AMB LAW

INSOLVENCY UPDATE

No. 16 • September 2016

And here is the 16th Edition of **AMB Law's *Insolvency Update***. This comes to you at a very peculiar time in the Insolvency world. Following the Brexit vote (or "*our having left Europe*" as people seem prematurely to call it) interest rates are now at an all-time low as are, predictably enough, levels of formal insolvency appointments. It may be that the next growth area is the insolvency of IPs and insolvency lawyers!

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MISCELLANEOUS

No Limitation Period on Action Against Trustee

Re Burnden Holdings (UK) Ltd

BH had been the subject of a s.110 reconstruction by which its shares were transferred *in specie* to a newco established for that purpose. BH then went into liquidation.

The liquidator of BH sought to challenge the scheme and brought an action against the former directors of BH for breach of trust in that they had effected a distribution when there were insufficient distributable profits.

It was clear that the events in question had taken place more than six years previously. Under s.21(1)(b) of the Limitation Act 1980, where a trustee effects a distribution of trust property to persons including himself as one of the beneficiaries, there will be no limitation period. The court held that the distribution came within that exemption so no limitation period applied.

VAT on IBRs

Airtours v HMRC

The Supreme Court has held that a company could not set off against output tax the VAT paid in respect of an accountant's Independent Business Report prepared at the behest of its bank; the fees did not reflect payment for a service "*attributable to … supplies made or to be made to*" the company.

This has become an increasingly common theme over the past 20 years as banks now routinely commission IBRs from insolvency accountants when a customer passes to the 'dark side' of the bank. Invariably the cost of such reports (which can be substantial) are borne by the company even though the reports are primarily for the bank's benefit.

Interestingly, the Supreme Court was split 3:2 so this may not be the last word on the subject. In the meantime, it might be possible to recover input tax if the company instructs the reporting IPs directly and the IBR is addressed to the company – that may, however, not be acceptable to the bank.

Consideration For Variation

MWB Business Exchange Centres Ltd v Rock Advertising Ltd

We all know that consideration must pass between the parties for a contract to be valid. Thus it has long be trite law that a time-to-pay agreement cannot usually be valid as, in return for the recipient's forbearance, the paying party has given no additional consideration beyond that which he already owes.

In this case, a tenant was given a payment schedule giving him more time to pay rent that was due. The Court of Appeal found that there was consideration moving from the tenant because the landlord obtained a practical benefit in keeping his tenant *in situ*.

It seems to us that it is stretching things to class a collateral benefit to one party *'consideration'* paid by the other. On the other hand, if the rescheduling agreement had been contained within a deed, the consideration issue would have been artificially pushed away so perhaps this is the right outcome.

Interestingly the Court of Appeal also endorsed its previous decision in *Globe Motors, Inc and others v TRW Lucas Varity Electric Steering Ltd* and held that a clause requiring any contract amendments could be itself be orally varied.

Challenging Dividends as Undervalue Transaction

BTI 2014 LLC v Sequana

Shortly before the sale of the business (the old *Arjo Wiggins* business) the directors declared various dividends to shareholders which were funded by the writing off of various loans due to the company from the shareholder.

Given that this was effected in anticipation of the forthcoming sale of the business, the court held that the declaration of dividends was intended to put the funds beyond the creditors' reach contrary to s.423 of the Act. Further, the court held that the shareholder could not rely upon the defence in s.425(2) – change of position by innocent party – as it had been party to the decision and was the beneficiary of the dividend.

Whilst the decision is obviously fact-specific, it is interesting to note that

this is the first reported decision of a declaration of dividends constituting a *'transaction'* for the purposes of s.424. Interestingly, a previous dividend payment declared six months earlier was held not to contravene s.423 as the decision to sell the business had not, at that stage, been reached so the necessary intention could not be inferred.

Claims Against Insured Insolvents

Third Party Rights Against Insurers Act 2010

With effect from **1 August 2016**, the 2010 Act has come into force replacing its 1933 forerunner.

The result is an improved regime that applies to all forms of insolvency (not just liquidation) and enables claims to be brought against insurers without first getting judgment against the insolvent company.

For a fuller Bulletin on this click here or go to our website.

Exercise of Termination Clause in Good Faith

Monde Petroleum v Westernzagros

Express contractual rights to terminate a contract are not affected by common law duties of good faith. Accordingly the High Court refused to imply a term into a commercial contract that a party should not terminate the contract in bad faith. An express contractual right may be exercised regardless of the terminating party's reason for doing so provided the conditions set out in the contract have been met.

In the instant case, the judge also found that a purported termination notice that had not complied in all respects with the provisions of the express termination clause was of no effect. It did not terminate the contract, and it was not a repudiatory breach.

Company's Articles Amended by Conduct

The Sherlock Holmes International Society Ltd v Aidiniantz

The articles required all directors to be members of the society. On several occasions the members had appointed directors who were not members. If these appointments were legal, there could only be two justifications: either the members thought that they could waive the requirements of the articles or the articles had been waived by the members' conduct. The first was clearly not the case as the articles remained binding until amended by the company in general meeting. Accordingly, the only explanation was that the members had fully intended to appoint external directors and had thereby, through their conduct, amended the company's articles of association to permit such appointments.

Implied Variation of Articles

Re BW Estates Ltd

A sole *de jure* director had purported to appoint administrators in an out-of-court appointment. This decision was challenged on the basis that the board meeting was inquorate. The court found, however, that the only two shareholders (being the director and his father) were present at the meeting. As there was 100% of the shareholders present, the court held, applying the *Duomatic* principle, that any formalities required by the company's articles could have been waived or amended.

ADMINISTRATION

Arbitration Precludes Admin Order

Fieldfisher v Pennyfeathers Ltd

It was clear that the applicant firm had the necessary *locus* to apply for an admin order and, even though the quantum of the debt was disputed, there appeared to be a good, arguable case that the company owed it a substantial sum. However, the applicant's CFA contained an arbitration clause which meant that the court could not, without further investigation, assess if the company was likely to become unable to pay its debts as they fell due.

The court held that it must, absent *exceptional* circumstances, exercise its discretion consistently with the provisions of the Arbitration Act 1996. Where parties had agreed to arbitrate a dispute they should not be able to bypass arbitration by issuing proceedings.

Does this mean that parties can protect themselves completely from future insolvency proceedings by inserting an arbitration clause in all commercial contracts? Perhaps a distinction should be drawn in this context between collective insolvency proceedings and actions to recover debts or damages.

LIQUIDATION

Validation Orders in the *Ordinary Course of Business*

Express Electrical Distributors Ltd v Beavis

The Court of Appeal restated the rule regarding validation orders under s.127. The starting premise that the unsecured creditors at the date of presentation should be paid *pari passu* in the ensuing liquidation could only be set aside by a validation order where there were *exceptional* circumstances. As a minimum, it would have to be shown that the payment or disposition being validated was in the overall best interests of the company's creditors as a whole, for example by enabling the business to be sold at a higher price as a going concern.

The court rejected the oft-cited notion that a validation order could generally be made in respect of any dispositions or payments made by a company in good faith in the ordinary course of business where the other party was unaware that a petition had been presented. Reliance has often been placed on the *dictum* in *Re Gray's Inn Construction*, which the court held could not be taken at face value and could not be applied as a rule in itself.

A tightening of the court's discretion in this area has been on the cards for some time as validation orders have been more and more frequently made at the expense of unsecured creditors.

Onus on Directors to Prove Case

Re Kiss Cards Ltd

A director and his wife were being pursued by liquidators in respect of numerous unexplained payments to them by the company. He had been uncooperative and slow in providing financial information to the liquidators. The director had stated that the liquidators had all the relevant information amongst the company's books and records and that it was not his job to sort it out for them.

The court did not agree. The director was under a statutory duty to furnish the liquidators with a statement of affairs whose purpose is to assist them and to fill in any holes in the information within the accounts.

In his judgment, the judge also made two other interesting, *obiter* comments. First, payments to a joint account were not evidence *per se* that there was a contract between the company and both account holders – there may or may not have been and that depended on extrinsic evidence. Secondly, it was not possible to highlight a single element of a remuneration package and declare it an undervalue on the basis solely of the recipient's job status (the director's wife, a part-time bookkeeper enjoyed a fully-funded R Class Mercedes).

Costs Against Liquidator Personally

Re Superspeed Limited

This was a case from the High Court of Hong Kong.

The liquidators, financially backed by the petitioning creditor, brought proceedings against a bank under the HK equivalent of s.127. The funder had agreed to pay any costs orders and, if necessary, to fund any security for costs. The bank successfully defended its case in both the HK High Court and HK Court of Appeal and obtained costs orders against the company in liquidation. The company could not pay those costs and the bank sought orders against the liquidators personally and the funder as they had pursued a 'hopeless' case against it.

The court recognised the public policy requirement for liquidators to be at liberty to pursue actions in the company's name. Accordingly, in order to make a costs order against the liquidators personally, it would be necessary to establish not just unreasonableness, but the bank also had to show impropriety on the part of the liquidators. Whilst the case against the bank had been wrong, it was not 'hopeless' and it could not be said that it had been improper to pursue it.

The funder, on the other hand, was not protected by any public policy requirements. It had acted in its own self-interest in deciding to back the claim against the bank and had to bear the consequences. The funder was ordered to pay the bank's costs.

Liquidators' Time Costs NOT Head of Damage

Re Ralls Builders Ltd (No 2)

Frequently, in general commercial litigation the parties' directors try to include their own time spent on the case as a head of damage arising from the other side's breach. Whilst this might seem logical it has always been, for reasons of public policy, *verboten.* All that is recoverable are damages for the loss naturally arising out of the cause of action and the successful party's legal costs.

Similarly, a liquidator (and, presumably, any other officeholder) could not claim his own time costs incurred in preparing for litigation as a separate head of damage in litigation.

The liquidators had tried to rely on an exception to the general rule, emanating from *Re Nossen's Letter Patent (1969)*, by which such time costs might be recoverable where a party's own employees are so specialised as to amount to expert witnesses. However, the judge relied on earlier authorities (and particularly Warren J's judgment in *SISU v Tucker (2006)*) to conclude that an IP was not entitled to be treated any differently to any other litigant and did not come within the Nossen exception.

Contingent Assets Excluded From Balance Sheet

Evans v Jones

The Court of Appeal has held that a dividend of £75,000 which was unlawfully paid to a shareholder and was thus repayable could not be accounted for when assessing the company's assets. The company's claim was a contingent claim (an "*unknown unknown*") and that contingent assets do not form part of the balance sheet test. Furthermore, it was not commercially realistic effectively to treat the monies as cash in the bank when the claim to them had yet to be properly formulated.

BANKRUPTCY

Costs of Challenging Bankruptcy

Cooke v Dunbar Assets

When a bankrupt unsuccessfully challenged his bankruptcy order, he was personally liable for both his own costs and those of the petitioner; they could not be claimed from the estate. In addition, to the extent that the bankrupt failed actually to pay the petitioner's costs, they could be treated as an expense of the bankruptcy.

Possession Order Cannot Be Adjourned Indefinitely

Grant v Baker

Even where there existed *exceptional circumstances*, the sale and possession the bankrupt's family home by his trustee should not be adjourned indefinitely but, rather, a reasonable longstop date should be set.

In this case, the bankrupt's adult child had a mental age of eight and was incapable of living on her own. There was no prospect of her condition ever improving but no evidence of a lower than normal life expectancy. At first instance, the court ordered a sale of the family home with vacant possession postponed the order until the bankrupt's daughter no longer resided at the property. The trustees appealed on the basis the order should have had a longstop date with liberty to apply.

The High Court allowed the trustees' appeal and inserted a longstop date of 12 months. Even if the circumstances were exceptional, it was incompatible with the underlying statutory purpose for the order to be postponed *sine die*. In all but the most truly exceptional circumstances (whatever that means), trustees should be able to realise their interest in a property within a reasonable time frame which would usually be measured in months rather than years.

Bankruptcy Order is at Court's Discretion

Hemsley v Bance

B was found liable to H in relation to fraud under a Ponzi scheme and was subsequently made bankrupt on H's petition. Following B's discharge, H presented a second petition based on the same judgment [NB – the debt was not subject to the discharge because it had arisen out of fraud]. H argued that a second bankruptcy was required to secure funds transferred to a Dubai company by B. B argued that the petition was an abuse of process.

The Registrar upheld H's right to present a second petition which was not an abuse of process however malicious H's motives. However, the Registrar had to balance the creditors' rights to have B's property collected in for the common good against B's right to be released from his debts and harassment from his creditors.

As the Dubai monies were the proceeds of fraud, they would be held on constructive trust and would not fall within the estate of a second bankruptcy which would therefore serve no useful purpose. On this basis, the Registrar declined to make an order but said that he might be persuaded to again if the first trustee's investigations revealed assets that would fall within the estate of a second bankruptcy.

Matrimonial Claims & Bankruptcy

Re Singh
Re Eliachaoff

Two cases that involved attempts by a trustee in bankruptcy to overturn pre-bankruptcy matrimonial settlements. *Singh* involved two trusts over his property created by the bankrupt and a consent order with his ex-wife all entered into shortly before his bankruptcy.

In *Elichaoff*, the bankrupt had, post-petition, agreed to pay maintenance to his far richer wife and the trustee sought to establish that the right to challenge the settlement under the Matrimonial Causes Act 1973 vested in him.

The judgments in the two cases reiterated a number of legal points:

- The trustee had to show a vitiating factor to set aside a consent order (such as collusion);
- The agreement in *Elichaoff* constituted a disposition and was therefore void under s. 284;
- The right under the MCA to challenge the agreement was personal to the parties and <u>not</u> vest in the trustee;
- A preference claim was not struck out on the basis that there was a legal presumption between spouses of an intention to prefer which had not be rebutted.

Contingent Vote at Creditors' Meeting

AB Agri Limited v Curtis

The creditor had a claim against the debtor in respect of a £470K PG liability. The creditor voted against the debtor's IVA proposals but its vote was admitted for £1.00 and the IVA was approved. Not surprisingly, the debtor challenged the chairman's decision and the validity of the IVA on the basis of a material irregularity at the meeting.

The chairman's defence was that he was persuaded by the debtor that the PG claim was bound to fail so he admitted the claim to vote for a £1 so that the creditor would be kept in the loop.

Citing with approval Harman J's judgment in *Re a Debtor (No 222 of 1990)* the court concluded that this course of action was not an option available to the chairman. The chairman was bound to do one of three things: (i) admit the claim if it was good, (ii) reject it if it was bad or (iii) if he was unsure, mark it objected but allow the creditor to vote in full.

Accordingly the court held that the creditor should have been allowed to vote in full which would have defeated the IVA. The chairman was ordered personally to pay 50% of the applicant's costs.

Property Transfer Was A Shame

Hall v Elia

E was a discharged bankrupt. Prior to his bankruptcy he has transferred his interest in a £4 million property to his mother for £25,000 and she also claimed to be the beneficiary of a £1.3 million prior charge. Mrs E had been barred from contesting the claim for procedural failures in the litigation.

On appeal, it was held that even though the trustee still had to prove her claim, the court was at liberty to prevent Mrs E adducing evidence. He found that the transfer was a sham.

The Registrar had found that the prior charge was valid but that it secured only €50,000. The appeal court would not look behind the registrar's finding.

Alistair Bacon
26 September 2016

Rent as an Administration Expense

Where are we up to?

If ever there was a topic that has bounced back and forth over the years, this is probably the best of them. Like many legal doctrines in this area, there appeared, in the early days of administrations, much confusion with the law as applied to receivers. A practice grew up in the 1980s and 1990s by which administrators would cause the company to continue to occupy premises and would offer to pay an ongoing occupational rent based only on their actual occupation – often calculated on a daily or weekly basis. This worked quite well for many years and the only real problem with it, apart from the landlord's disgruntlement, was that the matter had never been tested in the courts and had not had any form of judicial approval.

A couple of cases in 2009 and 2012, ***Goldacre (Offices) Ltd v Nortel Networks UK Ltd*** and ***Leisure (Norwich) II Ltd v Luminar Lava Ignite Ltd*** appeared to have settled the matter in favour of a new approach. Following the reasoning in *Goldacre*, the crucial issue as to the administrators' liability was whether the rent date under the lease fell before or after the commencement of the administration. If rent for the quarter had fallen due before commencement, it ranked only as an unsecured liability and not as an expense. The administrator would only be liable to pay rent as an expense in relation to a rent liability that became due on his watch – ie *after* his appointment. This effectively gave the administrator, if he got his timing right, up to a quarter's rent-free accommodation. This approach worked very well for administrators looking to trade a business for a relatively short period of time whilst a sale of the business was completed. On the whole, landlords were much less enamoured of the situation as they were kept out of their premises by a tenant with no interest in maintaining it and they were prevented from taking any action by the moratorium in para 43. Early support for the *Goldacre* approach began to wane and many IPs wondered whether, despite best advice, they were in fact getting this right.

The matter was settled in 2014 by the Court of Appeal in ***Re Game Retail Ltd*** by which *Goldacre* and *Luminar* were expressly overruled. *Game* invoked the so-called 'salvage principle' from early 20th century liquidation cases and held that, effectively, the administrator needs to pay for what he uses – thus reverting to the pre-*Goldacre* convention.

- The administrator will need to pay rent for any period during which the property is used by him (it is not clear whether this can abate if only part of the property is used);
- That rent will accrue on a daily basis, and
- The date on which rent falls due under the lease is irrelevant.

It was feared for a time following *Game* that there would be a rush to litigate by disgruntled landlords who had, in the past, been refused rent by administrators to which it was now clear that they should have been entitled. That does not appear to have happened – whilst the current position is not as advantageous to IPs it is fairer and it does at least provide certainty. In any case where an administration it being planned and there are leasehold premises essential to the process, the most sensible approach will always be to negotiate a consensual *modus vivendi* with the landlord anyway.

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