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Corporate Insolvency
Legal Update
2015

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JULIAN DOBSON SOLICITORS

We are solicitors dealing exclusively with insolvency matters. Based in the City of Brighton & Hove, we are close to Brighton County Court, one of the busiest bankruptcy courts in the country. The firm acts mainly for insolvency practitioners throughout England and Wales.

As a firm of solicitors, we have a Licensed Insolvency Practitioner (non-appointment taking). We emphasize a practical approach in our dealings with clients, the courts and others. For all enquiries on insolvency related matters contact:

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The contents of these notes are a summary of the relevant provisions. Legal advice should be taken in relation to specific enquiries. Any liability is disclaimed.

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ADMINISTRATION

RE Calibre Solicitors Limited (In Administration) [2015] BPIR 435

Whether to extend time to enable creditor to challenge administrators' remuneration?

Facts

08/2/2013	Administrators appointed
06/09/2013	First Progress Report
31/10/2013	First Remuneration Application
05/02/2014	Second Progress Report
13/06/2014	Second Remuneration Application
30/06/2014	Third Progress Report
	Third Remuneration Application

The respondents were appointed administrators of Calibre Solicitors Limited a company which practised as a firm of solicitors. The administrators issued their first progress report on 6 September 2013.

Having issued the first remuneration application challenge the applicant then sought to challenge the remuneration and expenses in the second progress report issued on 5 February 2014.

Rule 2.109(1b) of the **Insolvency Rules 1986** provides that:

> "The application must, subject to any order of the court under the Rule 2.48A(4) be made no later than eight weeks after receipt by applicant of the progress report which first reports the charging of the remuneration or the incurring of the expenses in question".

As the second application was already out of time, the creditor argued that the first application was sufficient to deal with the challenge to the remuneration in both the first and second progress reports.

The question the court had to decide was whether or not the second application was necessary and if so, could the court extend time. During the course of proceedings a third progress report was issued on 30 June 2014 which was followed by a third remuneration application challenging the administrator's remuneration which was issued within the requisite eight week time limit.

In considering whether the second application was necessary the court considered the basis on which the administrators' remuneration was fixed. This is set out in Rule 2.106. The remuneration being fixed either as a percentage of the value of the property dealt with or reference to the time properly given. The decision fixing the basis is made by the creditors' committee or (failing that) the creditors or (finally) the court.

Remuneration can be paid during the administration. The process by which creditors are informed of the remuneration charged by the administrator is by reference to the progress reports. These are detailed in Rule 2.47 which stipulates the information required to be set out in the progress reports. This includes the "remuneration charged during the period of the report".

Rule 2.109 enables creditors to challenge the remuneration and/or expenses charged by the administrator on the grounds that it is "*in all the circumstances excessive*". The application can be made by a secured creditor or an unsecured creditor with concurrence of at least 10% of creditors in value. The 8 week period in rule 2.109 (1b) is the period in which the creditor may challenge the remuneration incurred within the period of the relevant progress report.

The court therefore concluded that it followed that it was necessary to have one application for each report and that the applicant could not rely on the first remuneration application as being sufficient to challenge the remuneration in the second progress report as well as the first.

The court then had to consider whether the time period of 8 weeks could be extended. This involved first of all looking at the purpose of the time limit. The reason for the time limit was that Parliament wanted the process of determining the remuneration and expenses to be resolved quickly. This is particularly so in the case of administrations which ideally should last no longer than a year. Administrators need to know where they stand and what the financial position is of the company as do any office holders who may succeed them, such as liquidators.

With that in mind the court considered the provisions of Rule 12A.55(2) of the Insolvency Rules 1986 which provides:-

> "The provisions of CPR rule 3.1(2)(a) (the court's general powers of management) apply so as to enable the court to extend or shorten the time for compliance with anything required or authorised to be done by the Rules"

That Rule expressly applies the CPR and therefore the court was bound to consider the issues arising following the Court of Appeal's decision in **Denton & Ors. V T H White Limited & Anor. [2014] EWCA Civ 906**.

Decision

In applying the tests in Denton, the Registrar concluded that the failure to issue the second application in time was due to a misunderstanding of the rules. The consequential delay was not significant and the respondents indicated they would be willing to agree an extension subject to agreeing directions. These factors did not mean that this was a trivial case of failure.

After further considering the Denton test the Registrar took the view that he should exercise his discretion and grant an extension.

The Registrar noted that the costs of each side for dealing with the applications had been estimated at £75,000 for the first application, £50,000 for the second application and £50,000 for the third application. This had to be considered against the total sum of the remuneration claimed in each of the reports. Those sums were £166,000, £69,000 and £56,000. The applicants contended that the remuneration claimed was excessive. However the costs in dealing with the applications and dealing with the remuneration challenges were likely to be disproportionate. The Registrar therefore concluded that it was reasonable to assume that at least £150,000 of the remuneration claimed would be reasonable and therefore the parties should concentrate on the reasons why the additional costs were excessive.

To facilitate that the Registrar gave directions for the filing of further evidence as to why remuneration over £150,000 was excessive and provided cost budget guide lines for the filing of further evidence and determination of the claim.

Comment

- This case provides useful clarification as to the time limits that should apply to creditors' challenges in respect of remuneration. An application to challenge can only relate to the remuneration referred to in the respective progress report to which it relates.

- The time period of 8 weeks in which to make the challenge will not normally be extended but is capable of extension in certain circumstances. Notwithstanding the granting of an extension in this particular case, it is unlikely that extensions will be granted in the absence of compelling reasons as to why an extension should be given.

- The eight week time period came into force on 6 April 2010. Similar provisions apply in liquidation Rule 4.131(1B) and in Bankruptcy Rule 6.142(1B)

- The court recognised that the claim that the remuneration was excessive is a high hurdle to clear and in this particular case took a practical approach by effectively approving £150,000 of the remuneration and limiting argument to why remuneration over and above that figure could be considered to be excessive.

ADMINISTRATION

GSM Export (UK) Limited (In Administration) v HMRC [2015] BPIR 47 TCC

ATE Policy as security for costs and Quistclose trust

Facts

GSM and another company referred to as Sprint went into administration on 14 September 2009. GSM was insolvent. Sprint's statement of affairs suggested it would be solvent if it recovered a VAT refund. The application was made for a VAT refund in the sum of £2,288,715 to the First-Tier Tribunal which was refused. This case concerned an appeal to the Upper Tribunal against that refusal.

The matter had been listed for trial when, just over a month before the hearing, HMRC applied for security for costs against GSM Sprint. The initial response for security for costs was met with a response from the appellants that this "seems highly improper".

The appellant companies provided details of litigation insurance taken out in respect of the proceedings. HMRC responded that they did not consider that the policy sufficiently mitigated the risk that the respondents' costs at the tribunal would not be paid.

Under **CPR Rule 25.13** an order may be made for security for costs if the court is satisfied that having regard to all circumstances of a case, that it is just to make such an order and the relevant condition has been met. In this case the relevant condition was in **Rule 25.13(2)(c)** namely that the appellants are companies, and:

> "there is reason to believe that [they] will be unable to pay the [respondents] costs if ordered to do so".

The relevant condition is a threshold test. Unless it is satisfied, the jurisdiction to make an order for security for costs does not arise.

Once the threshold is crossed there are various principles that then come into play as to whether or not security for costs should be granted. They include the following:

(a) The balancing exercise must weigh the injustice to the party against whom an order is sought if that party is prevented from pursuing (in this case), its appeal, against the injustice to the respondents if no security is ordered and, having been successful, the respondents find themselves unable to recover costs.

(b) The possibility or probability that the appellants will be deterred from pursuing their appeals is not, without more, a sufficient reason for not ordering security.

(c) Regard should be had to the prospects of success but without going into the merits in detail.

(d) Before refusing security on the ground that it would unfairly stifle a valid claim, the court must be satisfied that in all the circumstances it is probable that the claim would be stifled. The court in such circumstances should consider not only whether the party concerned can provide security out of its own resources, but also whether it can raise the amount needed from directors; shareholders, other backers, or interested persons.

(e) The lateness of the application for security and the reasons behind that.

In the current case it was recognised the threshold test would be met if there is a reason to believe the appellants would be unable to pay the respondent's costs if their appeals were unsuccessful. This means that the test turns on the terms of the insurance policy which is relied upon by the appellants as in such circumstances they will both be insolvent.

The insurance policy was an "after the event" policy issued by IGI Insurance Company Limited. It was argued for HMRC that the terms of the policy placed doubt on whether or not the respondent's costs would be met from the policy in the event that the respondents were successful. It was argued that the insurers could determine whether or not a case had been successful and could do so in order to avoid paying the respondent's costs. It was also noted that the policy could be rendered voidable on a number of grounds. They could include a lack of cooperation with solicitors, failure to ensure accuracy of information provided by solicitors, failure to keep disbursements as low as possible or to notify possible settlement terms to the insurers. Any of those circumstances could give rise to the policy being rendered void and thereby enabling the insurer to terminate the policy and avoid payment.

Decision

Judge Roger Berner first of all considered the terms of the policy and the arguments put forward that it may be avoided or its terms may result in no payment being made. This the Judge concluded was a theoretical risk only.

The court also considered that the ATE insurance policy itself could constitute security for costs.

In considering his decision the Judge noted that the policy proceeds would be paid to the appellants themselves and as such they may just simply fall into the general funds of the administration. The administrators sought to reassure the court by stating that they thought the proceeds would not constitute company assets and therefore would be capable of being paid to the respondents. The Judge was not satisfied on this point and raised a further point that the policy proceeds may be impressed with a **Quistclose** type trust. This was held in the case of **Barclays Bank v Quistclose Investments Ltd [1970] AC 567**. In **Quistclose** monies were advanced to a company by way of a loan in order to fund dividends. It was held that in such circumstances the monies were impressed with the trust and therefore could not be utilised for any other purpose.

No detailed argument was heard on the question of whether or not a **Quistclose** type trust would apply to the policy proceeds. Nevertheless it was recognised that the principle is not confined to loans but extends to cases where a person making the payment is a debtor of the company.

In conclusion the court held that there was no real concern that the monies would not be paid to respondents and would simply fall into the assets available to creditors. As such the threshold test had not been met and the application for security for costs would be refused.

Having reached his decision the Judge also considered the position in the event that the threshold test had been met. In such circumstances the court would have to carry out a balancing exercise and have regard to whether or not an order would stifle the appeal. The court was particularly concerned about the unreasonable delay in making the application for an application for security for costs and as no proper explanation had been provided, the court took the view that the interests of justice do not now require that the appellants address funding questions at a time when they are in the late stages of preparing for trial. In

the circumstances it would not be just to make an order for security for costs and the application was dismissed.

Comment

- This case provides useful guidance as to the arguments that may arise in response to an application for security for costs against an impecunious company litigating through its administrator and/or liquidators. It confirms that the provisions of ATE insurance can constitute adequate security for costs.

- The case further sets out the principles that should be taken into account in relation to security for costs applications and in particular highlights the risks of making such an application at a late stage.

ADMINISTRATION

Lazari Investments Limited v Saville & Ors [2015] EWHC 2590 (Ch)

Forfeiture in Administration

Facts

This was a pre-pack administration involving some 43 different restaurants. Following the pre-pack, a licence to occupy was granted by the tenant to the purchaser which was in breach of the terms of the lease. The lease contained a pre-emption provision which required the tenant to offer a surrender of the lease to the landlord as a pre-condition of the grant of any licence to assign. The apportioned premium under the pre-pack sale agreement was £1,376,953 for the lease. This meant that if the administrators were able to obtain a licence to assign in circumstances where the landlord could not reasonably refuse then if the landlord wished to exercise its right of pre-emption it would have to pay that sum to the tenant. The landlord applied to court for permission to forfeit the lease.

The landlord issued a **s146** of the **Law of Property Act 1925** notice on the grounds that the tenant had breached the lease by reason of (a) the administration and (b) the granting of the licence to occupy.

The administrators made several applications for a licence to assign all of which were rejected by the landlord. The reasons for refusal were that the proposed assignee was a newly incorporated company with no trading history or assets. Whilst a guarantor was offered there were concerns as to the guarantors' financial standing. Further the tenant had not offered an authorised guarantee agreement.

Attempts were made to market the lease for sale and this procured an offer of £600,000 premium from a company related to the purchaser and a further offer of a £250,000 premium from Wagamama. The offer from Wagamama was subsequently withdrawn because the administrators were unable to procure a licence from the landlord in respect of the outside seating area. The administrators contended that the lease had significant value and that if the court granted consent to forfeit the lease to the landlord this would cause prejudice to creditors.

The court first of all considered the decision in **Sunberry Properties Ltd v Innovate Logistics Ltd [2009] BCC 164** in which the Court of Appeal allowed an appeal by the administrators against an earlier order granting permission to the landlord to commence proceedings against the tenant in circumstances where it had granted a licence to occupy without the landlord's consent. In that case the court considered the decision in **Atlantic Computer Systems plc [1992] Ch 505** and the provisions of **paragraph 43 of Schedule B1** of the **Insolvency Act 1986.** In particular the court noted the following points:

- The administrators are officers of the court
- The administrators act as agents for the company
- The burden is on the landlord to make out its case to show that it will be inequitable for it to be prevented from commencing the proposed proceedings
- The court will, in seeking to give effect to the statutory purpose of the administration conduct a balancing exercise of legitimate interests of the lessor and the legitimate interests of other creditors of the company

- The court will compare the financial loss suffered by the landlord if permission to commence proceedings is refused with the loss suffered by other creditors if permission is granted.

- The court must take into account money paid by the administrators to compensate the landlord

- The court attaches great importance to the proprietary interest of the landlord who should not be prejudiced by the way in which the administration is conducted "save to the extent that this may be unavoidable and even then this will usually be acceptable only to a strictly limited extent".

In **Sunberry** the landlord wanted the occupier to remain in possession as its tenant under an assigned or new lease rather than being in occupation under a licence to occupy.

In the current case, the court took further guidance from **Atlantic Computers** as follows:

- If granting leave to a landlord to forfeit is unlikely to impede the achievement of the purpose of the administration then leave should normally be given.

- The purpose of the balancing exercise is to enable or assist the achievement of the objective of the administration.

- The granting of leave is to enable the court to relax the prohibition where it would be inequitable for the prohibition to apply.

- When assessing the loss that a landlord might suffer by reason of a refusal to grant leave, loss can include any kind of financial loss direct or indirect and may extend to loss which is not financial.

- When assessing the respective losses the court will look at the financial position of the company and its ability to pay rental arrears and the continuing rentals. It would also look at how long the administrator's proposals will be for.

- The conduct of the parties may be a material consideration.

The court also considered the decision in **Lazari GP Ltd v Jervis [2013] BCC 294**. In that case the landlord applied for permission to exercise its right to forfeit a lease to a company in administration. The administrators had written saying they intended to make use of the property without adopting the lease but they had not paid the rent falling due under the lease which was in arrears. The administration was a pre-pack administration and the purchaser had been granted a licence to occupy the premises in breach of the terms of the lease. In that case the court accepted that there was no basis for believing that the purpose for which the administration order had been made would be in any way impeded by the landlord forfeiting a lease and as a consequence the balancing exercise that the court would perform if there would be some impeding of the purpose for which the administration order was made simply did not arise. The court noted that the buyer was aware of the full risk of the consequence of being in occupation without the landlord's consent. The buyer's attempts to obtain a licence to assign had been half-hearted. The pre-pack sale agreement did not provided for any deferred consideration which might be lost in the event that the occupier were evicted from the premises following forfeiture. There was evidence that the landlord would suffer a real financial loss if it was unable to enforce its rights.

Decision

The landlord's withholding of consent to the assignment was entirely reasonable for the following reasons:

a) The proposed assignee was not of sufficient financial standing

b) The guarantee offered on behalf of the proposed tenant was from another company of little or no financial standing

c) No authorised guarantee agreement had been offered

The court considered whether the grant of permission would impede the purpose of the administration. This involved considering the value of the lease in the hands of the administrators. It was noted that in applying for a licence to assign no authorised guarantee agreement had been offered by the tenant

The court then had to consider the value of the lease to the administrators and it noted that the offer of £600,000 was never going to materialise as the landlord was not going to grant consent to the assignment. Therefore the administrators would not be deprived of the opportunity of realising £600,000.

The offer from Wagamama to pay the sum of £250,000 would have been acceptable save that the administrators were unable to procure the seating licence from the landlord by separate negotiation and therefore Wagamama withdrew.

As a result the court held that the purpose of the administration would not be impeded by the granting of permission to forfeit and that there were no grounds to believe the administrators would achieve a premium on assigning the lease.

As in the case of **Lazari** the court held that it would not limit the forfeiture by legal proceedings only and would also allow peaceful re-entry.

In holding the purpose of the administration would not be impeded if the landlord were able to exercise its rights to forfeiture, the Judge also considered that if that was wrong and he carried out the balancing exercise as prescribed in **Atlantic Computers** where a grant of permission would impede that purpose, that exercise would come down in favour of granting permission to the landlord.

Comment

- This case gives an insight into the negotiations between administrators and the landlord in order to obtain a licence to assign and the material considerations. Whilst the case deals with the common scenario involving the granting of a licence to occupy to the purchaser in breach of the terms of the lease, in this particular case the court rejected the view that the landlord had additionally suffered just by having an illegal occupier. The court recognised there were good reasons to grant a licence to occupy even if in breach of the lease.

- Although the licence to occupy is in breach of the terms of the lease in the event that the premises were unoccupied a further breach of the lease by reason of not running a business at the property would have arisen.

ADMINISTRATION

Lehman Brothers International (Europe) (In Administration) Court of Appeal – Waterfall 1 [2015] EWCA Civ 485

Statutory interest and the ranking of claims in administration

Facts

Lehman Brothers collapsed in September 2008. Its main trading company Lehman Brothers International (Europe) (In Administration) ("LBIE") was now in a position to pay all its creditors in full. LBIE had been re-registered as an unlimited company for US tax reasons. Its share capital was held by Lehman Brothers Holdings Intermediate 2 Ltd ("LBHI2") and Lehman Brothers Ltd ("LBL"). All of the Lehman Brothers' companies referred to above are in administration.

The administrators of LBIE with permission of the court pursuant to **paragraph 65** of **Schedule B** of the **Insolvency Act 1986** made an interim distribution to creditors of 25.2 pence in the pound in November 2011. LBHI2 had made subordinated loans to LBIE in the sum of $2.225 billion for which it had lodged a claim in the administration.

The administrators of all three companies sought directions from the court on a number of questions. Judgment was given by David Richards J on 14th March 2014. In his judgment he made a number of declarations all of which were now the subject of the appeal to the Court of Appeal. The administrators of LBIE held a substantial surplus in the administration and sought directions as to how that surplus should be dealt with.

This first involved determining where in the order of priority for payment the subordinated loans due to LBHI2 ranked.

In **Re Nortel GmbH [2013] UKSC 52** Lord Neuberger identified that both in liquidation and in administration the order of priority for payment out of the company's assets is as follows:

1) Fixed charge creditors;
2) Expenses of the insolvency proceedings;
3) Preferential creditors;
4) Floating charge creditors;
5) Unsecured provable debts;
6) Statutory interest;
7) Non-provable liabilities; and

7A) Subordinated debt

8) Shareholders.

The question concerning the subordinated debt was whether or not it ranked immediately after unsecured provable debts (as category (5A)) or immediately after non-provable liabilities (as category (7A)).

The court considered the equivalent liquidation provision of **rule 4.73.** That describes the process of "proving". It also referred to **rule 12.3** at which Rule **12.3(1)** provides:

> "subject as follows, in administration, winding up and bankruptcy, all claims by creditors are provable as debts against the company or, as the case may be, the

bankrupt, whether they are present or future, certain or contingent, ascertained or sounding only in damages."

Whilst the definition of provable debts in **rule 12.3** is very broad it was noted that the class of non-provable debts must be small. It was also noted that the trend in legislation and judicial decisions has been to progressively widen the class of claims which can be the subject of proof in an insolvency. The intention of the legislature being to eliminate, so far as possible, non-provable claims.

Subordinated Claims

LBHI2 was a creditor of LBIE albeit a subordinated one. The reason for the subordinated loans was to provide LBIE with sufficient capital for regulatory purposes. The court considered the different ways in which subordination agreements can be drawn. There are three main types:

1) An agreement that if the subordinated creditor receives any payment in part satisfaction of its subordinated debt it will hold the monies on trust for senior creditors.

2) An agreement which expresses the subordinated creditor's right to repayment as being contingent on the satisfaction of conditions.

3) An agreement containing a provision precluding the subordinated creditor from proving in the insolvency of the debtor until all other creditors have been paid.

Lewison LJ accepted the argument that the subordinated debt was a contingent debt as the subordination agreement itself provided that repayment was not due until certain conditions had been satisfied.

Statutory Interest

It was noted that statutory interest may be payable in an administration or in a liquidation. The relevant rule in administration is **rule 2.88(7)** which provides:

> "…any surplus remaining after payment of the debts proved shall, before being applied for any other purpose, be applied in paying interest on those debts in respect of the periods during which they have been outstanding since the company entered administration."

In liquidation the relevant provision is **Section 189(2)** which provides:

> "Any surplus remaining after the payment of the debts proved in a winding up shall, before being applied for any other purpose, be applied in paying interest on those debts in respect of the periods during which they have been outstanding since the company went into liquidation."

As statutory interest is payable because of **rule 2.88** it therefore forms part of the insolvency code. The repayment of the subordinated debt is postponed to the payment of the statutory interest. The next question was whether the subordinated debt was also ranked after the payment of non-provable liabilities. On this question the court held that the subordinated debt is repayable on contingencies that include payment of statutory interest and non-provable liabilities before the subordinated debt is repaid.

Foreign Exchange Losses

A further ground of appeal was that many of LBIE's creditors were owed debts payable in foreign currencies. As the result of foreign exchange movements, foreign currency creditors suffered losses incurred from the date of conversion of their claim into sterling and the actual date of payment of dividends. The question the court was asked to consider was whether those foreign currency creditors could recover that loss. The court upheld the original decision of David Richards J that the currency conversion claims rank as a non-provable debt but disagreed in holding that foreign currency creditors could not claim for losses arising as a result of the decline in the value of sterling between the date of the administration and the date of payment.

Post Administration Interest

Such interest will only be payable where the administrators hold a surplus. The question was whether the right to statutory interest which had accrued during the administration would be lost if the company goes into liquidation. In considering Rule 2.88(7) and s.189(2) of the Insolvency Act 1986 this led to the possibility that interest which accrued in the administration would, where it was followed by a liquidation, potentially fall into a black hole as statutory interest would be payable out of a surplus only from the date of liquidation. It was recognised that this was clearly not what Parliament intended. In the current case, on this point the Court of Appeal overruled the Judge and held that the accrued rights of creditors to receive statutory interest under rule 2.88(7) *"did survive the transmission from administration to liquidation."*

Liability under Section 74 of the Insolvency Act 1986

Section 74 deals with the liability as contributories of present and past members. The court had to consider the extent of any such liability in the case of an unlimited company. On this point Lewison LJ held that the contributories liability under section 74 extends to all liability to the company at all stages of the waterfall. This would encompass all liabilities that are higher up the waterfall. On this point the court upheld the earlier decision of Richards J.

The administrator is entitled to prove the insolvency of a contributory for the contingent liability to answer a call made by a liquidator. The contributory's liability would extend to payment of statutory interest and non-provable debts in addition to the other liabilities detailed in the Insolvency Code.

Comment

- This is an unusual case in that it involves an administration containing such a large surplus.

- It provides clarification that the claims of creditors to statutory interest in administration will not be lost in the event that the company subsequently goes into liquidation.

- This however remains a matter to be clarified by Parliament and ideally will be addressed in the next update of the Insolvency Rules.

- The case also provides a helpful explanation as to the types of subordinated loan agreements that may be encountered and the way in which they should be treated within the Insolvency Code.

- The case examines in detail what constitutes "provable claims" and provides guidance as to the relevant considerations when considering a claim.

COMPANY VOLUNTARY ARRANGEMENT

Oakrock Limited v Travelodge Hotels Limited and others [2015] EWHC 30 (TCC)

Treatment of Landlord's claim in a CVA

Facts

The claimants were in the hospitality business. In 2001 they purchased a hotel in Tunbridge Wells. In 2007 they decided to let the hotel to Travelodge. In November 2007 they entered into a business sale agreement which granted a 35 year lease of the hotel to Travelodge. In return Travelodge carried out refurbishment work at the hotel. The claimant would fund the work up to a limit of £1.8M. That investment would be "rentalised" at 7%. For each £100,000 the claimant put in the rent would be increased by £7,000.

The claimant claimed that the refurbishment work was not carried out properly and brought claims against Travelodge. As part of the claim they alleged that Travelodge significantly overcharged for the work carried out at the hotel.

Travelodge Group had found itself in serious financial difficulties in 2012 and as a result of this put forward a proposal for a CVA which was entered into on 5th September 2012. The hotels within the Travelodge Group were banded into categories. The strongest hotels were classed as Category 1 and they received the full amount of the rent due during the course of the CVA. Less successful hotels were branded as Category 2 and were subject to a 25% rent reduction.

The claimant's hotel was in Category 2. The claimants had visited the hotel and found that it was in extremely poor state. They contended that had the hotel been properly refurbished it would have been in Category 1 and therefore there would have been no reduction in the rent payable under the CVA. Alternatively, under the terms of the CVA the landlord had the right to give notice terminating the lease thereby enabling them to re-let the hotel for a rent greater than that payable under the terms of the CVA.

Travelodge responded by seeking summary judgment in respect of the claims on the grounds that the claims were misconceived because they were bound under the terms of the CVA.

The terms of the CVA sought to compromise any "liability" arising under a Category 2 lease during the rent concession period.

Decision

Edwards-Stuart J first of all considered the wording of the CVA and held that the claim for the 25% rent loss during the rent concession period was compromised by the terms of the CVA and therefore the claimant had no claim in this respect.

On the question of the consequences flowing from the claimant giving notice to terminate the lease in accordance with the terms of the CVA it was held that that claim was not compromised by the terms of the CVA as following termination of the lease there could no longer be said to be any liability arising under it. Therefore that claim was not excluded by the terms of the CVA because the liability arose out of the breach of the original business sale agreement, and not the lease. That claim and a further claim in respect of an inventory of items situated at the hotel at the time the business sale agreement was entered into could not be determined by summary judgment and therefore the Travelodge's claim would fail in those respects.

Comment

- This case once again demonstrates the effectiveness of a CVA being entered into which if approved reduces the rent payable in respect of certain properties occupied by the company debtor.

- It also shows that notwithstanding the extensive wording used in a CVA it was not effective to mop up all other possible claims that may result from the occupation of the commercial property by the debtor.

GENERAL

Myers v Kestrel Acquisitions Limited [2015] EWHC 916 (Ch)

Can the prospect of restructuring be taken into account for balance sheet solvency?

Facts

Mr. and Mrs. Myers had built up a sub-prime lending business which traded under the title of Swift. In May 2004 Mr. and Mrs. Myers agreed to sell the entire issued share capital of Swift to Alchemy Partners LLP operating through Kestrel Acquisitions Limited ("Kestrel"). The total sale consideration was £85 million of which the Myers received £79.67 million in cash. Just over £5 million of the consideration was left outstanding on vendor loan notes The vendor loan notes (VLN's) carried interest at 12% compounded and were due to be redeemed in May 2010.

Following the global financial crisis, Kestrel made a number of amendments to the conditions applying to the VLN's which had the effect of subordinating the VLN's to further loan notes that were issued and postponed the redemption date from 2010 to 2018.

Mr. and Mrs. Myers challenged the ability of Kestrel to amend the terms of the loan notes and argued that any modification of the terms should have been carried out in good faith which would have meant having regard to the interests of both the Myers as holders of the VLN's and the holders of other loan notes equally.

The Myers further contended that following the issue of further loan notes and the subordination of the VLN's there was no real prospect that they would ever be repaid. The financial burdens now facing Swift meant that insolvency was rendered inevitable.

The Myers further claimed that Kestrel was now unable to pay its debts within the meaning of **Section 123** of the **Insolvency Act 1986** ("s.123") and was therefore insolvent. The terms of the loan notes provided that "if any group company" (which included Kestrel) shall be unable to pay its debts within the meaning of s. 123 of the Insolvency Act 1986" this would entitle the holder of the VLN to call for immediate repayment. The Myers sought a declaration that Kestrel was insolvent within the meaning of s123.

For Kestrel it was argued that the amendments were valid and that the company was not insolvent as it was planning to restructure its debt before the VLN's became repayable in 2018. It contended that it was therefore not insolvent within the meaning of s123.

Decision

The matter was heard before Sir William Blackburne who first considered the question of whether or not Kestrel was able to modify the terms of the VLN's in the way in which it had. He observed that the court must look objectively at the intention of the parties and that it should avoid applying additional provisions which would have the effect of placing either of the parties in a better position than they had originally bargained for.

The documentation relating to the issue of the VLN's was extensive and the Judge concluded that had it been intended by the parties that a provision implying good faith in the manner in which the Myers contended should be included then it would have been included in the documentation. The Judge therefore held that the court would not imply a term of good faith and that in any event such a provision would not operate in the manner that the Myers claimed to act in the interests of all of the holders of the various class of loan note as though they were one class. The amendments to the terms of the loan notes which had the effect of subordinating the VLN's and postponing their redemption date to 2018 were validly made.

As to insolvency the court referred to the Supreme Court Decision in **BNY Corporate Trustee Services Ltd v Eurosail-UK 2007 [2013] UKSC 28**. **Section 123** contains a two part test the first being the cash flow test.

Cash Flow Test

In **Eurosail** it considered the expression "debts as they fall due". Lord Walker SCJ stated:

> "…the 'cash-flow' test is concerned, not simply with the petitioner's own presently-due debt, nor only with other presently-due debt owed by the company, but also with debts falling due from time to time in the reasonably near future. What is the reasonably near future, for this purpose, will depend on all the circumstances, but especially the nature of the company's business…The express reference to assets and liabilities is in my view a practical recognition that once the court has to move beyond the reasonably near future (the length of which depends, again, on all the circumstances) any attempt to apply a cash-flow test will become completely speculative, and a comparison of present assets with present and future liabilities (discounted for contingencies and deferment) becomes the only sensible test. But it is still very far from an exact test, and the burden of proof must be on the party which asserts balance-sheet insolvency…"

On the cash flow test the Judge concluded that the Myers had not demonstrated that Kestrel was unable to pay its presently due debts at any time or was unlikely to pay debts falling due within the reasonably near future.

Balance Sheet Test

As to balance sheet insolvency the burden of proof was on the Myers to establish this. Consideration of this element of the test was made easier by the fact that the defendants acknowledged that it would be necessary to reconstruct the company to meet their liabilities as they mature in 2018. The Judge explained that the question the court had to consider was whether and in what manner the court may take account of a future restructuring of Kestrel's liabilities.

Again the Judge referred to Lord Walker in **Eurosail** in which he stated:

> "Essentially, s123(2) requires the court to make a judgment whether it has been established that, looking at the company's assets and making proper allowances for its prospective and contingent liabilities, it cannot reasonably be expected to be able to meet those liabilities. If so, it will be deemed insolvent although it is currently able to pay its debts as they fall due. The more distant the liabilities, the harder this will be to establish."

In conclusion the Judge noted that Kestrel's liabilities currently greatly exceeded its assets and there was a likelihood the deficiency would increase as each month passes up until the maturity date of the VLN's. It had been conceded that a restructure of some kind would be necessary to restore Kestrel to solvency, the details of the restructuring were unknown. As a consequence the Judge declined to declare that Kestrel was solvent and confirmed that the Myers had discharged the onus on them to demonstrate balance sheet insolvency. As such they were entitled to a declaration that Kestrel was insolvent thereby triggering the term of the VLN's which provided for them to become immediately repayable in full.

Comment

- This case once again confirms the importance of the decision in **Eurosail** in deciding whether or not either of the two tests in **s123** are satisfied.

- In determining whether or not a company is balance sheet insolvent, the mere prospect or hope of a restructuring will not be sufficient to restore solvency.

- The court will only be likely to take into account the effect of a future restructuring on the solvency of a company where clear and detailed plans have already been put in place and there is evidence that the key stakeholders are agreeable and committed to such a restructuring.

LIMITED LIABILITY PARTNERSHIP

Williams v The Law Society [2015] EWHC 2302 (Ch)

A Solicitor's Practice and the Statutory Trust

Facts

This was an application by a solicitor, Mr. Williams, who applied to enforce the terms of a consent order entered into with the Solicitors Regulation Authority (SRA) providing for certain sums received by the SRA from the Legal Aid Agency to be paid to Mr. Williams.

Mr. Williams had been in practice as a solicitor in a partnership with a Mr. Lillywhite. With effect from 1 February 2014 they converted the partnership to an LLP of which they were the sole members.

On 28 October 2014 the SRA resolved to intervene in the practice of the LLP and another practice, Nationwide Solicitors LLP and also in the individual practices of Mr. Williams and Mr. Lillywhite.

On 4 November 2014 Mr. Williams issued an application for an order that the intervention be withdrawn. That resulted in a consent order being made which withdrew the intervention with regard to Mr. Williams' practice and lifted the automatic suspension of his practising certificate. It had no effect on the intervention in the other practices.

Following the resolution being passed to intervene the provisions of Paragraph 6 of Part II of Schedule 1 of the **Solicitors Act 1974** applied. It provides:

> "6(1)……if the Society passes a resolution to the effect that any sums of money to which this paragraph applies, and the right to recover or receive them, shall vest in the Society, all such sums shall vest accordingly (whether they are received by the person holding them before or after the Society's resolution) and shall be held by the Society on trust to exercise in relation to them the powers confirmed by this part of the Schedule and subject thereto and to the rules under paragraph 6B upon trust for the persons beneficially entitled to them."

Subsection 2 of the paragraph continues:

> "(2) This paragraph applies - (a) where the powers conferred by this paragraph are exercisable by virtue of paragraph I to all sums of money held by or on behalf of the solicitor or his firm in connection with –
>
> > (i) <u>his</u> practice or <u>former</u> practice,
> >
> > (ii) any trust of which he is or formerly was a trustee, or
> >
> > (iii) any trust of which a person who is or was an employee of the solicitor is or was a trustee in the person's capacity as such an employee;..."

The trust referred to in paragraph 6B is referred to as "the statutory trust". The rules referred to are the **Intervention Powers (Statutory trust) Rules 2011**. Those rules require the SRA to identify and, subject to verification, distribute to all persons who have a potential beneficial interest in them the monies held in the statutory trust accounts for which they provide.

The issue the court had to consider was the scope of the statutory trust and in particular whether or not it extended to monies which could be shown to belong to the practice when it was conducted in the name of the partnership. Mr. Williams claimed that those monies were not caught by the statutory trust whilst the SRA maintained that they were.

The SRA following the intervention had received a payment from the Legal Aid Agency in the sum of £62,826. Mr. Williams claimed that those monies related to the partnership and therefore he was entitled to them. He wrote to the SRA requesting that sum be paid to him. The SRA responded by asking him to provide evidence in support of his claims. However before providing a response to the SRA's letter Mr. Williams issued the current application.

Before the application was heard the SRA reached terms whereby it was agreed that a sum of £22,552 would be paid to Mr. Williams and that a further payment of £22,108 would also be released to him. There was some delay on the part of the SRA in reaching agreement with regard to the latter sum as it was concerned that the Legal Aid Agency may seek to recover part of the monies that it had paid over to the SRA. The reason for this was that the partnership operated under a franchise agreement. Following the conversion of the partnership into the LLP, the franchise agreement was never transferred to the LLP. It was also noted that on the transfer to the LLP the partnership ceased to have any professional indemnity insurance.

During the course of submissions it was noted that Mr. Williams had suffered the draconian consequences of an intervention which can result in:

(a) A loss of control of practice monies and documents

(b) Suspension of the Solicitor's Practising Certificate

(c) The solicitor becomes instantly unemployable

(d) The costs of intervention are to be paid by the solicitor and are recoverable as a debt.

A further concern was the reference in **Regulation 6(2)** to *"former practice"*. The Judge expressed concern that the reference to former practice could automatically catch and vest in the SRA practice monies held in connection with other practices from which the solicitor in question had moved and in some cases had no doubt had long moved prior to the intervention into the practice named in the resolution. It was recognised that this would cause significant practical complications.

Decision

The Judge considered that the key to the matter was to understand what is meant by the expression "practice". In this context it means the activities of the solicitor or authorised body so far as carried out in that capacity

The Judge concluded that the Legal Aid monies insofar as they were attributable to the activities of Mr. Williams (as deriving from his "practice") while a member of the partnership fell within the scope of the statutory trust imposed by paragraph 6(1) as being sums held by or on behalf of the solicitor or his firm (or the recognised body) in connection with his (or its) practice or former practice.

The Judge acknowledged that in argument it had been explained that the statutory trust only operates in respect of monies held by the Solicitor or his firm in connection with that solicitor's practice or former practice. All other monies held by the former firm are untouched by the statutory trust.

Comment

- Whilst vesting only takes place following the Society passing a resolution to intervene, the effect of the resolution is retrospective.

- The SRA's position is that it also applies to work in progress despite the fact that until realised it would not ordinarily be a sum of money. Following intervention the intervening solicitor or his trustee/liquidator/administrator retains the right to recover practice debts. The effect of paragraph 6 would be to vest any sums actually recovered in the SRA. In **Dooley v The Law Society [2001**] Lightman J confirmed that an intervened solicitor could take action to recover costs but then stated that:

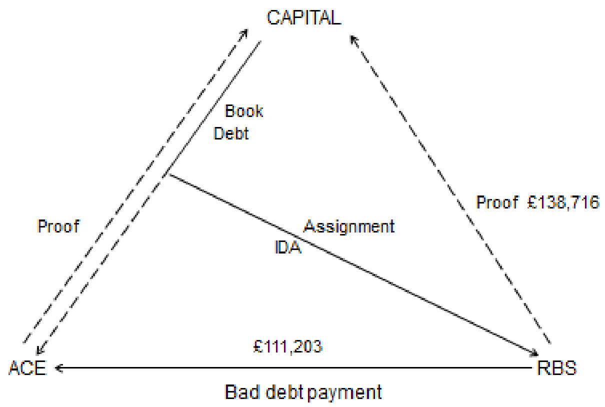
  "First, any recovery automatically vests in the Society. Second implicit in the statutory scheme a solicitor is precluded from any dealing with the debts before payment which operates to evade or undermine the scheme and protection intended to be afforded to clients and the Society."

- As an insolvency practitioner seeking an appointment in respect of a solicitor's practice, careful consideration should be given to the risk of a subsequent intervention and the effect that it may have on the way in which the assets and liabilities of the practice are dealt with.

LIQUIDATION

Ace Paper Limited v Fry and Hudson [2015] EWHC 1647 (Ch)

Whether a proof of debt had been assigned following termination of invoice discounting agreement



Facts

This was an appeal from an earlier decision of Deputy Registrar Garwood who refused the application of the Appellant (Ace Paper Limited ("Ace")) made under **Rule 4.83** of the **Insolvency Rules 1986** to set aside the decision of the joint liquidators of Capital Print & Display Limited ("Capital"), to reject Ace's proof of debt for £138,716. Ace and the Third Respondent RBS Invoice Finance Limited ("RBS") were parties to an invoice discounting agreement ("IDA"). Ace assigned all the debts to RBS who in turn made payments to Ace. Included amongst the invoices were debts due from Capital to Ace.

Capital went into administration on 26 June 2008 and subsequently went into creditors' voluntary liquidation on 12 March 2009.

The terms of the IDA contained bad debt provisions which enabled Ace to claim against RBS in respect of bad debts where there had been an insolvency event. Ace duly made a claim against RBS in respect of the debt due from Capital. On 26 August 2008 RBS paid out £111,203 to Ace being the total debt subject to certain deductions.

Previously on 31 July 2008 Ace had informed RBS that it had a retention of title claim in respect of goods supplied to Capital and that it had recovered goods supplied to Capital and had been able to realise the sum of £19,361. Ace had never accounted to RBS for that amount.

On 11 August 2008 RBS submitted a proof of debt in respect of the debt due from Capital to Ace by reason of an assignment of the debt by Ace to RBS totalling £138,716. On 15 August 2008 Ace confirmed that it had assigned the Capital debt to RBS. In 2011 discussions were entered into between RBS and Ace as to the termination of the IDA as this was no longer necessary as Ace no longer had any active customers. There followed an exchange of letters to enable the facility to be cancelled. Before that exchange on 1 April 2011 Ace had filed a proof of debt in respect of the Capital debt with the liquidators of Capital. This was the case even though it had not yet acquired the claim back from RBS.

On 5 June 2013 the joint liquidators of Capital rejected Ace's claim in respect of the Capital debt. The reason given was that in making the claim Ace was relying on its interpretation of a letter dated 12 July 2011 as effecting a re-assignment of the Capital debt by RBS to Ace. Following rejection of the proof of debt an application was made to Deputy Registrar Garwood whose decision to reject Ace's proof was the subject of this appeal.

The joint liquidators of Capital accepted RBS's claim in respect of the Capital Debt

On appeal the issue was whether or not the letter of 12 July 2011 ("the Letter") had been correctly construed. The letter in question was a short reply to an earlier letter:

> *"Dear Claire*
>
> ***Ace Paper Limited – Invoice Discounting Agreement dated 4 January 2008***
>
> *Many thanks for your letter of 5 July 2011 re the termination of the above agreement.*
>
> *So that we can close this matter down, could you please kindly sign above 'Agreed' below and fax back to me on 020 8447 4241, your confirmation for our records (and those of our auditors) that:-*
>
> - *Ace has discharged all its obligations to RBSIF under the Agreement.*
> - *RBSIF has no existing or prospective claims against Ace or against Paperun (the guarantor) either arising under or incidental to the Agreement and insofar as any such claims against Ace or any third party do exist or may arise in the future, such claims are hereby waived and released and transferred/re-transferred to Ace.*
> - *RBSIF will co-operate in removing any charge in connection with Ace Paper from the Companies Register.*
>
> *Many thanks for your help on this matter."*

Decision

The starting point is that the purpose of contractual construction or interpretation is to determine the objective common intention of the parties. Their subjective intentions in entering into the contract are irrelevant to the process of construction. Evidence of the pre-contractual negotiations of the parties was also irrelevant, other than to the limited extent that such negotiations illuminate the context of background facts in which the contract must be read.

Ace maintained that the Letter effected a re-assignment to Ace of the Capital debt. This was disputed by RBS. Having examined the wording of the Letter in detail, the Deputy Judge concluded that the language used, read as a whole, was ambiguous and required further interpretation.

Whilst Ace considered the language sufficient to assign the debt back to it, RBS's case was that the reference to "any such claims" is limited to Ace or Paperun. The Deputy Judge did not consider that argument to be sustainable. However RBS's secondary case was that "any such claims against…..any third party….." refers to claims of RBS against a third party that were originally customer claims of Ace assigned to RBS by the IDA which RBS has not paid Ace under the bad debt provisions.

The Deputy Judge concluded that RBS's secondary case was more consistent with business common sense. He observed that it was counterintuitive, to say the least, that RBS should re-assign to Ace the benefit of a debt in relation to which it had paid Ace the full value particularly in circumstances where Ace had also recovered additional value for goods supplied under retention of title in respect of which they had not accounted to RBS.

The re-assignment of the debt by RBS to Ace where it had already received more than full value would have required much clearer words than were used in the Letter.

As a result the appeal was dismissed.

Comment

- This decision demonstrates the operation of rules 4.82 and rule 4.83 of the Insolvency Rules 1986. When rejecting a proof of debt, it is important that the liquidator sets out clearly in his statement the reasons for doing so.

- Any creditor who is dissatisfied with the liquidator's decision to reject his proof must apply within 21 days of receiving the statement with reasons for rejection.

- Rule 4.76 enables the liquidator to call for the production of any documentary or other evidence he may require to assist for the purpose of clarifying or substantiating the whole or any part of a creditor's claim.

- Rule 4.78 provides that the creditor shall bear the costs of proving his own debt.

- Rule 4.83(6) of the Insolvency Rules 1986 provides that neither the Official Receiver or the liquidator shall be personally liable for the costs incurred with any application under rule 4.83 unless the court makes an order to that effect.

LIQUIDATION

Green V Eltai [2015] BPIR 24 ChD

Did the company own a property registered in a director's sole name?

Facts

18 March 2008	Dr. Mohsin ("Dr. Mohsin") makes employment tribunal claim
9 May 2008	Units 1 & 2 Freetrade House Lowther Road Stanmore HA7 1EP ("the Property") purchased
23 July 2009	Award by employment tribunal to Dr. Mohsin of £62,000
23 April 2010	Petition to wind up presented
14 July 2010	Al Fayhaa Mass Media Limited – Compulsory Liquidation

Claims were brought by the liquidator of Al Fayhaa Mass Media Limited (In Liquidation) ("the Company") against its sole director and shareholder for the following relief:

1. That the Property whilst purchased in the name of the director was beneficially owned by the Company.

2. That the re-payment of the director's loan to enable the Property to be purchased was a preference contrary to **S239** of the **Insolvency Act 1986**

3. That the director in repaying the loan to him and purchasing the Property acted in breach of his duties to the Company.

On 9 May 2008 the Property was purchased for the sum of £300,000 and registered in the name of the director. All monies relating to the purchase were paid from a bank account belonging to the Company. The director maintained that he had repaid his director's loan account to the Company in purchasing the Property.

In support of the liquidator's claim the liquidator relied on the Company's accounts for the year ending 31 July 2008 which contained a note as follows:

> *"4. Investment Long Term. The company bought office for £305,000 but the Dead [sic] registered in the directors name" ('Note 4').*

In the director's defence it was pointed out that

a. The Property was not included as a Company asset in the balance sheet for the accounts 31 July 2008 year end.

b. The same accounts were prepared showing that a sum equivalent to the purchase monies was treated as repayment of part of the director's loan account

c. Note 4 does not refer to any specific entry in those accounts and

d. Note 4 was absent from the accounts for the following year ending 31 July 2009.

The liquidator further claimed that the repayment of the director's loan account in order to provide monies to purchase the Property constituted a preference in breach of **s239** of the **Insolvency Act 1986**. It was claimed that at the time of the repayment the Company was insolvent and that it took place at a relevant time i.e, within 2 years of the onset of insolvency. The Tribunal claim having been commenced on 18 March 2008 resulted in an award of £62,000 being made on 23 July 2009. The liquidator contended that the balance sheet as at 31 July 2008 did not include the contingent liability owed to Dr. Mohsin.

Decision

Beneficial ownership of the Property

At the time of the purchase of the Property the respondent's director's loan account was in credit by more than the amount of the purchase price. All the conveyancing documents referred to the director as the purchaser of the Property and not the Company. There was no documentation to indicate that the Company was the beneficial owner other than the reference to Note 4 referred to above. The Registrar concluded that even taking into account Note 4 of the Company's accounts, there remained inconsistencies in so far as the Property was not recorded as an asset of the Company. The accounts reflected the fact that the director's loan account had been repaid. If the Company had become the beneficial owner of the Property then the Property would have been added to the Company's balance sheet. The Registrar held that the director was the legal and beneficial owner of the Property.

Preference

The Registrar concluded that the director was one of the Company's creditors and that the repayment of the director's loan in the sum of £285,000 was in the two years ending with the onset of insolvency. In order to establish a preference the repayment must have been at a relevant time, i.e, that the Company was unable to pay it's debts within the meaning of **s123** of the **Insolvency Act 1986**. The accounts for the Company year ending 30 April 2008 should have included the contingent claim of Dr. Mohsin.

In deciding whether or not the Company was balance sheet insolvent the court referred to the decision in **BNY Corporate Trustee Services Ltd v Eurosail UK 2007-3BL plc [2013] UKSC 28.** Applying Eurosail it was apparent that the Company was at all material times balance sheet insolvent.

Further it was held that for the purposes of **s239** the effect of the repayment of the £285,000 was to put the respondent in a better position than he would otherwise been had the Company gone into insolvent liquidation.

On the remaining elements that were required to be satisfied, namely that the decision to repay was influenced by the desire to produce the result set out in **s239(4)(b)** of the Act the Registrar referred to the decision of **Re MC Bacon** in which it was stated

> *"intention is objective desire is subjective. A man can choose the lesser of two evils without desiring either."*

A desire may be established by direct evidence or be inferred from the circumstances of the case. The Registrar found that the relevant date is the date of the decision to actually repay the loan i.e, when the Company decided to repay the loan.

Although there were no board minutes or any other documentation to support the date on which it was decided to repay the loan, the Registrar concluded that it should be taken from the date of the banker's draft used to purchase the Property i.e, 30 April 2008.

The respondent being a connected party therefore had to rebut the presumption that he was influenced by the necessary desire. The Registrar noted that the demand for repayment was after Dr. Mohsin's dismissal as an employee and after he had commenced the employment tribunal proceedings. The decision was at a time when the Company was balance sheet insolvent.

The director's position was that he thought the Tribunal Claim was of no merit, albeit that turned out to be incorrect. The Registrar concluded that the director was influenced by commercial reasons i.e, the provision of the premises which the Company was subsequently allowed to occupy rent free and not by Dr. Mohsin's claim which he considered to have no merit. The director reached his decision because repayment had been demanded and the purchase of the Property would benefit the Company and its future trading. The Registrar was satisfied they were genuinely held reasons and therefore the director had rebutted the presumption of desire on the balance of probability and the preference claim therefore failed.

As to the alleged breach of duty this involved consideration of the director's state of mind asking whether the director honestly believed his decision was in the interests of the creditors. Whilst it was clear that the respondent did not take into account Dr. Mohsin's contingent claim, on the evidence it was not a breach of duty when the Company would gain a benefit from being able to occupy the Property rent free.

Comment

- In establishing the necessary desire element in support of a preference claim under S239 it is a subjective test in order to establish the reasons of the party making the decision to repay the debt.

- Whilst it is usual to place a high degree of reliance on company accounts in pursuing such claims and directors loan account claims, it cannot be assumed that this will be conclusive in proving such claims.

LIQUIDATION

Hedger v Adams [2015] EWHC 2540 (Ch)

Liquidator's claim for breach of duty and misfeasance against director

Facts

The liquidator of Pro4Sport Limited ("Pro4Sport") issued a claim under **s212** of the **Insolvency Act 1986** against Mr. Adams the former director and majority shareholder of Pro4Sport. The claim arose out of the sale of the company's assets shortly before the company went into liquidation and the failure of the purchaser to pay all of the instalments of the deferred consideration. The sale took place on 25 June 2012 and Pro4Sport went into liquidation on 20 July 2012.

All of the assets included in the sale were transferred to another company called Pro4Sport.co.uk Ltd ("Pro4Sport.co.uk") for a deferred consideration of £47,000 plus VAT of £9,400. Mr. Adams was the majority shareholder and director of Pro4Sport.co.uk. Following the liquidator's appointment the liquidator adopted the contract for sale and agreed a payment schedule with the purchaser. Payments were then made by instalments over a period of time until they eventually stopped. The total amount paid was £35,910 against a total price of £56,400. The proceedings brought by the liquidator were to recover the sum of £20,490 that was outstanding.

The liquidator's claim was to recover that loss from the director personally. This was based on the liquidator's claim that the director was in breach of his duties under the **Companies Act 2006**.

Pro4Sport had been incorporated on 23 April 2007 and sold high-end sports clothing footwear and equipment on the internet. In the first three years of trading the turnover increased to £1.9 million with only a nominal profit margin. It was trading in a very competitive market. At the beginning of 2012 key suppliers reduced their credit facility which had a dramatic effect on cash-flow. More significantly EBay and Paypal suspended the company's account.

In May 2012 the director consulted the liquidator's company concerning the company's financial position. He was advised of several possible courses open to him which included a sale of the assets by Pro4Sport to Pro4Sport.co.uk. Other options included a sale by the liquidator of the assets as a going concern or a sale by the liquidator of the assets in the open market at auction. The director was at this time advised to obtain a valuation of the assets which he authorised the liquidator's firm to obtain on his behalf. The valuation was obtained and it provided a range of different figures depending on the method of realisation chosen.

In the proceedings it was noted that the valuation for goodwill would only apply if it was sold as a going concern and that there was unlikely to be any goodwill in the name as Pro4Sport.co.uk had a very similar name and had been trading since 2008. Although the valuation indicated that goodwill could be achieved at a figure of £15,000 the Judge concluded that a figure of £5,000 in the event of sale as a going concern would have been generous to the liquidator.

The sale agreement was very brief and consisted of an invoice. The invoice contained 5 clauses which included a provision requiring the purchaser to deliver up any stock affected by ROT and concluded by retaining title to the vendor until the monies had been paid in full.

It was established that the invoice had been drafted by the liquidator's firm and whilst it did not refer to payment of the consideration by instalments a schedule was agreed between the parties at a later date. The sale agreement did not provide for any personal guarantee by the director on behalf of Pro4Sport.co.uk. The assets had not been marketed before the transaction was entered into. After the sale had been agreed, the first instalment was received two days before the creditors meeting and on the appointment of the liquidator the contract was adopted by the liquidator.

The liquidator's claim alleged breach of duty under **s172** of the **Companies Act 2006**. That sets out the obligations on a director and includes:

> "(1) A director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole, and in doing so have regard (amongst other matters) to……"

The liquidator further claimed under **s174** of the **Companies Act 2006** which provides that:

> 174 Duty to exercise reasonable care, skill and diligence……

The liquidator also claimed that the sale of assets was a substantial property transaction in contravention of **s190, 191** and **195** of the **Companies Act 2006**. **S190** provides:

> "**190 Substantial property transactions: requirement of members' approval**
>
> (1) A company may not enter into an arrangement under which--
>
> (a) a director of the company or of its holding company, or a person connected with such a director, acquires or is to acquire from the company (directly or indirectly) a substantial non-cash asset, or
>
> (b) the company acquires or is to acquire a substantial non-cash asset (directly or indirectly) from such a director or a person so connected,
>
> unless the arrangement has been approved by a resolution of the members of the company or is conditional on such approval being obtained."

"Substantial" for the purposes of the section means that the value of the assets exceeds 10% of the company's asset value and is more than £5,000 or it exceeds £100,000.

Where a transaction is in contravention of s190 the transaction is voidable at the instance of the company and the directors concerned are liable:

> "(a) To account to the company for any gain………
>
> (b) (jointly and severally with any other person so liable under this section) to indemnify the company for any loss or damage resulting from the arrangement or transaction."

s195(6) provides a form of defence in that:

> "(6) In the case of an arrangement entered into by a company in contravention of section 190 with a person connected with a director of the company or of its holding company, that director is not liable by virtue of subsection (4)(c) if he shows that he took all reasonable steps to secure the company's compliance with that section."

Decision

His Honour Judge Behrens first of all considered the alleged breach of duty under **s172** of the **Companies Act 2006**. He noted that Pro4Sport was insolvent in June 2012 at the time of the transaction and that there was a duty owed to the creditors at that time. That duty is a duty imposed on the directors to act bona fide in the interests of the company. It is a subjective duty. The question is whether the director honestly believed that his act or omission was in the interests of the company. The issue is as to the director's state of mind.

In an earlier case of **Re HLC Environmental Projects Limited (in liquidation) [2013] EWHC 2876 (Ch)** it was held that in considering the interests of creditors, their interests must be considered as "paramount".

The Judge concluded that the director had considered the interests of creditors and that he had considered the contract to be in their best interests. The reason being that it avoided the costs of sale and that prior to entering into the transaction he had checked with two main suppliers who were also significant creditors that they would be prepared to continue supplies to Pro4Sport.co.uk. In addition the liquidator took no steps to avoid the contract. Accordingly it was held that the **s172** claim failed.

On the alleged breach of duty under **s174** of the **Companies Act 2006** it was found that the director had not been asked to provide a personal guarantee. A sale with deferred consideration carried a risk of default. The director had contacted two major suppliers to assess the risk and the ability of Pro4Sport.co.uk to continue trading. The agreement had been drawn up by the liquidator's firm and had been entered into on their advice. As such the court concluded that there was no breach of duty under **s174**.

In considering the transaction as a substantial property transaction, it was noted that there was a difference in the remedies available for breach of **s190** of the **Companies Act 2006** and **s212** of the **Insolvency Act 1986**. There was no evidence of any gain made by the director as a result of the transaction and further the director argued that he was under the belief that the shareholders had consented to the transaction. The Judge commented that had the case been pleaded more clearly the defence under **s195(6)** of the **Companies Act 2006** may have been available to the director. Taking into account the above, the Judge concluded that it was not proportionate to determine any claim under **s190** of the **Companies Act 2006**.

The director had claimed relief under **s1157** of **Companies Act 2006**. The Judge held that had the director been found to be in breach of his duties he would have granted relief under that provision to the director. In order to obtain relief the director would have had to establish that:

i. he acted honestly
ii. that he acted reasonably and,
iii. that having regard to all the circumstances he ought fairly to be excused

The court held that the director was acting both honestly and reasonably in entering into the transaction and that he was acting on the advice of the proposed liquidator. Had he been in breach he would have been excused.

Although the director was found not to be liable, the court did consider the question of loss in the event that the director had been unsuccessful in his defence.

The liquidator's loss would have been the difference between the amount the liquidator would have received if he had sold the assets and the amount that he actually received. The court concluded that in view of the various factors including the fact that Ebay and Paypal had closed down the trading platform the prospects of the liquidator achieving a sale as a going concern were minimal. In addition to this there would have to be an allowance made for costs.

Applying the above the Judge concluded that the amount the liquidator would have received would have been £32,400 against the figure of £35,910 which was actually received. His loss was therefore nil.

The application was dismissed.

Comment

- The court expressed concern over the relatively small size of the claim and the question of proportionality.

- The fact that the proposed liquidator had drafted the sale agreement and adopted the transaction effectively meant that he accepted the risk that without a personal guarantee the deferred consideration might not be received in full.

- It was significant that the director in contacting his suppliers/creditors had taken into account the interests of creditors when considering a sale of the company's assets at a time when the company was insolvent.

LIQUIDATION

Stevensdrake Ltd v Hunt [2015] EWHC 1527 (Ch)

Personal liability of liquidator under conditional fee agreement

Facts

This was an appeal from an earlier decision granting summary judgment in favour of a firm of solicitors against the liquidator for the payment of Counsel's fees.

The solicitors had originally sued the liquidator in his personal name "*as liquidator of Sunbow Limited ("Sunbow")* then as *Griffins (a firm)*". Judge Purle commenting on the various descriptions for the three defendants said that describing him as "liquidator of Sunbow Limited" does not turn him into a different person or affect or limit his liability. Further it would not be right to equate him with Sunbow Limited just because he is the liquidator. Sunbow is not a party. Sunbow Limited was in compulsory liquidation and the appointment of Mr. Hunt as liquidator was a personal appointment.

The proceedings arose out of litigation pursued by Mr. Hunt as Sunbow's liquidator. The solicitors pursued proceedings under **s.212** of the **Insolvency Act 1986** against the former administrators of Sunbow. The work was undertaken under a Conditional Fee Agreement ("CFA"), and the claim was successful in that

(a) The first defendant Mr. Simon settled and agreed to pay the sum of £125,000.

(b) The second defendant Mr. Papanicola settled but did not pay the £1.9 million as agreed.

The outcome was nevertheless a "success within the terms of the CFA".

The solicitors under the CFA were entitled to a success fee of 100%. Their bill of costs came to a figure of just under £1 million.

The liquidator in response to the claim for the recovery of the solicitors' costs claimed that the solicitors were only entitled to payment from recoveries made. They further argued that counsel's CFA was on a like basis, that is to say recoveries based.

In the meantime counsel had pursued the solicitors for recovery of counsel's fees and it was noted that the obligation on the solicitors to pay counsel did not have any recovery based provision in the agreement between the solicitors and counsel. The solicitors eventually settled with counsel and sought to recover counsel's fees from the liquidator.

During the course of the proceedings the liquidator alleged that he had reached a settlement agreement with counsel's clerk on behalf of counsel to the effect that counsel would only be paid out of recoveries. That argument was not pursued.

The CFA agreement between the solicitor and the liquidator contained some key provisions including the following:

> *"You are personally responsible for any payments that you may have to make under this agreement. Those payments are not limited by reference to the funds available in the liquidation".*

For the liquidator it was argued that he was not personally liable and that any liability would be the liability of the company payable in the insolvency in the order of priority set out in the Insolvency Rules.

The liquidator also counterclaimed against the solicitors alleging negligence, breach of fiduciary duty and an allegation of undue influence arising out of the fact that in entering into an agreement which imposed personal liability on the liquidator whether he recovered or not was manifestly to his disadvantage.

Decision

Judge Purle considered that the Master was right to give summary judgment in ordering that the liquidator should pay counsel's fees.

He further noted that the Master was plainly unimpressed by the defences advanced and had allowed most of them to proceed on condition of a payment into court of £100,000. Judge Purle ordered that that payment would remain as ordered if the liquidator wished to continue with a defence and counterclaim.

Comment

- It was noted that the expression "the solicitor to the liquidator" is meaningless in the sense that it does not refer to any office that the law recognises, and does not result in personal liability on the part of the liquidator. In this particular case it was the contractual provisions of the CFA that prevailed.

- The case demonstrates that the definition of "success" in a CFA may result in something more disappointing than the term would suggest.

- In seeking to recover their costs the solicitors sued three different parties. The liquidator in person, the liquidator as liquidator of the company, and the liquidator's firm. In doing so that presupposes that the solicitors had a formal retainer with each of the three defendants and had provided legal services to each of them. It is important to be clear as to exactly who the client is to which the services will be provided.

- As a general rule in proceedings brought in the name of the company by a liquidator any adverse order for costs will be made not against the liquidator personally but against the company. There are exceptions in that the court may make orders for costs against non-parties in certain circumstances.

- Where a liquidator brings proceedings in his own name, an adverse order for costs may be made against him in an appropriate case.

- Under **Rule 7.39** of the **Insolvency Rules 1986** where an office holder is made party to any proceedings on the application of another party to the proceedings, he shall not be personally liable for costs unless the court otherwise directs.

LIQUIDATION

Wilson v SMC Properties Limited [2015] EWHC 870 (Ch)

Court validates sale of property post petition – Section 127 of the Insolvency Act 1986

Chronology

17 February 2013	Short-term loan to company for £600,000 from Unitguide Limited (secured)
26 February 2014	HMRC issue winding up petition
6 March 2014	Contract for Sale of property for £850,000 to SMC
4 April 2014	Completion of sale of property to SMC
14 April 2014	Winding up order

Facts

The company operated from a property at 58G Hatton Garden, London EC1N 8LX ("the Property") from where it traded as a scrap gold and silver merchant. The Property had been purchased in 2011 for £1.2 million. On 7 February 2013 the company borrowed £600,000 on a short term loan from Unitguide Limited which was secured over the Property by means of a charge.

On 6 March 2014 the company agreed to sell the Property to SMC for £850,000. The contract for sale having been entered into after the presentation of the petition to wind the company up by HMRC on 26 February 2014. Completion of the sale took place on 4 April 2014 when the proceeds were distributed £631,049 to Unitguide the holder of the secured charge and £217,366 was paid into the personal bank account of the sole director.

Following the appointment of the liquidator, enquiries by the liquidator's staff established that the director of SMC and the solicitors acting for SMC on the purchase of the Property were unaware of the outstanding winding up petition.

Prior to the sale having been agreed, the Property had been marketed at £1.5 million and contracts had been issued to potential purchasers for £1.1 million and £1.3 million. Both of those sales failed to proceed. During the course of the proceedings it was stated that had the company not sold the Property to SMC, Unitguide would have entered possession and would have sought to sell the Property to recover its debt.

The applications before the court were firstly to validate the sale of the Property under **s127** of the **Insolvency Act 1986** ("s127") and alternatively the liquidator sought a declaration that the transaction was void and sought relief against the sole director of the company.

s127 provides that that in a winding up by the court,

> *"any disposition of the company's property made after the commencement of the winding up is void unless the court otherwise orders".*

The court considered the principles behind the section which it identified as the maintenance of the pari passu principle namely that the estate of the insolvent should be distributed rateably among creditors of the same class. The essential purpose of the principle is that by preserving the pari passu distribution of the company's assets it protects the interests of unsecured creditors.

In deciding whether or not to validate a transaction the court has a discretion and in exercising that discretion it carries out a balancing exercise weighing the interests of the general body of creditors against the target transaction under scrutiny. The principles under which the discretion will be exercised were set out in **Denney v John Hudson & Co Ltd [1992] BCLC 901**. They include the following:

(a) The policy underlying s.127 is that the assets of the insolvent should be distributed pari passu among the same class of creditors

(b) There may be situations where it is beneficial for the company and unsecured creditors that dispositions in the closing period are validated to enable the company to continue business in its ordinary course. In making its decision the court should ensure that the interests of unsecured creditors are not prejudiced.

(c) A disposition made in good faith in the ordinary course of business at the time when the parties were unaware that the winding up petition had been presented normally will be validated unless there are grounds for supposing that the payment was intended to prefer the recipient above other unsecured creditors.

(d) Good faith alone is not enough. The court should have regard to the interests of all creditors and not just certain creditors.

Registrar Briggs further added that the court would be slow to validate a transaction where there was a significant reduction in the Company's assets. The further away from value a transaction is or was the less likely it is that the court will find that it was made in good faith.

For SMC it was argued that they had entered into the transaction without knowledge of the petition, in good faith and had purchased the Property for full or near full value. The liquidator's position was that the transaction was not entered into in good faith and was at an undervalue.

Decision

Registrar Briggs heard evidence from the key witnesses. He accepted that the director of SMC and his solicitor were not aware of the presentation of the petition.

The Registrar considered in detail the differing methods of valuing the Property and took into account both its condition, costs of refurbishment and its value as an investment. Having conducted that exercise he stated that he had reached "the conclusion that the appropriate sum is £900,000".

He accepted that had the sums due to Unitguide (the secured creditor) not been repaid by 6th April Unitguide would have entered into possession of the Property and sold the Property.

Registrar Briggs held that SMC had entered into the transaction in good faith and that the sale of the Property at £850,000 meant that the company had in theory (against the value that he had held) suffered a loss of approx. £50,000.

He therefore held that there had been no significant loss to creditors and that the policy behind s.127 had not been undermined. He exercised his discretion to validate the transaction.

Comment

- The outcome of this case depended upon the conclusion reached as to value after having considered various valuation approaches.

- Whilst the Registrar held that there had been no loss to creditors it is not explained in the judgment as to the position with regard to the £217,366 paid to the director's personal bank account after the secured creditor Unitguide had been paid in full. If that money had been returned to the company, then this would explain the Registrar's findings that there was no loss to unsecured creditors.

- The original TR1 signed by the director of the company was subsequently rejected by HM Land Registry as it had not been attested. The document was then later attested by someone at the solicitors acting on behalf of the company's solicitors and then re-submitted. A more detailed explanation would assist in understanding exactly what took place. Nothing further seems to have turned on this point.

- In evidence the director of the purchasing company, a key witness, had to subsequently accept that earlier statements he had made were incorrect as a result of the liquidator obtaining metadata attached to photographs taken by the witness on one of his visits to the Property.