

Christmas hampers go bust

The facts

You will probably be familiar with the sad facts of the Farepak case in which 126,000 low-income households lost their Christmas savings last year when Farepak ceased trading in October 2006, with the result that orders for shopping vouchers and Christmas hampers could not be fulfilled.

Throughout the year customers placed orders with agents who collected instalments from the customers and remitted them to Farepak. The customers had no right to any goods or vouchers unless their payments were complete by the first week of November. On 11 October 2006 (by which date the company was heavily insolvent) the directors of Farepak decided to cease trading. Two days later they appointed administrators. On 12 October 2006 the directors executed a declaration of trust to attempt to ring-fence the moneys received from customers on or after 11 October 2006 so that it could be returned to customers if necessary.

The great majority of the customers' contributions had gone, but there was a modest credit balance in Farepak's current account and the administrators sought directions from the Court as to whether the money paid into that account or received by the company, on or after 11 October 2006, could be paid out immediately, so that customers could, if possible, use that money in the period between Christmas and New Year.

The law

The case is reported as (1) Shagun Sunil Dubey (2) Martha Hanora Thomson (Joint Administrators of Farepak Foods and Gifts Ltd v (1) HM Revenue and Customs (2) Suzy Hall (2006) EWHC 3272 (Ch.). Although the Judge would have found in the customers' favour if he could, he thought that he was compelled to rule that the legal case for an immediate distribution had not been made out.

Trusts

A trust is a useful weapon to protect money paid to a company from claims by a company's creditors. Essentially, a person who has provided money to a company on trust retains a proprietary interest in the money and thus is not an unsecured creditor in the company's insolvency. He is entitled to the return of his property. The customers claimed that the money they had paid on or after 11 October 2006 should be returned to them as it was subject to a trust. It was argued that the money was held on (1) a Quistclose trust (2) a constructive trust and (3) an express trust.

A Quistclose resulting trust

This type of trust derives its name from the House of Lords' decision in Barclays Bank Ltd v Quistclose Investments Ltd (1970) AC 567. A trust may arise where one person (A) advances money to another (B) on the understanding that the money may be applied by B only for the purpose stated by A.

The customers argued that the money provided by them was intended to be used only as part payment for the goods or vouchers, which they had ordered, and that since that purpose had not been fulfilled, the customers' money was held on resulting trust. This argument did not succeed, as a key factor in a Quistclose trust is an intention that the money could not be used

for any other purpose. The money received from customers, therefore, had to be kept in a separate account from Farepak's other moneys, untouched until the time when the goods or vouchers were acquired and sent out. However, that was commercially implausible and impracticable. It would have meant treating Farepak as a very odd savings organisation. Even banks do not have to keep money separate. Most savings organisations do not operate via a trust at all. They operate at the level of contract and debt; and the judge concluded that the payments made to Farepak were made pursuant to a contractual relationship.

A constructive trust

The customers claimed (and the Judge accepted that there was a strong argument) that a constructive trust could arise where money was paid by A and received by B in circumstances making it unconscionable for B to retain the money and that it was unconscionable for Farepak to retain the money they paid to Farepak on or after 11 October 2006 when Farepak had decided to cease trading, and indeed when it had indicated that payments should not be received.

The difficulty with that argument was that it appeared that Farepak received the money before the event giving rise to the alleged trust. The money was not paid directly to Farepak but to agents appointed by Farepak. Although the company's catalogue addressed to customers used the term 'your agent', the Judge was in no doubt that the agents were the agents of Farepak with the result that the money was paid to, and received by, Farepak as soon as the payments were made to the agents; and not, as was argued by the customers, when the money was credited to Farepak's account. Thus, in most cases, Farepak received the money prior to the critical decision to stop trading having been made.

Money, which was received by Farepak after it ceased trading, would be held on a constructive trust.

An express trust

To protect the customers' payments, which were still being received, the directors purported to execute a trust over moneys paid into the Farepak current account on or after 11 October 2006. Unfortunately the deed mistakenly referred to a different account, which had no money in it. However, the Judge had no difficulty in allowing the deed to be rectified so as to give effect to its obvious intention by substituting the name and number of the current account for the account identified in the trust deed.

However, the Judge ruled that the express trust gave rise to a preference in favour of the customers. The whole purpose of the trust deed was to protect money paid by the customers after the company had decided to cease trading; but if and in so far as money had already been paid to the company via the agents the customers were already creditors and the Judge could not permit any sums being paid out under the trust deed as that would amount to a preference in favour of the customers.

Comment

The Farepak customers were left with almost nothing because Farepak used their money to lend to its parent company, European Home Products, which went bust. Measures intended to prevent a similar situation were announced by the Government on 28 March 2007. It is proposed that money deposited with Christmas hamper schemes would be ring-fenced in trust accounts, so that it could not be swallowed up among other debts if a company or its parent collapses. Money collected would be held in a trust account managed by an independent

board of trustees and would be handed to hamper company directors only to purchase Christmas merchandise.

The law is often criticised for its delays, but this case is a good example of how the courts can move fast in appropriate cases. The case came on for hearing in just seven days. Counsel had scarcely more than a working day to understand the facts, work up submissions and prepare skeleton arguments.

The Court was also willing to proceed without the usual evidential requirements. Thus, for example, the Judge was prepared to rectify the trust deed, without evidence from the two persons who had signed the document and without any disclosure having been made.

However, the Court will still need to be satisfied that the claim has been sufficiently made out. As the Judge said, “claims have to be based on law, not sympathy”. Cases, which give rise to difficult issues in relation to trusts, are probably not the best ones to bring on speedily. That said, the Judge said that the customers could fight another day if a better case could be made out when there was more time available.

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