English High Court assesses whether a funder's security over the assets of the borrowing entity includes the proceeds of tax credit payments

Introduction

The recent case of *Plant & Plant (administrators of Relentless Software Ltd) v Vision Games 1 Ltd & Ors*[1] concerns the attempt of a funder of a video games developer to recover the proceeds of a tax credit payment made by HMRC to the developer, pursuant to the security that had been granted by the developer to the funder.

In assessing whether the funder could recover such sums, the High Court was asked to consider various issues, including:

(a) whether the video games developer's charge over book debts applied to the tax credits;

(b) whether there was an enforceable contract providing a proprietary interest in the tax credits; and

(c) whether the funder was entitled to a proprietary estoppel in respect of the tax credits.

Background

A video games developer, Relentless Software Ltd (the **"Company"**), entered into three development and sales agreements (the **"DSAs"**) with Vision Games 1 Ltd (the **"Funder"**). The structure of the DSAs set up two streams of payment, namely:

(a) amounts that would be provided by the Funder in order to finance the Company's development costs and which were intended to be paid into a "Production Account", which was an account in the name of Relentless Vision 1 Ltd (**"RVL"**), a wholly owned subsidiary of the Company; and

(b) amounts that flowed in the opposite direction, by which net sales revenue was to be paid into a separate designated bank account and subsequently attributed to the Funder and the Company in designated proportions.

There was also a specific requirement in the DSAs for the Company and RVL to pay all tax credits into the "Production Account", such that these funds would not be dissipated or come under the control of other secured creditors.

In parallel with the DSAs, the Company and RVL entered into various securities in favour of the Funder. Notably, such securities included:

(a) a Deed of Charge, granted by the Company, to secure all of its present and future liabilities to the Funder. The charged property included "book debts", defined as "*all present and future book and other debts and monetary claims due or owing to [the Company] in respect of the Products (the games funded by the DSAs)*". There was also a provision providing that the Company should, as an agent for the Funder, collect in and realise all book debts and pay those proceeds into a designated account and, pending payment, hold those proceeds on trust for the Funder; and

(b) a Debenture, granted by RVL, by which it charged all its assets as security for payment of all its present and future liabilities to the Funder. This included a fixed charge over all "book debts" (defined in similar terms as in the Deed of Charge) and all monies standing to the credit of RVL's accounts with any bank, which included the "Production Account".

1 [2018] EWHC 108 (Ch)

The Company had claimed video games tax relief and, on 3 August 2016, received a tax credits payment of £190,000 from HMRC, which was paid into its trading bank account. However, a few days later, the Company entered into administration.

Subsequently, the administrators of the Company applied to the High Court to ascertain whether the Funder and/or RVL had any security or proprietary interest in the tax credits payment of £190,000.

Did the company's charge over book debts apply to the tax credits?

The Funder's and RVL's primary submission was that the tax credits constituted book debts, and so were caught either by: (a) the charge on such debts created by the Company, which they submitted was a fixed charge; or (b) the trust set out in the Deed of Charge, which required the Company to hold pending payments of book debts on trust for the Funder.

The High Court rejected these arguments for a variety of reasons which, notably, include the following:

(a) there was no provision in the DSAs which explained why tax credits were to be paid into the Production Account, or what was to happen to them once they had been. As such, in the absence of any express provision about what was to be done with any tax credits paid into the Production Account, on the face of it, RVL had the power to deal with them without requiring the Funder's prior consent;

(b) if the parties' intention was that any tax credits available would operate to reduce the amount of funding required from the Funder, this was also not evident from the DSAs. For example, there was no obligation on the Company to apply for tax credits, as might have been expected if the Funder was anxious to minimise the finance required from it. Indeed, perhaps most pertinently, there was no express provision at all for payment of the amount of tax credits back to the Funder;

(c) if the Funder had any interest in or right of control over monies in the Production Account, it could only arise under RVL's debenture. However, the tax credits could not be book debts in relation to the RVL debenture because they were not sums "due to" RVL in respect of products (as required under the definition of "book debts"). They were to be paid to RVL by virtue of the Company's obligation to the Funder under the DSAs, not because of any obligation owed by any person to RVL; and

(d) the contractual and security documents treated tax credits in a materially different manner from other sums that would be regarded as book debts. For example, as noted above, the tax credits were not to be paid into a designated bank account (along with the net sales revenue) but were to be dealt with in a wholly different manner by payment into an account in RVL's name. It was therefore held that the tax credits were not intended to be treated as book debts for the purpose of the security created by the Company.

Was there a specifically enforceable contract giving RVL a proprietary interest in the tax credits?

A secondary case was advanced that RVL, rather than the Funder, had a proprietary interest in the tax credits because the Company was obliged by the DSAs to pay them into the Production Account held by RVL. As such, it was argued that this obligation amounted to a specifically enforceable contract to transfer or charge the tax credits and passed an immediate beneficial interest in them to RVL.

This argument was rejected on several grounds, including the fact that the obligation to pay tax credits to the Production Account was one imposed on both the Company and RVL, *not* one imposed on the Company for the benefit of RVL. In addition, even if the obligation was in principle enforceable by RVL, as noted above, the High Court concluded that the DSAs did not provide what was to happen to the money once paid to the Production Account.

Was the Funder entitled to a proprietary estoppel?

This was only briefly dealt with by the High Court but it was concluded that, contrary to the Funder's assertions, the Company had not offered assurances or made representations that it would deal with the net sales revenue and tax credits in accordance with the DSAs, on which the Funder had purportedly relied in not taking steps to, amongst other things, prevent payment into the Company's account and/or appointing a receiver to intercept them. As such, the Funder did not acquire any proprietary interest in the tax credits.

Conclusions

Overall, as is clear from the above, the primary reason that the High Court decided that the tax credits were not captured by the security arrangements and/or that the Funder had no proprietary interest in the tax credits was that the DSAs did not expressly provide that they did. There was, for example, no express provision at all for payment of the amount of tax credits back to the Funder.

Therefore, although this case turns on its specific facts, the decision acts as a useful reminder of the importance (particularly in bespoke and complex funding and security arrangements) of ensuring that the contractual and security documents clearly set out what the intention of the parties is and taken into account the risk of the intervening insolvency of one of the parties.

If you have any questions or comments in relation to the above, please contact the authors or your usual Mayer Brown contact.

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