DRN-4390050

The complaint

A company, which I'll refer to as "P", complains that National Westminster Bank Plc ("NatWest") wrongly applied funds held in its current account to settle the outstanding balance of its Bounce Back Loan.

As P is in liquidation, the complaint is brought on its behalf by its liquidator, albeit they are represented in doing so by the company's director and his solicitor.

What happened

P banked with NatWest, holding a current account. It borrowed £50,000 from the bank under the Bounce Back Loan Scheme in May 2020.

P went into liquidation on 22 October 2020. At that time, the company held £63,152.82 in its NatWest account. With no repayments yet falling due on the Bounce Back Loan and interest payments being covered by the government, it also owed the bank the full £50,000 it had borrowed.

Credits continued to be made to P's bank account over the weeks and months that followed, taking the balance to £120,710.40 by 17 November 2020. On that date, NatWest transferred these funds to P's liquidator.

A few weeks later, NatWest contacted the liquidator to advise that it had made an error in releasing the full account balance, from which it said it should've deducted £50,000 in order to settle P's Bounce Back Loan. The bank asked the liquidator to return £36,371.63 so that it could now do so (with the intention to use the credit balance that had since accrued on the account to repay the remainder).

The liquidator refused to return the funds, initially on the grounds that doing so would constitute a "preference payment" under the Insolvency Act (i.e. a payment to NatWest ahead of other creditors of P, putting the bank in a favourable position). The bank disagreed, highlighting that the funds had been sent to the liquidator in error and that it had the right of set-off (i.e. that it could use any credit balances held with it by P to repay or reduce any amounts it was owed by the company).

In response to NatWest's further requests, the liquidator said that the money in P's account had been incorrectly paid into it by the company's debtors. This was because P had assigned its book debts and work in progress to another company ("T"). So the liquidator said that the payments should instead be refunded to the payers. Payments continued to credit P's account in the meantime.

With the matter unresolved, solicitors acting on behalf of T (and who are now representing P in this complaint) wrote to the bank in April 2021 and argued that NatWest should refund the payments as it had no right of set off in respect of the funds received after the date of the liquidation and similarly no right to use funds that didn't belong to P.

NatWest rejected the arguments made by the liquidator and the solicitors, and proceeded to apply £50,000 of the funds held in P's account – which by this time totalled over £90,000 – to repay the company's Bounce Back Loan on 16 April 2021. The bank then paid the remaining account balance to the liquidator on 24 May 2021, but the account remained open and continued to receive credits before finally being closed in December 2021.

What the parties say

Those representing P say that NatWest had no entitlement to use the funds held in the company's account to repay the Bounce Back Loan in the way it did. In summary, they say:

- P sold all of its assets, including its debtors, to T on 26 September 2020. As a consequence of this transaction, T took an equitable assignment of the debts owed to P. So where payments were made to P rather than T in the fulfilment of these debts, those payments were held by P on trust for T. On that basis, the £50,000 that NatWest used to repay P's Bounce Back Loan belonged, in fact, to T and should be returned to that company along with compensatory interest.

- It would no longer be appropriate to return the payments in question to the payers as previously proposed, as those debtors of P have discharged their debts by virtue of the payments they made to P's account and T would be unable to pursue them for payment.

- A bank can't exercise a right of set off where it knows that the funds to be used for that purpose are held on trust for another party. P's liquidator notified NatWest that the funds held in P's account didn't actually belong to P before the bank utilised £50,000 of those funds to repay the Bounce Back Loan, which precluded the bank from taking the action it did.

- Moreover, it would be unjust for NatWest to capitalise upon and benefit from payments made by P's debtors to the wrong account in error, to the detriment of T.

So P seeks the return of the £50,000 taken from its account along with interest on that sum by way of compensation for being deprived of its use, albeit that it ultimately wants to send this to T. The company also seeks interest on the balance that was released to the liquidator, which it says was subject to an unreasonable delay. And it asks that NatWest pay T's legal costs in connection with the matter.

NatWest doesn't accept P's position, and says – again in summary – that:

- P didn't seek the bank's consent to the sale or notify it of the sale at the time of completion. The terms and conditions of the Bounce Back Loan agreement required P to notify the bank immediately of any material adverse change in its business or financial condition. These conditions also said that P must not make any material change in the nature of its business without consent from the bank. And a significant drop in the value of the business could also constitute an event of default under the terms of the loan agreement too.

- Insolvency set-off is mandatory, automatic and self-executory. This results in a net balance owing between an insolvent company and its creditor on the date of liquidation. As at the date of liquidation, P owed NatWest £50,000 while holding a credit balance of £63,152 in its account. Given the credit balance in the account was sufficient to discharge the loan debt, and insolvency set-off applied automatically as at that date, only the net balance (i.e. £13,152) was payable to P.

- The bank mistakenly transferred the entire credit balance in the account to P's liquidator, without deducting the £50,000 to which it was – and remains – entitled, pursuant to the insolvency set-off rules. Its requests of the liquidator to return the funds that it mistakenly released were wrongly rejected on the basis that doing so would constitute a preference payment. It believes the £50,000 should not have formed part of the insolvency estate and that the liquidator ought to have returned it.

- The argument that funds received into P's account were held on trust for T was not advanced by P, the liquidator or the solicitors prior to the complaint. And it isn't appropriate, or fair and reasonable, to retrospectively argue that the consequence of the sale of P's assets is that certain funds were held on trust and that the bank had notice of the alleged trust, and that it should've acted as if the funds were indeed held on trust, given that:

    - The actions of P, its liquidator and solicitor were inconsistent with the existence of the alleged trust. The account activity – including debit payments on behalf of P after the date of sale – suggest that the account continued to be used as P's trading account for a period and, at least, "trust monies" were mixed with "P monies", which is inconsistent with the existence of a trust arrangement.

    - Neither P, its liquidator nor its solicitor notified the bank of the alleged trust until 9 April 2021 (and even then, the points raised were somewhat contradictory as to whether the funds were held on trust or whether they had been received in error). Earlier correspondence had said that the funds had been paid into P's account in error and that the funds belonged to T, but with no further explanation. And all such correspondence was sent over two months after the date of liquidation. There is a particular procedure for the holding of funds for another party, ensuring that all parties are clear that monies are being held on trust, which neither P nor its liquidator sought to follow.

My provisional decision

I shared my provisional decision with the parties and their representatives last month. This explained that I didn't intend to uphold the complaint, set out the reasons why and invited them to respond with anything else they wanted me to take into account before I made a final decision. I said:

> Our powers are set out in the Financial Services and Markets Act 2000 and the rules in the Financial Conduct Authority's handbook. These require me to determine the complaint by reference to what is, in my opinion, fair and reasonable in all the circumstances of the case. And in considering what is fair and reasonable, I must take into account the relevant law and regulations, regulators' rules, guidance and standards, codes of practice, and – where appropriate – what I consider to have been good industry practice at the time.
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> I highlight this because, as I've summarised above, both parties have referred us to matters of law that they believe support their case. And there are some particularly complex matters of law involved here, relating to equitable assignment, funds held on trust and insolvency (and how they might interact with or override one another). The question of who is *legally* entitled to the funds at issue – in consideration of all these matters – is one that only a court could make. Our remit is much broader, in that I am not bound to reach the same decision as a court would and with the relevant law

being one of many relevant considerations in how I come to a conclusion as to what represents a fair and reasonable outcome.

The complexity of the legal arguments and their centrality to the basis of P's complaint also led me to consider whether it would be more suitable for the complaint to be dealt with by a court – being grounds on which we could dismiss the complaint without considering its merits. But I think I can reach a decision on what is fair and reasonable in all the circumstances, while taking into account the relevant law and the arguments upon it that have been made by the parties.

Turning then to the dispute itself, my provisional decision is that it wouldn't be fair and reasonable for me to require NatWest to return the funds at issue to P. I'll explain why.

As a starting point, P borrowed £50,000 from NatWest and it is fair and reasonable for that debt to be repaid. NatWest utilised funds held in P's account to settle the outstanding debt, which it was entitled to do under the terms and conditions of both P's Bounce Back Loan and its current account (using its "right of set off").

Those representing P say that the funds used by NatWest to settle the debt didn't belong to P given their equitable assignment to T, and that NatWest wasn't entitled to exercise its right of set-off over these funds being that it was on notice that they were being held on trust for a third party. I'm not wholly persuaded that NatWest was properly made aware that the funds held on P's accounts were being held on trust before it utilised them to redeem the Bounce Back Loan. It is argued that notice was given on three occasions:

- On 21 January 2021, when the liquidator said that the funds had been paid into P's account "*in error and are not funds of [P]*".

- On 28 January, when the liquidator reiterated that the funds "*are not Company funds*" and instead "*belong to [T]*".

- On 9 April, when the liquidator said that P "*does not have any interest in the funds received into [P's account] since 22 October 2020*".

None of these communications, to my mind, state clearly that the funds in P's account were being held on trust. There was no reference to the prior sale or assignment. The thrust of the liquidator's contentions was, in my view, that the funds had mistakenly been transferred to P's account rather than being held within it on trust for another. There had also been no previous disclosure of the sale of the company's assets some months earlier, which – as NatWest has highlighted – P ought to have given in line with its obligations under the terms and conditions governing its relationship with NatWest that required it to "*immediately notify the Bank … if there is a material adverse change in its business or financial condition*". Had that happened, the bank may have defaulted the loan at that point – and exercised its right of set off – which would've prevented events unfolding in the way they did (with the sale of P's assets predating the company's liquidation).

More broadly, I don't think I can determine that the legal position would deem NatWest to have been barred from utilising the funds in the manner due to the alleged trust arrangement. That is not a readily apparent situation, in as much as it is not a black and white position set out by statute but rather an area of case law which, to me, seems dependent on the facts of each individual case. There are significant differences between the facts underpinning the court judgement to which P's

representatives have referred me and those that gave rise to P's complaint. I can't say with any certainty that a court would find in P (or T)'s favour on this point. There is then a further question as to how a court would consider any rights or protections under the trust arrangement against NatWest's rights as a creditor of P's under insolvency law.

In any event, even if I were to accept that NatWest had properly been notified that the funds in P's account were being held on trust for T, and then that a court *may* find that P was holding funds on trust for T and that NatWest was therefore precluded from utilising them in the manner it did, the broader circumstances of this complaint still lead me to consider that it would be unfair to require NatWest to return the funds at issue.

As I see it, the debt only remained outstanding following an administrative error on NatWest's part when it released the entire account balance to the liquidator on 17 November 2020. Had things gone as they should have, NatWest would've debited £50,000 from the amount it transferred to the liquidator on that date – exercising its right of set off to repay the money P owed on the Bounce Back Loan with the funds held in its account at that time. There is no suggestion that NatWest was notified before this date that the funds in P's account were being held on trust for another party.

I don't think it would be fair or reasonable to require NatWest to return the funds – and in doing so, bear responsibility for the £50,000 liability given P's liquidation – when it was only by dint of an unfortunate error that the debt wasn't settled using funds held in P's account at an earlier juncture.

P's representatives have also suggested that it would be unjust for NatWest to benefit from payments made by P's debtors to the wrong account. It hasn't been evidenced that the payments were actually made to P's account in error (as I've not seen, for example, that P told its clients of alternative payment arrangements). And it strikes me that P (or T) could've done more to stop payments going to P's account if that was the intention. In any case, I don't think NatWest is benefitting unjustly from payments continuing to be made to P's account. I think the position that the parties have ended up in is the position in which they should and would be, had things gone as they should have – that is, P's Bounce Back Loan has been fully repaid and the remainder of the funds held in P's NatWest account has been released to the liquidator.

P's representatives have raised further points around the time it took NatWest to release the remainder of the funds held in P's account to the liquidator. I can see that there was some delay in doing so – and that while the ongoing argument as to whether or not NatWest was entitled to retain some of those funds to repay the Bounce Back Loan would've contributed to this, the bank could've mitigated this by retaining only the funds it needed to clear the loan and releasing the rest. At the same time, and as touched upon earlier, P could also have taken steps to avoid this situation arising – the number of payments still crediting the account suggests to me that more could've been done to direct payers to make payments to an alternative account.

Ultimately, it doesn't seem to me that P – being the eligible complainant under our rules and therefore the only entity to which I can award compensation – suffered as a result of this delay. The claim has been submitted on T's behalf, with the argument being that this was T's money all along and that it has been deprived of its use. The same can be said of both any inconvenience and cost that has been incurred in

pursuing the release of the money. The work in that respect has been conducted by parties acting on T's behalf, with any costs involved therefore being incurred by T rather than P. I can't award any compensation to T.

So taking all of this into account, I'm not currently intending to require NatWest to return the funds at issue to P or take any other action in response to this complaint.

P's representatives replied to say, in summary, that:

- They still thought T was an eligible complainant under our rules and requested a determination from us on this point.

- It wasn't fair or reasonable to expect P's liquidator to have been aware of the trust that arose "automatically by operation of law" such that he ought to have made NatWest aware of this prior to the bank's utilisation of the funds to settle P's Bounce Back Loan. Rather, it was sufficient that he had communicated the "essence" of the trust to NatWest, which he'd done in explaining that the funds had been received into P's account in error and belonged to T.

- It was acknowledged that I wasn't required to decide what a court would conclude as to the interaction between the existence of a trust and NatWest's insolvency rights. Accepting the *possibility* that a court would consider NatWest debarred from utilising the funds purportedly held on trust to settle P's Bounce Back Loan, it was then a question of what was fair and reasonable in the broader circumstances. On that question, four specific points were cited:

    - I'd provisionally found that it wouldn't be fair to require NatWest to refund the £50,000 on the basis that it could've exercised its right of set-off earlier but made a mistake in releasing the funds – but this overlooked that *all* funds received after the date of assignment were held on trust for T. This meant that NatWest had never been entitled to exercise a set off. Requiring NatWest to repay the funds would in fact return it to the position of every other unsecured creditor – whereas it stood to benefit from the mistakes made by third parties to the detriment of T.

    - My finding that there was a substantial credit balance on the account as at the date of the liquidation, against which NatWest would've been entitled to exercise a right of set-off, did not reflect their understanding. Without access to statements, they asked for conformation of the balance as at the date of liquidation.

    - I'd suggested that P should've informed NatWest earlier of a material change to its business or financial condition prior to the assignment and that, had it done so, NatWest might've defaulted the loan at such time. But without specifying when that should've happened, it was impossible to say what funds might've been available for NatWest to exercise its right of set-off. But it certainly couldn't have used funds belonging to T. It was unfair for T to suffer any failings on P's part. Any criticism that the assignment took place at all would be a matter for the liquidator to pursue, or possibly for NatWest to pursue, against P – and shouldn't entitle NatWest to retain funds which belonged to T pursuant to a valid and enforceable contract.

    - Contrary to repeated instructions to close P's account in order to stem the flow of mistaken payments, NatWest appeared to have intentionally kept the

> account open and able to receive credits. So while it was suggested that T could've done more to prevent the mistaken payments being made, it was within NatWest's gift to have stopped such payments immediately – but it had instead sought to capitalise upon them, to T's detriment.

NatWest replied simply to confirm it had nothing further to add.

What I've decided – and why

I've considered all the available evidence and arguments to decide what's fair and reasonable in the circumstances of this complaint.

The question of whether T is an eligible to bring this complaint has been dealt with by way of a separate decision, so I won't comment further upon that here. This decision deals only with NatWest's actions in respect of its dealings with P.

I've reconsidered this complaint carefully in light of all that P and its representatives have sent in response to my provisional decision. Having done so, I've not seen reason to reach a different decision. I'll explain why these further points haven't changed my mind.

I remain of the view that NatWest wasn't aware that the funds held within P's accounts were being held on trust for another. I take the point that the liquidator might not reasonably be expected to have understood the complex legal position, or to have communicated this to NatWest. But I do think it is reasonable to suggest that the circumstances giving rise to that position – namely the sale of the business – could and should have been communicated to the bank previously. I don't think it is fair or reasonable to oblige NatWest either to have accepted the rather vague submissions that the funds sitting in P's accounts didn't actually belong to P, or for it to have to investigate that in order to establish the basis for this claim.

The question of notice is significant given P's arguments, which are predominantly based upon the court judgement in *The Royal Bank of Scotland pic v Wallace International Ltd [2000] WL 405*. It is argued that if a bank *knows* the money held in an account is held on trust, and the trust arose when the money was paid into that account, then that bank cannot exercise a right of set-off over the funds held therein. My finding here is that NatWest did *not* know that the funds held in P's account were held on trust for another. While noting that P, or others on its behalf, need not have explicitly stated that there was a *trust* arrangement, I don't think there was enough for the bank to have been aware that such an arrangement existed. I would also reiterate that there are significant differences between the circumstances of the case decided by the court to which I have been referred, and those at issue here – notably including the factors that could be said to have given rise to the bank being on notice of a trust arrangement.

Even setting this point aside, and again accepting the possibility that a court *may* find that P was holding funds on trust for T and that NatWest was therefore precluded from utilising them in the manner it did, I still reach the same conclusion that it would be unfair to require NatWest to return the funds at issue in light of the broader circumstances for the reasons set out in my provisional decision.

I said in my provisional decision that I thought the debt had only remained outstanding following an administrative error on NatWest's part when it released the entire account balance to the liquidator on 17 November 2020. Had things gone as they should have, NatWest would've debited £50,000 from the amount it transferred to the liquidator on that date – exercising its right of set off to repay the money P owed on the Bounce Back Loan with the funds held in its account at that time. P's solicitors queried this on the basis that it didn't consider the account balance as at the date of liquidation was sufficient to have

allowed for this. But statements for the account show that the balance on this date was in excess of the debt owed.

P's solicitors contest that it wasn't fair for NatWest to use the funds given that they belonged to T by virtue of the equitable assignment that took place in September 2020. Even accepting this transfer of ownership, I don't think it would be fair for P to be able to circumvent its liabilities in reliance on this transfer. In reaching this view I've borne in mind that the two companies involved are owned and operated by the same people – and that this was, in the companies' director's own words, a "result of restructuring within the Group".

I also said in my provisional decision that had P disclosed the transfer to NatWest as it seemingly ought to have done under the terms and conditions of its accounts, the bank may have terminated the loan – and exercised its right of set-off – earlier. I accept the point that it isn't possible to know what would've happened in this regard, as there was no set date on which such notice should've been given. It isn't determinative, as ultimately I reach the same view on the fairness of NatWest utilising the funds in the manner it did irrespective of the fact that if it had been properly informed of the transfer then it may also have been able to do so at an earlier juncture.

Similarly, while I've now been given evidence that T did ask at least some of P's clients to use alternative payment methods, that doesn't change my view. As I said in my provisional decision, I think the position that the parties have ended up in is the position in which they should and would be, had things gone as they should have – that is, P's Bounce Back Loan has been fully repaid and the remainder of the funds held in P's NatWest account has been released to the liquidator.

My final decision

For the reasons I've explained, I don't uphold this complaint.

Under the rules of the Financial Ombudsman Service, I'm required to ask P to accept or reject my decision before 30 November 2023.

Ben Jennings
Ombudsman