AMB LAW

INSOLVENCY UPDATE

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Welcome to the 11th Edition of **AMB Law's *Insolvency Update***. Now that England's short-lived foray into RWC15 is over we can get back to concentrating on our day jobs. As ever, if you would rather not receive our ***Insolvency Update,*** please email *office@amblaw.co.uk* and we will remove you from the list.

MISCELLANEOUS

New SIP 1

ICAEW, Statement of Insolvency Practice 1

A new Statement of Insolvency Practice 1 comes into force with effect from **1 October** 2015.

Essentially, there are three changes as follows:

- IPs must report to the Insolvency Service or the RPB any breach of relevant law or regulatory provision by a fellow IP;
- IPs must inform creditors as soon as possible that they are bound by a Code of Ethics; and
- IPs must, if asked, tell creditors about any perceived or predicted difficulties that they might have in complying with the fundamental code of conduct in SIP1.

Not convinced about this; it's a bit Orwellian – IPs are professionals and ought to be allowed to exercise their discretion in deciding whether or not to report the conduct of fellow IPs.

New Bona Vacantia Procedure for Mortgagees

BVD Guidelines BVC6

The *Bona Vacantia Department* of the Treasury Solicitor's department (now nattily called *T-Sol)* deals with land and buildings that belonged to a dissolved company and now pass to the Crown following dissolution. Since **1 July 2015**, the BVD has been piloting a new procedure for selling *bona vacantia* land under a mortgagee's power of sale.

Under the new provisions, a mortgagee only needs to notify the BVD if there are going to be surplus funds out of the sale proceeds which would be due to go *bona vacantia* to the Crown.

If, on the other hand, a sale of charged property by a mortgagee were to produce a surplus that would be due to the Crown, the mortgagee must write to the BVD and include:

- The name, company number and registered office of the mortgagor company.
- Office copy entries and title plan for the land.
- A copy of the mortgage deed and a copy of TR2.
- A completion statement.

A minor, esoteric change in the law but it will avoid on of the more pointless processes of obtaining BVD consent for all mortgagee sales of *bona vacantia* property even where the Crown has no tangible interest.

Directors' Dates of Birth

Companies (Disclosure of Date of Birth Information) Regulations 2015

With effect from **10 October 2015** the Registrar will not display directors' dates of birth on the publicly available registers although such information will be available on application to credit reference agencies and others.

More on Balance Sheet Insolvency

Re Kestrel Acquisitions Ltd

The main issue in this case concerned a company's ability unilaterally to amend the terms of loan notes already issued. There was, however, also an interesting side issue concerning the test for balance sheet insolvency.

The company in question was in the throes of a restructuring and the applicants claimed that it was *ipso facto* insolvent (which would have been a triggering event under the terms of the loan notes).

The judge found that a general intention to perform some form of restructuring was not enough to dispel charges of insolvency. There was no concrete restructuring plan available and there was no evidence that a restructuring would actually take place. On this basis it was found that the company was balance sheet insolvency.

This case shows the reasonably high hurdle that a debtor company needs to overcome in such circumstances in order to persuade a court that a restructuring plan will return it to a solvent position.

Principal to a Fraudulent Agent

Credit and Mercantile plc v Wishart

W owned and lived in a property. He was induced by a friend, S, to give a charge over the property to C&M to secure the borrowings of a third party company owned and managed by S.

S then went bankrupt and the company defaulted – C&M issued possession proceedings and sold the property for £1.1m from which it sought to retain £694K to redeem the loan.

W claimed that he was the beneficial owner of the property and that he had an overriding interest as against

C&M, so that he was entitled to the entire proceeds of sale of the property. C&M also put forward a technical argument based on the rule in *Brocklesby v Temperance Permanent Building Society* which is that, where an agent has been fraudulent, the principal should suffer any loss as against an innocent third party.

C&M won on both counts at first instance and on appeal. (1) W's decision not to be involved at all in the mechanics of the loan or dealing with C&M meant that he had allowed S to hold himself out as the owner of the property. The *Brocklesby* principle further supported this position. (2) It was apparent from the wording of the mortgage that C&M's costs in *'enforcing or attempting to enforce the rights and powers of the Lender'* were recoverable.

In many ways a pretty extraordinary set of facts. Whilst the result might be harsh on W, he was where he was through his own foolishness whereas C&M was the wholly innocent party.

Monies Held on Constructive Trust

Re Crown Holdings (London) Ltd

The liquidators of this company were concerned with two classes of monies in the company's control. First, monies from customers paid into its bank account after its going into administration and, secondly, cash in envelopes addressed to its customers. The customers claimed to be entitled to rescind their contracts with the company because of the fraud perpetuated on them and thus to be entitled to both pots of cash by way of constructive trust. The liquidators contended that customers had failed to rescind their contracts with the company and so the funds fell within the company's general assets and not subject to any special trust treatment.

In relation to the first pot, the bank transfers, the judge found that the right to rescind was personal between the company and the individual creditors and that it had been lost on liquidation. The court also rejected any notion of the bank's being the company's agent. However, in relation to payment to the company *after* it's going in to administration, there had been a total failure of consideration and mistake as to the company's ability to repay. In that case, the court would be permitted to find that the funds were held on trust as to do otherwise would be unconscionable.

In relation to the cash in envelopes, the judge found that title did not pass to the addressees simply by their being identified and that title would not pass until delivery.

Overpaid VAT

Stringfellow v HMRC
Re Premier Foods (Holdings) Ltd

Stringfellow was a sole trader who sold his business as a going concern to a limited company which went into liquidation a year later. He claimed and was paid a refund of VAT overpaid during his tenure as sole trader.

HMRC subsequently reviewed their decision and sought to reclaim the VAT refund on the basis that the right to a refund had been transferred to the limited company when sold the business. HMRC succeeded even though the right to claim a refund had not expressly been transferred. The court held that such a right would, in a going concern sale, pass by operation of law.

In *Premier Foods*, PF had wrongly been charged VAT by a supplier which had accounted properly to HMRC. When the supplier went bust, HMRC repaid the overpaid VAT but it also sought to claim back from PF the corresponding amount of input VAT that it had set off against its own historic VAT assessments.

The court however overturned HMRC's decisions: to repay the supplier would be little more than unjust enrichment of the supplier. In the case of PF, it was in any event entitled to apply directly to HMRC in respect of overpaid VAT and so should not be required to repay such amounts.

The *Stringfellow* case is a useful *caveat* to those involved in sales of businesses as going concerns although the reservation of such rights is pretty standard in almost all sale agreements.

Protected Essential Supplies

Insolvency (Protection of Essential Supplies) Order 2015

This set of regulations came into force on **1 October 2015** with the aim of strengthening protection afforded to insolvent companies which require '*essential supplies*' in order to continue to trade.

Practitioners will, of course, realise that this is basically an extension of the current provisions of section 233 of the Act which prevents the suppliers of public utility companies using the supply of electricity, gas, telephone or water to blackmail insolvent companies.

Under the new Order, the list of what constitutes an "essential supply" will be expanded to IT and electronic services which will include WiFi, broadband, mobile networks, software and even things like chip and pin devices. Furthermore, the new provisions will not apply just to public utility providers but also equally to private companies.

The new Order will go much further than section 233 inasmuch as it will render void any contractual provision in a suppliers terms that purports to enables them to terminate a supply on the customer's insolvency.

Where companies go into an insolvency process, the suppliers of essential services will still be entitled to require a PG form the relevant office holder. Nonetheless, this is a very welcome and long overdue amendment to the legislation; we have seen numerous cases of decent pre-pack opportunities held to ransom by ISPs.

Burden of Proof on Directors in Section 214 Claims

Re Robin Hood Centre plc

The case concerned an action for wrongful trading and misfeasance against the director of the company. It was established that the director knew or ought to have concluded that there was no reasonable prospect that the company would avoid going into insolvent liquidation, and therefore he sought to raise as a defence the fact that he had he had taken every step to minimise the potential loss to the company's creditors.

In terms of the burden of proof, the court held that it fell on the director to prove his defence; it was not for the liquidator to show that the director had failed to take such steps. The court applied the settled provisions relating to the test of the reasonably diligent director and fond that, once a VAT liability had been confirmed by HMRC, the directors ought to have wound the company up.

It never occurred to us that anyone would think that the burden of proof wasn't on the directors under section 214(3) but it's never a bad thing to have these things clarified.

ADMINISTRATION

Administrators' Proposals Rejected

Re Pudsey Steel Ltd

The judge here (HHJ Behrens) appears to have followed his own earlier decision in *Lavin v Swindell* in finding that administrators should always apply to court for directions if their proposals are rejected by creditors. In *Re Parmeko Holdings Ltd*, the court had held that such an application need only be made where rejection of the proposals gave rise to real questions as to how to proceed.

The judge considered, however, that the matter did in any event give rise to such questions. He held that the company should proceed by way of CVL (a dissenting creditor sought a compulsory if certain terms imposed by it could not be met) and declined to place a cap on the IPs' costs.

Insolvency is a Pre-Requisite

Re Gigi Brooks Ltd

The applicant was a director and creditor of the company but had been excluded from it by the major shareholder who was also a director. She applied for administration. The Court rejected her application on the basis that there was no evidence that the company was or would become unable to pay its debts. The company was a new start-up so its accounts were of little relevance. There was also no real evidence that an administration would have a real prospect of success.

The judge expressed some regret at not being able to intervene but said that there was insufficient grounds for the court to exercise its discretion to take such a serious step.

LIQUIDATION

CVL Liquidator Personally Liable For Petition Costs

Re Bargain Foods Ltd

Chief Registrar Baister has laid down a new *'standard'* order to be made in cases when a petition comes before the court notwithstanding that a CVL has already commenced. Whereas the courts' *modus operandi* appeared to be to allow the CVL to stand and, absent any dissent from the petitioner, to dismiss the petition, According to Baister a compulsory winding up order should be made in such cases. As a concession to the liquidator, the CVL liquidator should be appointed as liquidator under the compulsory liquidation but he should jointly and severally with the company be personally liable for the petitioner's costs with no right of indemnity from the company's assets.

We are not aware of this judgment yet having been made public and we await its publication with interest as it raises several issues. Not least of these is the fact that the court has no power to appoint a liquidator other than under section 140 which does not apply in such cases.

Fraudulent Assignment of Book Debts

Re Barons Finance Ltd

The company has assigned all of its book debts to itself jointly with another company owned by its director in return for the assignee's agreeing to settle a costs order that had been made against the company. The company then went into liquidation and the liquidators sought to set aside the assignment as (1) a post-petition dissipation, (2) an undervalue transaction and (3) under s. 423.

The court found that (1) the director had backdated the assignment to a date prior to the petition; (2) that the book debts amounted to some £373,000 which was clearly substantially less in money's worth than the £76,500 costs order and (3) the only inference that could be drawn from the facts was that the director had sought to defraud the company's creditors by putting a major asset – the receivables – beyond their reach.

BANKRUPTCY

Chairman's Actions Material Irregularity

Rowbury v Official Receiver

Where the chairman of a meeting had refused to adjourn or suspend the meeting for an hour or so in order that evidence could be obtained to clarify a manifest error on a proof, such refusal could amount to a material irregularity.

PG Not Undervalue Transaction

Re Rashid

Bankrupt failed to attend at branch of HSBC to sign a PG for his company's loan until 6 months after the loan had been made and by which time the facility was fully drawn. The company later went into administration and R as made bankrupt.

R's trustee challenged the PG on the basis that it was an undervalue transaction as no benefit flowed to R from his giving a PG because the facility was already fully utilised.

The court found that the trustee had not reached the evidential burden required. In valuing the PG in money or money's worth, one had to look at the relative values at a the time when the PG was granted not at the moment of default. In this case, the company had been solvent at the time of the PG and accordingly the value of the PG to the bank was relatively low so it did not constitute an undervalue transaction.

Annulment Through Incapacity
Re Brister

The debtor was in his eighties, unable to stand or see properly and suffering from dementia. Evidence of his condition had not been put before the court at the hearing of the petition neither had a letter from solicitors requesting an adjournment to allow the debtor to take advice.

On appeal, the judge held that it was clear that the debtor had not understood the nature of the stat demand served on him. No reasonable court with full knowledge of the situation would have made the order which would, accordingly, be set aside.

Claimant With No Cause of Action
Eaton v Mitchells & Butler

The successfully claimant sued M&B for a personal injury claim. It subsequently transpired that the claimant had been made bankrupt on his own petition several years before he issued proceedings but *after* the accident complained of.

M&B applied to have the action struck out as a nullity as the claim had vested in the OR. The court declined to strike out the action and gave the claimant three months to regularise the position.

This was a surprising decision given that the court itself thought it unlikely that the position could be regularised! The only courses would either be to take an assignment of the cause of action from the OR to seek to amend the pleadings to insert the OR as claimant. Neither was particularly likely given the effluxion of time.

Whilst this seems a perfectly obvious point to all insolvency lawyers and IPs it was overlooked by non-specialists. Perhaps the question of historic bankruptcy should be asked of all clients in such situations.

Time For Issuing Applications
Sands v Singh

This case involved the challenge of possession proceedings under the three year 'use it or lose it' rule.

The final day for issuing an application under s.283A was 26 September on which day the trustee's staff attended at the Coventry County Court with their application. Because a previous contentious issue had been transferred to the Birmingham court the court staff refused to accept the application. Following the ensuing administrative farrago, the sealed application was eventually stamped '1 November 2014'. The bankrupt challenged the application as it was brought out of time.

The court, however, upheld the trustee's application. Judge Purle QC found that the trustee could rely on either or (1) Practice Direction 7A of the CPR which provides that a claim is 'brought' when papers are delivered to the court office or (2) CPR 23.5 which provides that '*where an application must be made within a specified time, it is so made if the application notice is received by the court within that time*'.

EMPLOYMENT

TUPE Does Not Apply To Absentees
BT Managed Services v Edwards

An employee who had been off work for six years with no prospect of ever returning was not "assigned" to an organised group for TUPE purposes.

The EAT distinguished this from cases of maternity leave or long-term sick leave at the time of a TUPE transfer as such absences could be temporary.

It strikes us as remarkable that the claimants could even have the temerity to bring this claim!

CROSS-BORDER

Concurrent Jurisdiction in Primary and Secondary Proceedings
Comité d'Entreprise de Nortel Networks SA v Cosme Rogeau

Nortel was subject to and English admin. Secondary proceedings were opened in France in respect of a French offshoot of the Nortel empire. The French company was liable to a substantial deferred severance payment in respect of its employees. The French liquidator sought to effect a payment to the French employees notwithstanding agreements with the global group which would have seen the English admin expenses paid first.

The French court sought an opinion from the CJEU as to (1) whether it had sole or concurrent jurisdiction and (2) which law applied to the French assets.

The CJEU found that, in cases where there were primary and secondary proceedings in different member states, the courts of those states would have concurrent jurisdiction to determine which assets fell within the secondary proceedings.

In relation to the proper law to be applied, the CJEU said that it was settled that the appropriate law was as follows:

(i) tangible property: the member state in the property was located;

(ii) registered rights of ownership: the member state in which the register was kept, and

(iii) claims: - the member state in which the person liable had his COMI.

Directors' Duties in Insolvency

Re Micra Contracts Ltd

The directors of Micra were also directors of a number of other group companies, including Micra Interiors Ltd. The business ran into financial difficulties due to the failure of a building contract with which it had been involved. On 9 April 2008, the directors consulted an IP and, on that same day, took the following steps:

- a loan from Micra to Interiors in the sum of £400,000 was called in;
- an invoice from Interiors for £142,500 was set against the loan;
- various 'recharges' of £329,725 were entered into Micra's books and also set against the loan;
- this left £72,225 due to Interiors which Micra paid that day.

Between 9 April and 16 April (the date of the s. 98 meeting) the directors caused £515,000 to be paid out of Micra's bank account to various creditors one of which later employed one of the directors.

The issue for the court was as to whether the directors' actions constituted a breach of (1) their duty of good faith under s.172 CA1986 or (2) their duty to exercise reasonable care and skill under s.174 CA1986.

In relation to s.172, the court held that it should first apply a subjective test (ie as to what the directors actually thought) and, absent evidence of such thought, an objective test (ie what would a reasonable director would have thought).

In relation to s.174, the test was *both* subjective and objective looking to the higher of the general skill and knowledge of the directors and the general skill and knowledge expected of a reasonable person carrying out these directors' functions).

The burden of proof was on the directors to show that the transactions were genuine and the Registrar was prepared to accept their evidence that they were even though they could only be explained on the oral evidence of the company's bookkeeper.

There was no commercial benefit to carrying out the balancing exercise in the middle of the financial year and it was effectively little more than a pre-liquidation exercise. The payment of £72,225 to Interiors was not in the ordinary course of business and was held to be a breach of the directors' duty under s.172 – it could not on any stretch be said to be for the benefit of the company or its creditors and the directors failed both the subjective and the objective tests.

The directors were, accordingly, required to repay the sum of £72,255 to Micra together with the liquidators' costs on an indemnity basis due to their poor conduct of the litigation.

It is clear that directors of companies in distress need to consider the interests of all the creditors and not a small class of them. Directors should never be permitted to pre-empt the liquidation process and to seek to settle the creditors themselves which invariably ends in tears.

Another aspect for those advising directors to consider is the new amendments to the CDDA regime which allows the court to make a compensation order on the back of a disqualification.

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