the GCA’s report of its investigation into practices by another key player in the grocery sector, launched following this operator’s announcement of an over-statement of profits in 2014.¹⁴ Material findings were that debts acknowledged by the operator as being due to suppliers could go unpaid for over 12-24 months, or until abandoned by suppliers;¹⁵ that the operator routinely deducted or delayed payments of funds due to suppliers for goods it had received, including instances where there was a dispute between the parties over financial claims by the suppliers that did not relate to the supply of goods to the operator.¹⁶ The operator did not take timely action to rectify data input errors; neglect which meant suppliers were overcharged or underpaid, and occasioned delays in payments to suppliers of 9 months to 2 years for amounts ranging from £200,000 to multiple millions.¹⁷ The operator issued duplicate invoices to suppliers and deducted both amounts from its own payments to them; errors which took up to 12 months to rectify.¹⁸ Conversely, if the operator identified underpayments by suppliers dating back a considerable period of time, it could demand settlement of its claim within a matter of weeks.¹⁹

The findings in these investigations are supported by results of a 2015 survey, that incorrect deductions from invoices, incorrect demands for payments or charges going back many years, and demands for lump sum payments ‘over and above those agreed’, featured most prominently among issues experienced by suppliers.²⁰ Suppliers were inevitably at a disadvantage in endeavouring to resolve such issues: incorrect deductions from invoices could be difficult to prove, and could involve a long wait for a refund.²¹ Retailers’ aggressive pursuit of payments going back a considerable period meant suppliers simply paid up or sought proof to the contrary among previous years’ records.²² Lump sum payments were often demanded to compensate for profit shortfalls, and in some instances retailers reduced product prices and looked to suppliers to make up the deficit.²³

¹² *Code clarification: requests for lump sum payments* (GCA, 2016) <https://www.gov.uk/government/case-studies/code-clarification-requests-for-lump-sum-payments>

¹³ <https://www.gov.uk/government/case-studies/code-clarification-requests-for-lump-sum-payments>

¹⁴ *GCA investigation into Tesco plc final report* (2016) – [3.1] and [4.1]-[4.6].

¹⁵ *Ibid*, [20.2].

¹⁶ *Ibid*.

¹⁷ *Ibid*, [22.1]-[22.6].

¹⁸ *Ibid*, [23.1]-[23.5].

¹⁹ *Ibid*, [26.1]-[26.2].

²⁰ YouGov, *GCA - Annual Survey Results 2015*

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/436481/2015_Conference_-_YouGov_slides.pdf;

YouGov, *Groceries Code Adjudicator – Follow-Up Survey* (2015), 4

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/401525/GCA_follow_up_survey.pdf

²¹ *Follow-Up Survey* *ibid*, 11.

²² *Ibid*, 12.

²³ *Ibid*, 4, 10, 11.

Nor are such challenges unique to the supermarket retail context: a global beer brewer ‘routinely’ paid suppliers’ invoices four months following fulfilment of its orders;²⁴ and a chain of health food shops requested a reduction from suppliers, together with a contribution to costs of security to prevent product theft.²⁵ A national department store group was said to have requested a reduction on suppliers’ invoices in exchange for making payment 30-60 days earlier than its standard payment terms,²⁶ following disclosure of previous requests for suppliers to extend the waiting period for payment of invoices from a 90-day window up to 120 days, against a 42-day industry average.²⁷ As trade credit is widely used by UK companies,²⁸ issues of this nature reverberate across sectors.

It is debatable whether these examples reflect the ‘rough and tumble’ of commerce: the GCA acknowledged the trading and financial difficulties experienced by one operator during the period under investigation, as a contributing factor to practices including the deliberate withholding of payments due to suppliers to enable the operator to present a stronger financial position at key reporting periods.²⁹ The food producer’s ‘investment payment’ requests arose during the year it commenced a profound restructuring exercise to reduce its debt and pension deficit.³⁰ The department store group requested extended suppliers’ payment terms was during a trading period marked with profit warnings.³¹ Evidently, major supermarket operators are also susceptible to onerous demands from their own muscular trading partners.³² Of the 20% of suppliers in the 2015 survey who affirmed that they would not complain or submit disputes to the GCA, only 28% saw such problems as ‘a normal part of doing business’.³³ For larger companies, these examples illustrate tensions that can arise between directors’ statutory duty to promote a company’s success, and the factors which they should consider in performing this duty, including ‘the need to foster the company’s business relationships with suppliers’.³⁴ ‘The practice of delaying payment accords with conventional commercial wisdom’ whereby trade debtors take as long as possible to pay, financial texts venturing to ‘suggest that purchasing companies should aim to stretch the credit period offered by suppliers’.³⁵ During recessionary periods when there is limited access to traditional sources of credit, debtors have stronger incentives to delay payments to creditors, converting trade credit into a cheap loan.³⁶ Moreover, ‘pressure on suppliers [increases] freedom of choice for consumers’,³⁷ another

²⁴ ‘AB InBev payment terms to small suppliers criticised’ BBC (18/01/15).

²⁵ E. Simpson, ‘Holland & Barrett accused of squeezing suppliers’ BBC (18/01/16).

²⁶ A. Armstrong, ‘Debenhams in new “Santa tax” row’ Telegraph (21/11/2015).

²⁷ Ibid.

²⁸ Cowton and San-Jose (n.5), 674; C. Howorth, ‘Small Firms’ Demand for Finance: a Research Note’ (2001) 19 I.S.B.J. 78, 82.

²⁹ GCA (n.14), [18.1]-[18.5], [25.2]-[25.4]; S. Butler, ‘Tesco delayed payments to suppliers to boost profits’ Guardian (26/01/16).

³⁰ S. Bowers and J. Kollwe, ‘Premier Foods launches £353m cash call’ Guardian (04/03/14).

³¹ Armstrong, (n.26).

³² ‘Tesco and Unilever end price war’ BBC (13/10/16).

³³ *Annual Survey Results*, (n.20) 14; S. Daneshku and K. Shubber, ‘Business groups hit out at late payment “scandal”’ Financial Times (19/01/15).

³⁴ Companies Act 2006 (‘CA 2006’), s.172(1)(c).

³⁵ Cowton and San-Jose (n.5), 675.

³⁶ Ibid; FSB, *Time to Act: The Economic Impact of Poor Payment Practice* (2016), 18; N. Cohen, ‘Suppliers lend £327bn to businesses in form of late payments’ Financial Times (01/06/14).

³⁷ C. Luetge, ‘Economics and Ethics: How to Combine Ethics and Self-Interest’, J.D. Rendtorff (ed), *Power and Principle in the Market Place* (Ashgate, 2010), 69.

constituency to be considered by directors promoting a company's success.³⁸ Nonetheless, risks arising from delayed payments, underpayments, withheld and improper payments may be acute for a financially distressed business. Insolvency practitioners have identified late payment as a 'primary or major factor' in business failures, wholesale and retail sectors being among the worst offenders.³⁹ Small businesses are susceptible to the demands of large clients who have power to stipulate their own payment terms.⁴⁰

The issues arising in this context may thus be viewed against the backdrop of ethics,⁴¹ the role of major companies as 'public actors' with power and influence that encompasses different spheres of modern life,⁴² and consistency with SBEEA reforms increasing the availability of financing options for smaller businesses – introduced in recognition of constraints affecting small businesses in establishing their creditworthiness to traditional lenders, challenger banks and alternative finance providers.⁴³ These reforms, and other measures enhancing the protection of smaller businesses, are considered below.

C. Developments in the agenda to promote small business interests

The trading challenges encountered by smaller businesses intensified the focus on late payments regulation. Following a governmental consultation on the duty to report payment practices and policies, the Secretary of State can now require certain companies to publish information about payment practices, policies and performance in business-to-business contracts involving the supply of goods, services or intangible assets.⁴⁴ This aims to help small businesses 'by making the payment practices of businesses more transparent, incentivising improvements in payment culture, and helping small businesses agree fair payment terms'.⁴⁵ The duty joins a long history of mechanisms whereby companies have publicised their payment practices, suppliers' rights to claim interest on overdue payments have been strengthened, and limits have been imposed on payment periods for commercial debt.⁴⁶ The Small Business Commissioner's office has furthermore been established as a source of advice and information, and to 'consider complaints from small businesses relating to payment matters in connection with the supply of goods and services to larger businesses'.⁴⁷

³⁸ CA 2006, s.172(1)(c).

³⁹ Association of Business Recovery Professionals, 'Late payment causes 20% of insolvencies, says R3' (11/04/14).

⁴⁰ Cowton and San-Jose (n.5), 675.

⁴¹ Ibid.

⁴² S. Wheeler, 'Contracts and Corporations', P. Cane and H. Kritzer (eds), *Oxford Handbook of Empirical Legal Research* (OUP, 2010), 130.

⁴³ SBEEA, Explanatory Notes paragraphs 8-18, s.5.

⁴⁴ SBEEA, s.3; *Duty to Report Payment Practices and Policies* (DBEIS, 2015), 3; Reporting on Payment Practices and Performance Regulations 2017; Limited Liability Partnerships (Reporting on Payment Practices and Performance) Regulations 2017.

⁴⁵ SBEEA, Explanatory Notes paragraph 91.

⁴⁶ E.g. Prompt Payers Code (CBI, 1991); Method for achieving good payment performance in commercial transactions BS 7890:1996 (BSI, 1996); Better Payment Practice Code (DTI, 1997); Prompt Payment Code (CICM, 2008); Companies Act 1985 (Directors' Report) (Statement of Payment Practices) Regulations 1997; Late Payment of Commercial Debts (Interest) Act 1998; Directive 2011/7/EU of the European Parliament and of the Council of 16 February 2011 on combating late payment in commercial transactions OJ L 48, 23.2.2011, p. 1–10; Late Payment of Commercial Debts Regulations 2013.

⁴⁷ Enterprise Act 2016, s.1.

Although concern to protect small businesses from disadvantageous payment practices is well-documented, Cowton and San-Jose have identified several flaws in these initiatives; namely that suppliers may be deterred from charging interest on overdue debts by the expense involved in pursuing claims against powerful customers, and the risk of damaging their commercial relationships.⁴⁸ Comparisons of the speed with which companies pay their debts are naturally relative, and do not provide an objective standard from which ideal payment patterns can be ascertained.⁴⁹ Prescribed payment periods also seem arbitrary since they constitute ‘economy-wide stipulations or recommendations of what a generally “fair” maximum payment period might look like’ (e.g. 60 days),⁵⁰ and do not allow for sector-specific circumstances in which large customers benefit from fast movement of stock and receive payment for the onward sale of goods shortly after their supplies have been delivered – e.g. in the food retail industry.⁵¹

It is also doubtful whether mechanisms focused on regulating payment practices offer an adequate means of protecting smaller businesses, for example if large organisations tend to agree specific terms at the outset of contractual relationships, and subsequently find ways of securing more favourable arrangements.⁵² Late payment rules are also manipulable if long credit periods are set, favouring debtor companies by enabling them to create an appearance of timely payment.⁵³ This diminishes the likelihood of the late payments framework comprehensively addressing the difficulties encountered by smaller businesses. As mentioned above, the new Small Business Commissioner aims to assist small businesses,⁵⁴ preventing a “winner takes all” approach to commercial dealings which is unfair to small businesses’.⁵⁵ The outcome of the GCA’s investigation into a leading grocery operator supports the argument for greater State involvement in developing commercial norms applicable to relationships between small and large businesses. Although the investigation was conducted before the GCA had any power to impose financial penalties for breaches of the Groceries Supply Code of Practice (‘GSCP’),⁵⁶ the operator responded by taking steps to improve compliance with the GSCP.⁵⁷ An ‘overwhelming majority’ of suppliers consequently indicated that relationships with the operator had become more positive and they could perceive a shift towards ‘a more open and collaborative approach’.⁵⁸ The release of the GCA’s report was therefore softened by news items confirming that action had since been taken to simplify the operator’s practices and improve relationships with suppliers.⁵⁹

⁴⁸ Cowton and San-Jose (n.5), 677; FSB (n.36), 3.

⁴⁹ Cowton and San-Jose, *ibid* 678.

⁵⁰ *Ibid*, 680.

⁵¹ *Ibid*.

⁵² A. Felsted, ‘Tesco puts a brave new face on old problems’ *Financial Times* (21/09/15).

⁵³ CBI, *Duty to Report on Payment Practices and Policies: CBI response to Government consultation on transparency in payment practices* (2015), [14]; L. Conway, ‘Late Payment of Commercial Debt’ (House of Commons Library Research Paper 97/25, 1997), 3.

⁵⁴ Enterprise Act 2016, Part 1.

⁵⁵ *Government Response: Small Business Commissioner*, (DBIS, 2015) 2.

⁵⁶ Groceries Code Adjudicator (Permitted Maximum Financial Penalty) Order 2015 applies to breaches which occurred on/after 06/04/15; GCA (n.14), 7, [2.2], [60.1]; S. Butler, ‘Tesco must pay £1m costs for watchdog investigation’ *Guardian* (03/02/16).

⁵⁷ (n.14), [55.1]-[55.9].

⁵⁸ *Ibid*, 6, [56.1]

⁵⁹ S. Neville, ‘Tesco torn apart as watchdog finds supermarket repeatedly withheld payments from suppliers’ *Independent* (27/01/16).

However, the implementation of the measures sketched under this heading, which can be traced back to the 1990s,⁶⁰ raises doubts whether respect for small business interests is adequately embedded in the commercial culture. Suppliers are not inevitably weaker parties: the collapse of a large UK mobile phone retailer demonstrates the dependence of some high-profile businesses on their powerful suppliers.⁶¹ A Federation of Small Businesses' ('FSB') survey found that 52% of members had been adversely affected by supplier contract terms.⁶² 40% of respondents 'felt powerless to do anything ... because the supplier was too important or powerful to challenge'.⁶³ It has also been argued that deeper investigation into the practices highlighted by the GCA report could reveal complicity on the part of larger suppliers in manipulating financial accounts and presenting their own inaccurate reports.⁶⁴ Added to this, complex questions arise in contract law regarding the extent to which the law can intervene to set aside contracts on the basis that they are unfair, unconscionable, or have been brought about by an inequality of bargaining power.⁶⁵ It is accordingly the adequacy of the legal framework for supporting smaller businesses that deserves attention, rather than support for suppliers *per se*. This scrutiny is in the wider interest, as small businesses constitute 99.3% of all UK businesses, accounting for 47% of private sector turnover and employment of 60% of the private sector workforce.⁶⁶ Consequently, pervasive trading challenges may have ripple effects of an economic and social nature, including influencing small businesses' decisions to delay hiring new staff, paying tax obligations, making new investments or paying their own suppliers.⁶⁷

Two recent legislative interventions will strengthen the financial position of small and medium sized businesses. One is a duty for banks to provide information regarding small and medium sized business customers whose applications for loans or credit facilities have been rejected, to finance platforms that facilitate access to alternative sources of finance.⁶⁸ As the alternative lending market becomes a prominent source of finance for smaller businesses,⁶⁹ the businesses will benefit from increased availability of financing options as well as also a difference in approach to the lender/debtor relationship as non-traditional lenders are more supportive of financially distressed customers.⁷⁰ The negative effects of companies' financial difficulties have also been eased by amendments to the Insolvency Act 1986 ('IA 1986'). These reforms have extended the statutory requirements for essential utility supplies to be maintained for companies in insolvency proceedings,⁷¹ to cover point-of-sale terminals, computer hardware/software, data storage/processing, website hosting, and information technology-related services.⁷² Continuation of business during insolvency is accordingly encouraged by preventing 'suppliers of essential goods or services from relying on their insolvency-related

⁶⁰ (n.46) instruments; Conway, (n.53); Cowton and San-Jose (n.5), 675-676.

⁶¹ S. Read and A. Lawson, 'Phones 4U goes into administration: Why its suppliers hung up on mobile phone retailer' *Independent* (16/09/14).

⁶² *Treating Smaller Businesses Like Consumers: Unfair Contract Terms* (FSB, 2016), 2.

⁶³ FSB, 'Unfair contract terms costing small firms billions' (22/08/16).

⁶⁴ A. Hilton, 'Suppliers must come clean in Tesco scandal, too' *Evening Standard* (03/02/16).

⁶⁵ S. Smith, *Atiyah's Introduction to the Law of Contract* (6th edn OUP, 2009), Chapters 11, 12.

⁶⁶ *Business Population Estimates for the UK and Regions 2016* (DBEIS), 1.

⁶⁷ FSB (n.36), 23-24.

⁶⁸ SBEEA, s.5, Explanatory Notes paragraph 91.

⁶⁹ A. Jackson, 'Marketplace lending: a new strategy for dealing with distressed businesses' (2016) 3 C.R.& I. 125.

⁷⁰ *Ibid.*

⁷¹ IA 1986, s.233.

⁷² IA 1986, s.233A.

contractual terms to charge higher prices or terminate the contract'.⁷³ The Government's evaluation of the benefits of imposing these controls recognized that a substantial number of such service suppliers are small and medium businesses, whose ability to withdraw services or extract 'ransom' payments from customers, has been modified by the introduction of this legislation.⁷⁴ Formal intervention of this type was justified since the 'market power' of essential service suppliers to hold businesses to ransom undermines prospects of a successful business rescue and recovery of amounts owed to creditors.⁷⁵ This necessity for addressing imbalances in contractual relationships, to ensure the survival of businesses and increased returns to creditors, corresponds with the argument in this paper that the insolvency framework can play a part in regulating the practices of powerful commercial actors. Notably, given the historical role of soft law in regulating late payments,⁷⁶ the Government considered that a code of conduct would be ineffective, taking account of the 'contractual nature' of the relationships involved and the need to provide 'the required degree of certainty surrounding continuity of supply'.⁷⁷ The success/failure of any attempt to redress imbalances will thus be strongly affected by the type of response that is engaged.

The SBEEA insolvency-related reforms, discussed below, were not premised on the objective of boosting small business interests.⁷⁸ They are however relevant to smaller businesses on the basis that increased scope for pursuing transaction avoidance actions will have limited impact where it arises with respect to companies whose insolvency has resulted from the practices of larger trading partners, and/or the finances or assets of such companies have been eroded by such practices. As seen above, not all these forms of conduct can be redressed under measures of the type highlighted in the first 3 paragraphs of this Section; and even where they are, smaller businesses may be reluctant to jeopardise significant trading relationships by invoking such remedies. The question therefore remains: how may large-debtor/small-creditor relationships be superintended to protect small business creditors from practices that hamper their solvency, reduce the amount available to pay their creditors in the event of formal proceedings; and run counter to conceptions of good business conduct, and deliberate efforts to improve the position of small businesses? The conjunction between the current reinforcement of small business interests, and the raised profile of the transaction avoidance regime, affords an opportunity to consider whether the demands of commercial morality should regulate the totality of trading arrangements, rather than remain confined to the remedies that are only potentially invocable in the event of the failure of a small business creditor.

D. Significance of the SBEEA insolvency reforms

⁷³ *The Insolvency (Protection of Essential Supplies) Order 2015 Guidance for insolvency practitioners and suppliers* (Insolvency Service, 2015), 1.5.

⁷⁴ *Impact assessment: continuity of essential supplies to insolvent businesses* (Insolvency Service, 2014), [49]-[70].

⁷⁵ *Ibid*, pp.1-2.

⁷⁶ Conway (n.53), 9-10; FSB, 'Small firms have little confidence in the Prompt Payment Code, says FSB' (19/03/15).

⁷⁷ *Impact assessment* (n.74), 1.

⁷⁸ *Transparency & Trust: Enhancing the Transparency of UK Company Ownership and Increasing Trust in UK Business: Government Response* (DBIS, 2014), [31], [262], [270].

The investigative processes within the insolvency regime promote justice and fairness by enabling improper transactions entered into by the insolvent company, or improper conduct on the part of its directors and/or third parties, to be redressed.⁷⁹ These functions have been enhanced by SBEEA changes affecting directors' liability and vulnerable transactions. The first reform is that the power to bring actions for fraudulent/wrongful trading, previously enjoyed only by liquidators,⁸⁰ has been extended to administrators.⁸¹ The second is that insolvency practitioners are now empowered to assign rights to pursue claims for fraudulent/wrongful trading, transactions at an undervalue, preferences and extortionate credit transactions.⁸² Hence, the fraudulent/wrongful trading remedies have been buttressed by their new application in the context of administration. They have furthermore been reinforced by the new ability of third party assignees to pursue fraudulent/wrongful trading claims, or the three voidable transaction remedies mentioned above, as a means of recovering funds or reversing transactions 'where the directors and others have acted in a way that has caused harm to creditors'.⁸³ These changes are harmonious, since claims concerning vulnerable transactions and wrongful trading, have often arisen in the same case.⁸⁴ The potential impact of the changes is amplified by the principle that transaction at an undervalue, preference, and fraudulent trading remedies have extra-territorial effect.⁸⁵ A virtuous circle is also identifiable between the power to challenge vulnerable transactions and to pursue claims for directors' liability – the difficulty of establishing liability for wrongful trading can be a strong motivating factor for bringing a claim for a preference.⁸⁶

The IA 1986 provisions for overturning suspect transactions govern invalid dispositions (s.127), transactions at an undervalue (s.238), preferences (s.239), late floating charges (s.245), extortionate credit transactions (s.244) and transactions defrauding creditors (s.423). However, SBEEA reforms have only empowered administrators/liquidators to assign *three* causes of action: transactions at an undervalue, preferences and extortionate credit transactions. These three remedies are actions that can only be brought by an office-holder. The prominence accorded to transactions at an undervalue and preferences is especially apt in light of an empirical study investigating 'how transaction avoidance provisions actually operate in practice', published in 1998. The study found that preferences were the most common type of transaction encountered by insolvency practitioners,⁸⁷ compared with transactions at an undervalue, invalid floating charges and transactions defrauding creditors.⁸⁸ Funding constraints meant that proceedings were rarely instituted, and the majority of cases concerning preferences were abandoned without settlement or settled before trial.⁸⁹ The SBEEA reforms aimed at ensuring that 'the causes of action which currently exist to protect creditors and

⁷⁹ Cork Report (n.1) paragraphs 193-194, 198(h), 235(b)-239.

⁸⁰ Ss.213-214 IA 1986.

⁸¹ Ss.246ZA-246ZB IA 1986 (s.117 SBEEA 2015).

⁸² s.246ZD IA 1986 (s.118 SBEEA 2015).

⁸³ SBEEA, Explanatory Notes paragraph 713.

⁸⁴ *Re Brian D. Pierson (Contractors) Limited* [2001] 1 BCLC 275; *Re Bangla Television Ltd* [2006] EWHC 2292; *Singla v Hedman* [2010] EWHC 902.

⁸⁵ *Bilta (UK) Ltd v Nazir* [2015] UKSC 23, [110], [214]; *Re Paramount Airways* (n.3).

⁸⁶ A. Keay, 'Wrongful trading: problems and proposals' (2014) 65 N.I.L.Q. 63, 79.

⁸⁷ R. Parry and D. Milman, 'Transaction avoidance provisions in corporate insolvency: an empirical study' (1998) 14 IL&P 280.

⁸⁸ *Ibid.*

⁸⁹ *Ibid.*

secure financial redress' are 'more likely to be pursued' if they are assigned to a third party⁹⁰ have increased the scope for pursuit of such actions.

The convergence between the SBEEA insolvency reforms and the drive to boost small business presents an opportune moment to assess whether the transaction avoidance regime can influence the development of standards that are beneficial for protecting smaller businesses. Conceivably, the pressure exerted by a larger trading partner can be one of the factors forming the background to a small business debtor's financial distress, e.g. if its status as the largest customer⁹¹ causes delays in receiving payments to weaken the small business's financial position.⁹² The integrity of insolvency law is affected insofar as the weakened financial position of smaller businesses as a result of such practices contributes to their financial distress, and (in the event of administration/liquidation) reduces the amount available to pay creditors. Two dimensions of the transaction avoidance regime resonate with difficulties of this nature. The first is that the investigation that is performed into the validity of transactions entered by the debtor is vital to upholding business standards and confidence in insolvency laws.⁹³ The transaction avoidance regime thus forms part of the legal framework that exists for promoting high standards of business conduct. As seen in Section B, smaller businesses' concerns related to the extent to which they felt compelled to concede to disadvantageous terms, and the struggle of challenging practices whereby funds were extracted from them or monies due to them were retained by powerful counterparties. Secondly, the transaction avoidance regime enables 'certain transactions between a debtor and other parties to be set aside in appropriate circumstances'.⁹⁴ This raises the question whether undesirable arrangements between smaller and larger businesses may likewise be untangled. As demonstrated below, despite the congruence between this role of transaction avoidance law and the insolvency implications of challenges identified in Section B, it is unlikely that conventional avoidance mechanisms could reverse the types of arrangements that attracted negative publicity. The congruence does however invite reflection on the possibility of drawing on the jurisprudence surrounding the transaction avoidance regime in order to devise standards aimed at improving the protection of smaller businesses.

E. The limited capacity of transaction avoidance remedies to target sharp practices

The proposition of finding ways to contest transactions between small businesses and larger trading partners fits with the transaction avoidance regime's function to 'preserve the company's net asset value'.⁹⁵ Indeed, Anderson has observed that there is a preponderance of transaction avoidance cases involving small companies.⁹⁶ He has also noted that 'transaction avoidance law overlaps with insolvency law but can also go wider', and consequently is capable of intervening to control contractual conduct in circumstances where no insolvency proceedings are underway.⁹⁷ Just as

⁹⁰ *Transparency* (n.78), [270].

⁹¹ *GCA* (n.14), [37].

⁹² *Ibid*; *FSB* (n.36), 3.

⁹³ *Cork Report* (n.1), paragraph 238.

⁹⁴ *Ibid*, paragraph 1200.

⁹⁵ R. Goode, *Principles of Corporate Insolvency Law* (4th edn, Sweet and Maxwell), 13-03.

⁹⁶ H. Anderson, 'The Nature and Purpose of Transaction Avoidance in English Corporate Insolvency Law' (2014) 2 *NIBLeJ* 5, [32].

⁹⁷ *Ibid*, [2].

transaction avoidance mechanisms control contractual conduct by 'curb[ing] certain forms of debtor behaviour and ... [imposing] some limits on the extent to which individual creditors can secure advantages through their own diligence',⁹⁸ the sort of problems identified in Section B point towards a need to curb practices of powerful debtors with respect to weaker creditors, and determine the extent to which such debtors can retain any advantages secured through these practices.

The transaction avoidance provisions in the Insolvency Act 1986 cannot be employed as direct weapons in the armoury available for protecting smaller businesses from any sharp practices by their larger trading partners, if the smaller business were to enter administration/liquidation proceedings. The first main reason for this is that some remedies operate only with respect to transactions where the insolvent company is in the position of debtor and its counterparty is a creditor. They consequently cannot apply to situations where a financially distressed smaller business is *owed* money by a trading partner and hence has creditor status, as in some of the instances chronicled in Section B. The second reason is that, even in relation to transaction avoidance remedies that govern transactions between an insolvent company and non-creditor parties, the circumstances of the trading relationship between the financially distressed smaller business and its larger partner may fall short of the essential requirements for establishing a cause of action. Or at the very least, such circumstances may fit awkwardly within the 'mould' of that particular remedy, weakening the potential success of a claim by a liquidator/administrator/third party assignee. This point may be illustrated with reference to transactions at an undervalue.

A transaction at an undervalue involves a company making a gift to a person or entering into a transaction, on the terms that the company will not receive any consideration, or will receive consideration of a significantly lower value than the value of the consideration it has provided. The company must have entered into the transaction at 'a relevant time': within two years of the onset of insolvency,⁹⁹ when it was unable to pay its debts or became unable to pay its debts as a result of entering into the transaction.¹⁰⁰ S.238 IA 1986 'is concerned with the depletion of a company's assets by transactions at an undervalue',¹⁰¹ its obvious purpose being 'to restore to a company ... money or other assets which ought not to have left the company'.¹⁰² This view has also been expressed with respect to ss.588FB and 588FC of the Australian Corporations Act 2001, that their 'purpose or object ... is to prevent a depletion of the assets of a company which is being wound up by ... "transactions at an under-value" entered into within a specified limited time prior to the commencement of the winding up'.¹⁰³ Some practices highlighted in Section B, e.g. unpaid debts, unilateral deductions from amounts owed, data errors resulting in creditors being overcharged or underpaid, seemingly fit this description – especially where creditors eventually abandoned their claims for repayment or accepted lower amounts in settlement of their claims.¹⁰⁴ A brief comparison between the value obtained by the company for the transaction and the value of the consideration provided by the company suggests that these transactions were at an undervalue. As regards the resulting inability to pay debts, withholding of payments significantly affects the cash flow of small businesses – to the extent of

⁹⁸ Ibid, [28].

⁹⁹ IA 1986, s.240(1).

¹⁰⁰ IA 1986, s.240(2).

¹⁰¹ *Re MC Bacon Ltd* [1990] B.C.C. 78, 91.

¹⁰² *Re Taylor Sinclair (Capital) Ltd* [2002] 2 BCLC 176, [16].

¹⁰³ *Demondrille Nominees Pty Ltd v Shirlaw* [1997] 25 ACSR 535, 548.

¹⁰⁴ GCA (n.14), [39.1], [31.10].

forcing them to use overdraft facilities, fearing that they might breach covenants with their banks or finding themselves obliged to seek bridging loans or additional finance from their parent companies.¹⁰⁵ The consonance between these practices and the transaction at an undervalue remedy is reinforced by the decision, in an Australian case applying the s.588FB remedy, that the forgiveness of a debt amounts to an ‘uncommercial transaction’.¹⁰⁶ The court had regard to the Explanatory Memorandum of the legislation introducing s.588FB,¹⁰⁷ which records that s.588FB ‘is specifically aimed at preventing companies disposing of assets or other resources through transactions which resulted in the recipient receiving a gift or obtaining a bargain of such magnitude that it could not be explained by normal commercial practice’.¹⁰⁸

Prima facie, it is therefore possible for the waiver of a debt owed to an insolvent small business to be regarded as a transaction at an undervalue. Yet, it is disputable whether depletion of a small business’s assets resulting from non-payment or underpayments by larger debtors, or forced over-payments by the small business to such debtors, constitutes transactions that a small company has ‘entered into’ under s.238.¹⁰⁹ This is borne out by the recent case of *Re Ovenden Colbert Printers Ltd*,¹¹⁰ where it was held that the expression ‘entered into’ in s.238 ‘connotes the taking of some step or act of participation by the company’, for it to be a party to the transaction or involved in it.¹¹¹ This outcome weakens the ability of the transaction avoidance regime, at the core of which lies the principle of ‘commercial morality’,¹¹² to act as an instrument of deterring or policing the kinds of financial appropriation which small businesses may experience at the hands of large counterparties.

Although factors such as these put traditional transaction avoidance remedies out of reach, it would be unproductive to focus on applying existing remedies or developing new ones, since a problem highlighted with regards to late payments and unfair terms affecting smaller businesses is reluctance to invoke remedies against prominent counterparties.¹¹³ Secondly, an emphasis on protection *ex ante* insolvency would be more supportive of the needs of commercial morality and business rescue, and of the agenda to promote small business interests outlined in Section C, than *ex post* responses provided by transaction avoidance remedies. All the same, there is some resonance between the role of the transaction avoidance regime to prevent commercial immorality and the dissipation of assets,¹¹⁴ and the ways in which trading conduct which attracts unfavourable publicity and/or formal censure for large enterprises also strains the finances of small business counterparties. This lends weight to the idea that the jurisprudence surrounding the transaction avoidance regime can be cultivated for the purpose of safeguarding smaller businesses. This question is approached from two angles: in Section F, starting from the premise that transaction avoidance remedies are viewed through the prism of restraining the debtor’s actions with respect to its creditors, proposing that there is scope for

¹⁰⁵ *Ibid*, [39.1]; FSB (n.36), 3.

¹⁰⁶ *Lewis v Cook* [2000] NSWSC 191.

¹⁰⁷ *Ibid*, [45].

¹⁰⁸ Corporate Law Reform Bill 1992, Explanatory Memorandum paragraph 1044 (Parliament of the Commonwealth of Australia).

¹⁰⁹ J. Armour, ‘Transactions at an Undervalue’, J. Armour and H. Bennett (eds) *Vulnerable Transactions* (Hart, 2003) 2.60.

¹¹⁰ [2013] EWCA Civ 1408.

¹¹¹ *Ibid*, [32].

¹¹² Cork Report (n.1), paragraph 235(b).

¹¹³ FSB (n.36), 17.

¹¹⁴ Cork Report (n.1), paragraphs 235, 1200, 1209.

developing analogous principles to protect small business creditors by imposing duties on their powerful debtors – thereby reducing the small creditors’ risk of insolvency and encouraging the maintenance of high business standards. In Section G, noting that inasmuch as transaction avoidance law acknowledges the need to distinguish between ‘good’ and ‘bad’ transactions,¹¹⁵ any intervention aimed at reviewing/adjusting trading relationships between smaller and larger businesses should be tempered by an understanding of the circumstances in which seemingly disadvantageous arrangements may in fact be desirable from the weaker counterparty’s perspective.

F. Proposing a set of standards to control the conduct of a smaller business’s counterparty

As seen above, techniques that have emerged in response to late payments problems and risks surrounding continuity of essential supplies circumscribe the power that a stronger counterparty enjoys by virtue of the terms of a contract, the niche nature of its products/services,¹¹⁶ or its financial clout as a customer.¹¹⁷ Prevention of ‘abuse of a dominant position’ is familiar to the field of competition law, which places controls on conduct of undertakings that command substantial market power.¹¹⁸ It is arguably a suitable corollary of preventing dominant undertakings from engaging in illegitimate practices with respect to their competitors, that their excesses as debtor/customer counterparties should also be curbed. Parallels with the circumstances described in Section B include the notion that an undertaking may be accountable for abusing its dominance in the capacity of a purchaser of goods/services.¹¹⁹ This is also a context in which it is vital to distinguish between legitimate (non-abusive) conduct and illegitimate conduct.¹²⁰ In *FENIN v Commission*, the contention that ‘systematic delays in payment’ constitute an abuse of a dominant position, failed on the ground that the purchasing entities did not constitute ‘undertakings’ within the scope of the prohibition in European Union law.¹²¹ In *Land Rover Group Ltd v UPF (UK) Ltd*, an application for an injunction securing the continued supply of goods, the court had difficulty applying the abuse of dominance prohibition to circumstances where there was no evident ‘market’ and the goal was to regulate the single commercial relationship of a particular seller and a particular buyer.¹²² It more willingly accepted that fiduciary duties could arise within a contractual setting, for parties to exercise contractual rights in good faith, and ‘not to exploit the dependency created by the relationship for either party’s own advantage’.¹²³ The outcomes of these cases underscore the value of having rules which are applicable in situations that fall short of the requirements of existing prohibitions.

Not only is the substance of such rules important, it is crucial to consider what form they should take. A contrast may be drawn between the reasoning behind recent legislative reforms regarding continuity of essential supplies (that a non-legislative code would not provide the required amount of

¹¹⁵ C. Tabb, ‘Panglossian Preference Paradigm?’ (1997) 5 Am.Bankr.Inst.L.Rev. 407, 409.

¹¹⁶ *Impact assessment* (n.74), [65].

¹¹⁷ see Reporting ... Regulations 2017 (n.43) – regulation 5.

¹¹⁸ Competition Act 1998, s.18; Treaty on the Functioning of the European Union, Article 102.

¹¹⁹ *British Airways v Commission* [2004] 4 C.M.L.R. 19, [101]

¹²⁰ *Hoffmann-La Roche v Commission* [1979] E.C.R. 461, [91]; *NV Nederlandsche Banden Industrie Michelin v Commission* [1983] E.C.R. 3461, [70].

¹²¹ [2006] 5 C.M.L.R. 7.

¹²² [2002] EWHC 303, [45]-[49].

¹²³ *Ibid*, [40].

certainty),¹²⁴ and the way in which the GCA's investigation report had the effect of improving a major supermarket operator's compliance with the Groceries Supply Code of Practice and relationships with suppliers.¹²⁵ This latter outcome suggests that standards with enforcement 'bite', which are not restricted to a single sector (given the breadth of the practices described in Section B) could improve the balance between the interests of smaller and larger businesses. A persuasive argument for greater State involvement in the development of commercial norms has previously been advanced in the transaction avoidance context.¹²⁶ State intervention is justifiable in situations where powerful commercial actors lack incentives to treat smaller counterparties fairly. The arguments below are therefore presented on the basis that for any obligations formulated below to have an impact, they require State backing in the form of transparent enforcement mechanisms.¹²⁷

*F.(i) **Standard 1:** A larger trading partner's behaviour should be constrained where the financial risk to the smaller business proportionately outweighs the payoff to the larger firm*

Within the transaction avoidance arena, provisions such as s.238 IA 1986 respond to 'perverse incentives experienced by debtors facing financial distress'.¹²⁸ However as seen in Section B, powerful *debtors* of a (potentially) financially distressed company have incentives to extract value from its estate through failure to pay debts, delays in payment, underpayments or erroneous payments – especially as a strategy to secure preferable trading terms. Loss of value to a financially distressed company's debtor counterparties is detrimental to the interests of its shareholders as well as its creditors (i.e. it does not benefit the former at the expense of the latter); compared with the settled view that transactions at an undervalue tend to benefit an insolvent company's shareholders, who may be inclined to 'bet the firm' on high risk projects.¹²⁹ The Cork Committee recognised suppliers of goods and services as involuntary creditors, bound by trade custom to extend credit facilities and 'sometimes unable to exercise credit control'.¹³⁰ Small business suppliers that lack diversity in product offerings and customer base, and find themselves buffeted by intense price competition,¹³¹ hold a weaker bargaining position with regards to larger counterparties. This is more pronounced where enterprises with a very large market share in certain sectors constitute 'unavoidable business partner[s]' in those markets.¹³²

It is therefore necessary to prevent the depletion of a small business's assets through transfers of wealth that occur as a result of the practices of its larger trading partners. A principle which seeks to control value-depleting actions by larger firms in their dealings with smaller businesses would be engaged where the financial risk to the smaller business proportionately outweighs the payoff gained by the larger firm's practices. This resembles the perverse incentive imputed to financially distressed

¹²⁴ *Impact assessment*, (n.74).

¹²⁵ A. Allen, 'How the GCA's Tesco investigation changed supplier relations' Supply Management (15 December 2015).

¹²⁶ Parry and Milman (n.87).

¹²⁷ e.g. FSB's recommendations for a penalties regime to accompany the Prompt Payment Code (n.36), 8.

¹²⁸ Armour, (n.109) 2.28.

¹²⁹ *Ibid*; T. Jackson, *The Logic and Limits of Bankruptcy Law* (Beard Books, 1986), 122.

¹³⁰ Cork Report (n.1), paragraph 1414.

¹³¹ D. Korobkin, 'Vulnerability, Survival, and the Problem of Small Business Bankruptcy' (1994) 23 Cap.U.L.Rev. 413, 426.

¹³² *British Airways v Commission* [2007] ECR I-2331, [75].

companies regarding transactions at an undervalue, that they may move the company's assets towards 'high-risk, high payoff activities'.¹³³ A standard that can be framed and measured in these financial terms is capable of providing an effective test compared to the variety of existing checks on the trading behaviour of larger businesses (such as the mandatory or voluntary disclosure of payment practices, prompt payment codes and the regulation of late payments¹³⁴).

F.(ii) Standard 2: A larger trading partner should be constrained from seeking/exploiting transfers or advantages that are given by the smaller business, at the expense of the latter's responsibilities to its creditors or other trading partners

S.239 IA 1986, governing preferences, targets transactions whereby a company 'does anything or suffers anything to be done which ... has the effect of putting [a creditor] into a position which, in the event of the company going into insolvent liquidation, will be better than the position he would have been in if that thing had not been done'.¹³⁵ Although the remedy clearly cannot be brought to bear on situations where the beneficiary of a transfer is a debtor rather than a creditor of the insolvent company, a trading partner that has retained monies belonging to a now-insolvent company is evidently in a better position than it would otherwise have enjoyed, in the event of the company's liquidation. A preference embraces 'a wide range of transactions or dealings',¹³⁶ including the insolvent company's release of its counterparty's obligations,¹³⁷ and a preference may arise where a company 'suffers anything to be done' that puts the creditor in a better position than they would otherwise have enjoyed. Thus there may be a thin dividing line in terms of facts triggering s.239, and those falling outside the scope of the provision due to the insolvent company occupying the position of creditor rather than debtor.

This reasoning, that it is improper for a debtor to honour a single creditor's claims when it is insolvent or about to become so,¹³⁸ could be extended to transactions between a small business and non-creditor counterparties. It would take the form of a principle rendering it objectionable to seek transfers which impede the small business's ability to fulfil commitments to other trading partners or fulfil its obligations to its creditors. Withholding of payments can severely affect small businesses' cash flow,¹³⁹ and in sectors where it is apparent that a large counterparty swiftly receives payments from its own customers, it cannot easily justify withholding funds due to the smaller business for an inordinately long time.¹⁴⁰ The large counterparty can consequently be deemed to be acting with awareness that it is squeezing the smaller business – especially if the large enterprise tends to engage in poor payment practices with smaller counterparties more consistently than it does with its own large trading partners.¹⁴¹ Hence the imposition of a standard on larger trading partners, preventing

¹³³ Armour (n.109), 2.28.

¹³⁴ E.g. (n.46) initiatives.

¹³⁵ IA 1986, ss.239(4), 240(1)-(2); A. Walters, 'Preferences', J. Armour and H. Bennett (eds) *Vulnerable Transactions* (Hart, 2003) 4.14-4.18.

¹³⁶ Walters, *ibid* 4.28.

¹³⁷ *Ibid*, 4.35.

¹³⁸ R. Clark, 'The Duties of the Corporate Debtor to Its Creditors' (1977) 90 Harv.L.Rev. 505, 511-512; *Freeman v Pope* (1869-70) L.R. 5 Ch. App. 538, 540.

¹³⁹ GCA (n.14) [39.1; FSB (n.36), 3.

¹⁴⁰ Cowton and San-Jose (n.5), 680-681; FSB, *ibid* 13.

¹⁴¹ Cowton and San-Jose, *ibid* 678; *FENIN* (n.121), [4].

them from seeking or benefiting from transfers/advantages provided by the smaller business, at the expense of the latter's responsibilities to its creditors or its other trading partners, is warranted. This standard has the advantage of being somewhat measurable, since it assesses the impact of transfers on the smaller business's capacity to satisfy contractual/financial commitments. The FSB has highlighted the potential for payments technology to play a more prominent role in addressing late payments problems, e.g. through generating 'nudge' reminders to debtors to settle outstanding accounts.¹⁴² This technology could also be adapted to alert large debtors of impending perils to a smaller business's finances, caused by their non-payment/underpayment, without obliging a small business to fully disclose its financial position. In long-term business relationships, these alerts would gradually increase the larger business's consciousness of these 'pinch points', and its ability to avoid exerting them on the small business.

G. Preventing a 'blunt-instrument approach' to applying new standards

As argued above, while substantive transaction avoidance mechanisms are not inherently suited to the task of challenging the types of contractual arrangements outlined in the introductory part of this paper, precepts associated with the remedies provide a source from which some expectations regarding the conduct of larger businesses (particularly as debtors) may be drawn.

At the same time, it is dangerous to assume that all contractual arrangements between smaller businesses and their larger trading partners, especially those which come about through the latter's exercise of significant financial/negotiating power, should attract the same level of scrutiny. Contracting parties may have an interest in seeing that the outcome of a rigorous (yet unequal) exchange is respected, in similar manner to the emphasis placed upon the concept of predictability within the transaction avoidance regime.¹⁴³ Governmental consultations on the regulating late payment practices have noted concern that measures to reduce late payment would impinge on freedom of contract.¹⁴⁴ Thus, standards aimed at controlling the trading behaviour of large commercial actors should not focus exclusively on constraints, but should also be capable of signalling the types of transactions that would elicit positive responses from smaller businesses' perspective. Hence – as considered under the following subheadings – the controlling effect of Standards 1 and 2 should be complemented by indicia of the factors that are useful in affirming the propriety of the dealings between a smaller business and its larger trading partners.

The importance of adopting a nuanced approach to questioning contractual arrangements is reinforced by an insight from the GCA's investigation report, that a large grocery retailer's staff often used prospective repayment of debts owed to a supplier 'as a bargaining tool to encourage suppliers to make proposals for the next trading year'.¹⁴⁵ Suppliers' responses ranged from believing 'that they achieved a good deal out of these negotiations',¹⁴⁶ to accepting the proposed terms under pressure 'in order to ensure they received something in return for money that they had feared that they would

¹⁴² FSB (n.36), 31-34.

¹⁴³ Anderson (n.96), [32].

¹⁴⁴ *Duty to report on payment practices and performance: government response* (DBEIS, 2016), 6.

¹⁴⁵ GCA (n.14), [31.8].

¹⁴⁶ *Ibid.*

not recover¹⁴⁷ (even waiving amounts they believed were owed to them, rather than continue difficult negotiations and risk damaging a long-term relationship).¹⁴⁸ The report cites the example of a supplier who agreed to invest more than half of a multi-million pound debt that it was owed into the next trading period, once this amount had been repaid.¹⁴⁹ Suppliers commonly offered to ‘fund future activities on condition that outstanding debts were repaid’.¹⁵⁰

This opens up the broader question of where a line can be drawn, in devising standards, between concessions that have been tendered by small businesses willingly as a result of negotiations, and concessions that represent an admission of defeat on the part of smaller businesses. It echoes the attention given in transaction avoidance law to whether ‘bargained for advantages ... are an acceptable means of [preserving] a creditor’s position’.¹⁵¹ The transaction avoidance regime, which involves a balancing act between striking down transactions and facilitating ‘economically desirable’ activity,¹⁵² recognises that not all *prima facie* suspect transactions should be overturned. For example, a disposition of a company’s property after the commencement of winding up proceedings, which would otherwise be void, may be validated in circumstances where the transaction ‘in the interests of the creditors as a whole’.¹⁵³ Similarly, a transaction at an undervalue will be upheld if the debtor entered into it in good faith for the purpose of carrying on its business, with reasonable grounds for believing it would benefit the company;¹⁵⁴ and a transaction conferring a preference will only be overturned if the debtor was influenced by a desire to improve the position of a particular creditor.¹⁵⁵ Late floating charges granted by a debtor will be upheld insofar as they have been exchanged for consideration in the form of money, goods, services, or reduction/discharge of debts owed by the company.¹⁵⁶ Walters notes that ‘wider issues of policy within commercial law and the credit economy’, ‘such as the need to promote finality of transactions or to encourage the provision of credit to struggling or potentially viable businesses’, detract from the collective scheme provided by insolvency law.¹⁵⁷ Likewise, it is appropriate, in formulating affirmative rather than restraining principles, to explore what imperatives can form the basis of a suitable differentiation between beneficial and disadvantageous arrangements/transactions.

G.(i) Standard 3: Arrangements that are free from counterparty threats/pressure may be condoned

¹⁴⁷ Ibid.

¹⁴⁸ Ibid, [31.10].

¹⁴⁹ Ibid.

¹⁵⁰ Ibid.

¹⁵¹ V. Leow, ‘Cutting the Gordian Knot of Intention in Unfair Preferences’ (2004) 16 SAclJ 236, [27].

¹⁵² G. van Dijck, ‘Comparing Empirical Results of Transaction Avoidance Rules Studies’ (2008) 17 I.I.R. 123, 141.

¹⁵³ IA 1986, s.127; *Express Electrical Distributors v Beavis Ltd* [2016] EWCA Civ 765, [20].

¹⁵⁴ IA 1986, s.238(5).

¹⁵⁵ IA 1986, s.239(5).

¹⁵⁶ IA 1986, s.245(2).

¹⁵⁷ Walters (n.135), 4.2.

As indicated in the previous paragraph, the question of the debtor company's good faith arises in relation to transactions at an undervalue and preferences. It is an element that is especially pertinent to small companies, where the controllers' state of mind is easier to ascertain.¹⁵⁸

With respect to transactions at an undervalue,¹⁵⁹ an insolvent company's good faith is attached to the question whether it acted with the purpose of carrying on the company's business.¹⁶⁰ In instances of the type sketched in Section B, the idea of having acted in good faith to ensure continuation of the company's business could be supported where small businesses are satisfied with gains from their negotiated exchange with a larger trading partner and regard any concessions they have made as worthwhile consideration for the preservation of a significant trading relationship and future benefits accruing from it. On the other hand, where a smaller business finds itself subject to implacable pressure to waive all or part of its trading partner's indebtedness, it is more difficult to ascribe a good faith belief to both parties that the contractual arrangements under scrutiny would ultimately be beneficial for the smaller business. This lack of good faith could, for example, be evinced by board level decisions by a (smaller) supplier company not to pursue debts owed by a (larger) retailer following indications by the retailer that the supplier's 'future business ... was at risk' if it continued to press for repayment.¹⁶¹

Queries regarding whether contractual arrangements have been entered into freely also arise in relation to preferences. An insolvent company's good faith is dependent on whether it 'was influenced ... by a desire' to confer a preference on a particular creditor,¹⁶² i.e. if it 'positively wished to improve the creditor's position in the event of its own insolvent liquidation'.¹⁶³ Two facets of this essential element of preferential transactions echo problems encountered in the context of relationships between small businesses and their large trading partners, with regards to distinguishing between transactions which should be revisited and those which should be respected. One is that an insolvent company would not be seen as having sought to improve a creditor's position if it conferred a preference to enable its struggling business to continue.¹⁶⁴ Another relevant facet is that the desire to improve a particular creditor's position is seen as lacking where the preference has come about as a result of the insolvent yielding to the creditor's demands/pressure.¹⁶⁵ This is described as a 'structural bias' of English preference law 'in favour of diligent creditors who actively press for recovery of their debts',¹⁶⁶ specifically 'large corporate or institutional creditors' who have greater bargaining power.¹⁶⁷ Against this backdrop, it may be asked whether corresponding principles can be developed to determine if advantages secured by a larger debtor from its smaller creditor may be seen as legitimate, e.g. if good faith may be inferred from the presence/absence of pressure in their contractual arrangements. This is especially important as a relationship with a large customer can provide the factual background behind a small business's conferment of a preference on a powerful creditor, as

¹⁵⁸ Ibid, 4.74.

¹⁵⁹ IA 1986, s.238(5).

¹⁶⁰ Parliamentary Debates, HC Deb 28 October 1985 vol 84 cc686-7.

¹⁶¹ GCA (n.14), [40.2].

¹⁶² IA 1986, s.239(5).

¹⁶³ *Re MC Bacon Ltd* [1990] B.C.C 78, 88.

¹⁶⁴ *Re Fairway Magazines Ltd* [1993] B.C.L.C. 643.

¹⁶⁵ *Re MC Bacon Ltd* (n.163).

¹⁶⁶ Walters (n.135), 4.20.

¹⁶⁷ Ibid, 4.79; A. Keay, 'In Pursuit of the Rationale Behind the Avoidance of Pre-Liquidation Transactions' (1996) 18 Syd.L.Rev. 55, 79.

seen in 'the seminal case on preferences' under IA 1986,¹⁶⁸ *Re MC Bacon Ltd.*¹⁶⁹ This case illustrates the insolvency risks of a small business's efforts to gratify a significant trading partner, and supports the notion that good faith can be tested according to whether the small business succumbed to a stronger party's demands. A company in financial difficulties granted security to its bank to prevent the closure of its overdraft facility and continue trading. The bank was ultimately successful in defending its receipt of this preference, since the small business debtor had not been motivated by any desire to improve the bank's position in the event of insolvent liquidation. However, the bank was called upon to defend the transaction as a result of its small business debtor's own relationship with its major customer. The small business had scaled down its decade-old line of business in the production of traditional bacon and 'diversified into the supply of pre-packaged manufactured products' to fulfil the needs of this customer whose business represented almost 60% of its turnover.¹⁷⁰ When the customer abruptly withdrew its business, the small business failed to regain its former level of sales, and incurred substantial losses before entering liquidation less than one year later.¹⁷¹ The small business, which had not needed to provide any security for its overdraft when it was trading profitably in the past, became obliged to tender a debenture in exchange for the bank's continued support, following a sharp increase in its indebtedness within months of losing this main customer.¹⁷² Thus, the consequences of such small business failures may reach lenders who have to justify the steps taken to protect their position in s.239 proceedings. As the creditor's successful defence of its security in *Re MC Bacon* is perceived to have become a dissuasive factor in liquidators' decisions to pursue avoidance actions,¹⁷³ regulating small creditor/large debtor relationships could pre-empt instances of the financial extremity in which small businesses must yield to their large creditors' self-protection techniques.

Doubts have been expressed regarding the courts' inclination to uphold transactions where pressure has been brought to bear by the recipient of the preference.¹⁷⁴ By contrast, Standard 3 proposes that the presence of threats/pressure should provide a ground for revisiting transactions with a view to potential adjustment/renegotiation, rather than a defence. As a form of good-faith ground for scrutinizing contractual arrangements entered into between a small business and large counterparties where advantages conferred on the latter are a product of threats/pressure, it would be more protective of small business creditors facing financial ruin.

G.(ii) Standard 4: Transactions/arrangements entered into for the purpose of preventing closure of the business may be condoned

¹⁶⁸ A. Keay, 'Transactional Avoidance: Critical Aspects of English and Australian Law' (2000) 9 I.I.R. 5, 14.

¹⁶⁹ (n.163).

¹⁷⁰ *Ibid*, 79.

¹⁷¹ *Ibid*.

¹⁷² *Ibid*.

¹⁷³ Keay, (n.168) 33.

¹⁷⁴ Leow (n.151), [27]-[32]. R. Parry and D. Milman, 'Challenging Transactional Integrity on Insolvency: an Evaluation of the New Law' (1997) 48 N.I.L.Q. 24, 29.

As seen under the previous heading, the question of an insolvent company's good faith is closely linked to the aim of carrying on the company's business. Since the aim of continuing an insolvent company's business constitutes a key factor in decisions concerning the validation of vulnerable transactions, independently from the issue of good faith, it can provide a useful means of distinguishing between arrangements that have facilitated the continuation of the smaller company's business, and arrangements that endanger the survival of its business.

Small businesses that are limited in their choice of trading partners, may take the view that extending credit on disadvantageous terms outweighs the potential consequences of losing a major counterparty. This can arise where a trading partner is the largest customer for a significant proportion of suppliers, accounting for as much as one-quarter of their overall business,¹⁷⁵ or is an inescapable business partner within certain markets.¹⁷⁶ A similar perception of the value of continuing the company's business is identified with the remedy for transactions at an undervalue. Even where requirements for a s.238 claim have been met, the court will not exercise its discretion to grant a remedy if the insolvent company evidently would not have been better off if it had refrained from entering into the transaction. This recognises that a company on the verge of collapse,¹⁷⁷ which would have had to close down its business if it had not received the lower consideration which gave rise to the s.238 claim, would be in a worse financial condition if it had not entered into the transaction at an undervalue.¹⁷⁸

The ability to continue the company's business is a key factor in relation to other transaction avoidance mechanisms besides preferences and transactions at an undervalue. A principle governing the approval of dispositions of the company's property made after winding-up proceedings have commenced,¹⁷⁹ is that 'it may sometimes be beneficial to the company and its creditors that the company should be able to continue the business in its ordinary course' by disposing of some of its property.¹⁸⁰ Similarly, floating charges granted by a debtor company within a certain period preceding its insolvency are only valid insofar as they secure money, goods, or services, or any reduction/discharge of the company's debts supplied or effected by the charge at the time of creation of the charge.¹⁸¹ Security which enables a company to continue its business is accordingly prized over security which secures past indebtedness of the insolvent company.¹⁸²

On this basis, burdensome arrangements between small business creditors and their larger debtors should be respected, if they provide a means of averting the collapse of the small business creditor, in the interests of all parties potentially affected by such failure. Ideally under Standard 4, it would be possible to establish that the arrangements at issue have been pivotal in promoting the survival of the small business creditor, e.g. by mitigating its reliance on overdraft or lending facilities or enabling the small business to avoid defaulting on payment to its own creditors. This reasoning, that arrangements entered into for the purpose of ensuring continuation of the company's business are treated as legitimate, emulates the outlook (in the transaction avoidance context) that creditors are willing to

¹⁷⁵ GCA (n.14), [37].

¹⁷⁶ *BA v Commission* (n.132).

¹⁷⁷ *Whalley v Doney* [2003] EWHC 2277, [122].

¹⁷⁸ *Ibid*, [123].

¹⁷⁹ IA 1986, s.127.

¹⁸⁰ *Denney v John Hudson & Co Ltd* [1992] BCLC 901, 904.

¹⁸¹ IA 1986, s.245(2).

¹⁸² *Re Matthew Ellis Ltd* [1933] Ch. 458, 473-474.

forego any entitlement to equal treatment, in the interests of their debtor carrying on business as usual.¹⁸³

G.(iii) Standard 5: Transactions/arrangements which are in line with enforceable public standards/codes may be condoned

The point has been expressed, concerning late payments issues, that responses should target the culture of poor practice.¹⁸⁴ In the realm of relationships between small businesses and large counterparties, the 'normalcy' of commercial practices works against small businesses insofar as payment terms 'are typically imposed upon [them] rather than negotiated'.¹⁸⁵ Furthermore, various practices distort ideas of what constitutes conduct in the ordinary course of business. These include the prevalence of payments outside agreed contract terms (for which responsibility is chiefly attributed to large private businesses),¹⁸⁶ and 'bullying' trends within supply chains through practices such as demands for supplier investment payments and withholding funds owed to suppliers by unilaterally deducting discounts.¹⁸⁷ The setting of fixed payment periods by small business creditors does not preclude their large debtors from demanding lengthy payment terms.¹⁸⁸

On the other hand, an element in the development of transaction avoidance law has been to gauge the legitimacy of transactions depending on whether they occurred 'in a course of dealing and trade'.¹⁸⁹ This concept has played a role in discerning what constitutes acceptable commercial conduct. For example, in distinguishing between situations where a payment has been made or an act has been performed 'in pursuance of a prior agreement',¹⁹⁰ and those where the object of the insolvent's payment or action is to improve the position of a creditor.¹⁹¹

The problems thrown up by using the 'ordinary course of business' to test the legitimacy of transactions between commercial actors may be seen from its implementation in modern common law jurisdictions such as the United States. This defence for transactions conferring a preference, that the transaction occurred in the ordinary course of the particular relationship between the debtor and the creditor, or that it falls within the range of terms applicable to a given industry,¹⁹² is described as the most litigated preference defence.¹⁹³ Ascertaining whether a payment has been made in the ordinary course of business involves a factual investigation,¹⁹⁴ and the flexibility with which this defence is applied appears from decisions holding that a transaction may be treated as being in the ordinary course of a particular debtor/creditor business relationship even if it was a one-time

¹⁸³ Tabb (n.115), 418.

¹⁸⁴ Conway, (n.53) 32-33; CBI, *Response* (n.53) [2]; FSB, (n.36) 35-36; CIMA, 'It's Time to Change the Payment Culture' (1998) 76 *Management Accounting* 28.

¹⁸⁵ FSB, *ibid* 34.

¹⁸⁶ *Ibid* 6.

¹⁸⁷ *Ibid*, 16-18.

¹⁸⁸ *Ibid*, 18; Conway, (n.53) 30, 32; CBI, *Response* (n.53) [13]-[14].

¹⁸⁹ *Harman v Fishar* (1774) 1 Cowper 117, 123.

¹⁹⁰ *Ibid*, 125.

¹⁹¹ *Rust v Cooper* (1777) 2 Cowper 629, 634.

¹⁹² US Bankruptcy Code, Title 11 Chapter 5 U.S.C. §547(c)(2); *Re Tolona Pizza Products* (1993) 3 F.3d 1029.

¹⁹³ B. Kotliar, 'A New Reading of the Ordinary Course of Business Exception in Section 547(c)(2)' (2013) 21 *Am.Bankr.Inst.L.Rev.* 211.

¹⁹⁴ *Re Paradise Valley Holdings, Inc* (2006) 347 B.R. 304, 310.

transaction,¹⁹⁵ or events which occurred during the preference period had never previously occurred in the parties' shared history.¹⁹⁶ In considering whether a transaction is 'ordinary' in the sense that it complies with widespread industry standards,¹⁹⁷ courts have held that only transactions which are so unusual or uncommon as to constitute 'an aberration'¹⁹⁸ or 'a gross departure'¹⁹⁹ from prevailing industry practices will be regarded as preferential. Although effects-based preference remedies such as the U.S. model²⁰⁰ are regarded as providing more certainty through an objective approach,²⁰¹ there is difficulty in anticipating when a preference will be overturned.²⁰² Preferential transactions are furthermore susceptible to manipulation in that recipients of payments are encouraged to adopt mathematical methods of calculating and presenting their ordinary course of business defence, and thereby strengthen their position in litigation or negotiations with a bankruptcy trustee.²⁰³ Larger creditors who are well-resourced to conduct such strategic analyses, will be better placed to retain the benefits of preferential transactions. Thus, conceptions of 'normal' or 'ordinary' conduct can be somewhat malleable in the transaction avoidance context itself.

As seen from Section B, some commonplace commercial practices are underlain by an imbalance of negotiating power that small businesses would be unlikely to accept as normal. Industry norms play a limited role in this type of setting if, for example, the formal material provided to a large organisation's employees conforms to relevant industry code(s), but the contents of the material are not followed consistently, and employees are occasionally instructed to act in contravention of the code(s).²⁰⁴ While this casts some doubt on the extent to which industry norms are capable of controlling the behaviour of larger market actors, it is notable that the publication of the GCA's investigation report into a supermarket operator's practices is associated with improved relationships with suppliers and compliance with the Groceries Supply Code of Practice.²⁰⁵ The FSB has highlighted this example, in arguing that negative publicity of poor practices can spur behavioural change on the part of companies that are 'named and shamed',²⁰⁶ a technique currently used to improve employers' adherence to their duty to pay minimum wages.²⁰⁷ Thus, Standard 5 is formulated on the basis that mechanisms such as industry codes make a useful contribution to determining what constitutes acceptable commercial conduct, provided that they are capable of enforcement in the public eye.

¹⁹⁵ *Re Express Factors, Inc.* 2005 Bankr. LEXIS 2156, 26-29.

¹⁹⁶ *Re Roberds, Inc.* (2004) 315 B.R. 443, 546-457; *Re Tri-Union Development Corp.* (2006) 349 B.R. 145, 150.

¹⁹⁷ US Bankruptcy Code, Title 11 Chapter 5 U.S.C. §547(c)(2)(B); *Re Globe Manufacturing Corporation* (2009) 567 F.3d 1291, 1298.

¹⁹⁸ *Re Carled, Inc.* (1996) 91 F.3d 811, 818.

¹⁹⁹ *Re Kevco, Inc.* 2005 Bankr. LEXIS 1249, 76.

²⁰⁰ Cork Report (n.1), paragraph 1256.

²⁰¹ Keay (n.168), 33; Leow (n.151), [35]-[46]; S. Quo, 'Insolvency law: a comparative analysis of the preference tests in the UK and Australia' 2007 Co.Law 355.

²⁰² B. Gotberg, 'Conflicting Preferences in Business Bankruptcy: the Need for Different Rules in Different Chapters' [2014] 100 Iowa L.Rev 51, 57.

²⁰³ K. Winiecki, 'Defending Preference Actions: Optimal Strategies for Comprehensive Mathematical Analyses' (2006) 25-8 ABIJ 18; G. Abrams, J. Steinfeld and J. Hess, 'Prosecuting Preference Actions Post-BAPCPA: Another View Toward a Reliable Statistical Model' (2006/2007) 25-10 ABIJ 5; Tabb (n.115), 421-422.

²⁰⁴ GCA (n.14), [31.12].

²⁰⁵ A. Allen, 'How the GCA's Tesco investigation changed supplier relations' Supply Management (15 December 2015).

²⁰⁶ FSB (n.36), 19, 28.

²⁰⁷ DBEIS, 'Record number of employers named and shamed for underpaying' (15/02/17).

H. Conclusions

The vulnerability of small and medium enterprises (SMEs) is associated with access to credit, an environment in which freedom of contract favours lenders' exercise of stronger bargaining power.²⁰⁸ While the SBEEA has sought to enhance SMEs' access to credit, the fact remains that where creditors' bargaining power is taken to the extreme, the squeezing of a financially distressed debtor can diminish the assets available to meet the claims of the general body of creditors. However, a comparable danger, illuminated by news coverage of the problems affecting small businesses and soft/hard law responses to the problem of late payments, is that SMEs may be squeezed in a variety of ways by their own large debtors.

Despite the strengthening of some transaction avoidance remedies through SBEEA reforms, these challenges for small businesses undercut the argument that while a debtor is a going concern, it freely makes choices regarding settlement of its creditors' claims,²⁰⁹ and the transaction avoidance regime steps in to prevent a race to seize the debtor's assets once it becomes insolvent.²¹⁰ This reasoning over-estimates the level of choice that smaller businesses have, with regards to making payments from their resources, as seen from the discussion in Section B. Trading conditions of the nature outlined in Section B are not only troubling for individual small businesses, but have an impact on the economy insofar as poor practices lead to business failure.²¹¹ Moreover, in circumstances where questionable arrangements cannot be prevented or remedied, existing transaction avoidance mechanisms are likely to be engaged in relation to insolvent smaller businesses that have progressively lost value during the course of their trading life as a result of practices they have encountered.

Transaction avoidance jurisprudence nevertheless offers useful insights regarding ways in which the legitimacy of *prima facie* suspect arrangements might be tested, and these have informed the formulation of the proposed Standards 1-5. Raising business standards that are relevant to the operation of companies while they are going concerns would lessen the incidence of small business failures caused by the strain of unequal trading relationships, and bolster the insolvency regime's objectives of preserving viable enterprises²¹² and upholding commercial morality.²¹³ Behavioural standards that operate as a combination of enforceable constraints and guides to commendable actions also respond to concern that measures targeting payment practices have been inadequate in changing the culture affecting small businesses in the UK.²¹⁴ A fresh approach is needed, to bring about the level of culture change that generates a discernible shift in the imbalance of power between small businesses and their larger trading partners.

²⁰⁸ O. Akseli, 'Vulnerability and access to low cost credit', Chapter 1 in J. Devenney and M. Kenny (eds), *Consumer Credit, Debt and Investment in Europe* (CUP, 2012) 10-11, 12.

²⁰⁹ Jackson (n.129), 124.

²¹⁰ T. Jackson, 'Avoiding Powers in Bankruptcy' (1984) 36 *Stan.L.Rev.* 725, 758.

²¹¹ R3, (n.39); FSB (n.36), 21.

²¹² Cork Report (n.1), paragraph 198(j).

²¹³ *Ibid*, paragraph 191.

²¹⁴ FSB (n.36), 30.