AMB LAW

INSOLVENCY UPDATE

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Welcome to the 21th Edition of **AMB Law's *Insolvency Update***. We apologise for the lack of *Insolvency Update* over the Summer but we are now back in plenty of time for the Christmas rush. The economy is looking a bit weaker now; the pound is down, inflation is up and wholesale fuel prices are rocketing. Surely interest rates will have to follow with the inevitable result for the insolvency industry. We anticipate a rise in numbers of insolvencies in 2018 (but not in quality!).

For us the Big Topic *du jour* has to be the current state of the court system, the general administration of which has descended to such a low level as to render many courts all but unusable. Tales of lost files, missing evidence, inordinate delays etc etc now attach to every single case that we have issued in this calendar year. London has historically been the world centre for dispute resolution but with a system that has become lost in an Orwellian spiral of bureaucracy and with issue fees of £10,000 it is all but inevitable that one of our biggest exports will be lost to other jurisdictions.

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MISCELLANEOUS

Liquidator's Personal Liability For CFA Costs

Re Sunbow Ltd

This much-publicised case has reached the Court of Appeal which found in favour of the IP on the facts of the case although the solicitors' legal argument was largely upheld, in principle.

At first instance, it had been held that it was necessary to imply a term into the contract between the IP and his solicitors that the legal fees would only be paid from actual recoveries (the good old *'swings and roundabouts*' basis on which many IPs like to operate).

The Court of Appeal held (rightly) that it was neither necessary nor possible to imply such a term in this case. Generally a term would only be implied into a contract if it was necessary to do so to give 'business efficacy' to the contract or if the term was so obvious that it 'went without saying'. In either case, no term could be implied at all if it contradicted an express term.

The Court of Appeal found that Stevensdrake's terms were clear: the IP would be personally liable for their uplifted costs once "success" under the CFA had been achieved. There was no ambiguity and no need for any term to be implied.

The Court of Appeal also found, however, that Mr Hunt was not liable for his solicitors' costs as there was clear evidence of a mutual understanding that, *pace* the terms of the CFA, the costs would in fact only be paid from *actual* recoveries made by the IP. This was a shared understanding that would give rise to an estoppel by which the solicitors would be estopped from enforcing the strict terms of the CFA against the IP personally.

It is generally accepted in the grubby world of insolvency that we solicitors will not pursue our IP clients personally for costs regardless of what our terms of business might say. If a firm wishes to depart from that convention, it should be agreed expressly and explicitly with the IP client – and he should be afforded the opportunity to go elsewhere which he undoubtedly would.

Directors' Knowledge in Wrongful Trading

Re Main Realisations Ltd

The liquidators brought wrongful trading proceedings on the basis that the directors had continued to trade for a period of two years not-withstanding that the company was loss-making and owed HMRC more than £1 million.

The court held that the liquidators had to show that no reasonable director would have continued to trade based upon the projections that the directors had relied upon. Those projections were not available in evidence so the liquidators were unable to make their case.

Cases like this and *Re Ralls Builders Ltd* appear to us to be overly tightening the requirements of section 214 which is phrased in some fairly absolute language ('took *every* step to *minimise* the loss to creditors'). Without a change of approach from the Court of Appeal the real power of section 214 may be lost to office holders in all but the most extreme cases.

Group Tax Relief Surrendered

Farnborough Airport Properties v HMRC

Where receivers were appointed over a subsidiary within a group of companies, it could no longer be said to be under the control of the parent company and could not therefore be part of the group for tax purposes. This meant that the group could not use the company's losses to set against other profits arising elsewhere within the group.

A technical but simple tax point which IPs and LPA receivers should consider in advance of any such appointment.

Termination Fees

BHL v Leumi ABL

Leumi had a receivables finance agreement and on the administration of the company it began to collect out the ledger itself. Leumi charged £1.2m being the 15% 'collect out' fee to which it was contractually entitled. The collect out fee was challenged by the claimant.

Under the agreement. Leumi had a discretion to charge up to 15%. The court held that in exercising its discretion, Leumi could not act capriciously but had to seek to reimburse its loss; the maximum that that could be would in this case be 4%.

Misfeasance By Office Holders

Re F W Mason & Sons Ltd

The liquidators sought damages for misfeasance and dishonesty from a pair of IPs who had been the company's former administrators and liquidators and who were alleged systematically to have overcharged fees. The sum sought was £1.2 million plus £370,000 interest and costs on an indemnity basis.

The second respondent was happy to sign up to a consent order admitting everything (including the dishonesty) and agreeing to all payments. This was on the basis that he was boracic and would inevitably go bankrupt so, win or lose, the scheduled fifteen-day trial was completely pointless.

In respect of the first respondent, the liquidators merely sought an order as to liability without any admission of dishonesty. The first respondent was prepared to agree to this provided that the liquidators agreed not to pursue his personal assets and that there was no finding of dishonesty. Absent a settlement, he was happy for the matter to proceed to trial.

The court held that a finding of dishonesty was unnecessary and, in any event, could not be ordered by consent. Whilst the court was attracted to the notion of fully exploring allegations of dishonesty by two of its officers, that was not the court's function in litigation.

Failure to Give Notice of Assignment

General Nutrition v Holland and Barrett

The assignee of a contract sought to serve a notice terminating a licence. The court held that such notice was invalid because the recipient had not been given notice of the assignment of the original contract.

It is well understood that until notice of an assignment is given, the assignment takes effect in equity only. This means that the equitable assignee cannot sue in its own right under the original contract nor can it give any legal notices.

Liability for Negligent Valuation

Re Tiuta International Ltd

A lender had relied on its surveyors' valuation to effect a short-term loan. The same lender subsequently made a second advance which partly redeemed the first loan and partly consisted of a further advance.

The lender sued the valuer on the basis that it valuation in respect of the second loan had been negligent.

The Supreme Court held that, even if the valuation had been negligent, the lender could only recover damages in respect of the additional advance (£289K) and not in respect of the balance (£2.79 million) which went to satisfy the first advance. In assessing damages, it was necessary to compensate the loss that was suffered but for the negligence – the loss attributable to the first advance would have been suffered anyway.

Directors' Duties to Insolvent Company

Wagner v White

This case involved a desperate attempt by the director of a company to avoid liability for a $2 million loan to the Company in respect of which he had given a PG. The directors' various protestations were largely rejected by the court on the evidence. One issue that is of interest is that of the duties of a director.

The lender had, as part of the loan, also become a *de jure* director of the company although he had not taken any part or carried out any directorial functions. The defendant director tried to suggest that he would have a counterclaim against the lender director for breach of directors' duties. This argument was rejected on the basis that, in light of the company's insolvency, any duty owed by the lender director would be owed primarily to the company's secured creditor.

ADMINISTRATION

Electronic Notification of Creditors

Re All Leisure Holidays Ltd

The court permitted administrators of four holiday companies to give notices to creditors by email pursuant to rule 12A.13 of the 1986 Rules.

In this matter, the creditors were customers of the holiday companies who had all provided email addresses which could be taken as their consent to electronic communication. Most customers would not become creditors at all so it would be disproportionate to send every notice to every customer. Accordingly, the administrators were permitted to send a single notice giving details of and access information to a website on which would be uploaded all future notices.

The administrators had also sought an order limiting disclosure which the court rejected on the grounds of Data Protection but acceded to on the ground of commercial sensitivity.

Appointment By Second Ranking Charge Holder
Property Edge Lettings Ltd

The company challenged the appointment of administrators under a second floating charge as invalid on the grounds (i) that it had been granted without the consent of the first charge holder and (ii) that the earlier floating charge had crystallised and, accordingly, there were no assets to which the appointor's charge could attach. Not surprisingly the challenge failed both at first instance and on appeal.

Provided that the QFC met all the requirements of paragraphs 14-16 of Schedule B1 it would be enforceable. It is also a long established principle that a floating charge may still be valid even if, at the time of its creation, there were no assets over which it could float (see Vinelott J in *Meadrealm v Trans-continental*).

Appointment By Inquorate Board
Re BW Estates Ltd

Where the company's articles required there to be a quorum of two directors for a valid board meeting, it was not possible for a single director validly to effect the appointment of administrators.

The company could not rely on the *Duomatic* principle because there was a 25% shareholder that had not agreed to the appointment (largely by dint of its having been dissolved some years before) and Duomatic required unanimous consent of the members. For the same reason, neither could it be said that the company's articles had been varied by conduct.

The application challenging the appointment of administrators had been brought by a number of creditors and there was no evidence of *mala fides* or abuse of process; accordingly, the Court of Appeal found the purported appointment of administrators to have been ineffective.

LIQUIDATION

Scope of Operation of s. 127
Re Saad Investments Co Ltd

A trustee held shares on trust for another but he transferred the shares to a third party in extinguishment of the trustee's personal exposure to that party. The beneficiary of the trust claimed that the equitable interest transferred by the trustee belonged to him and that that transfer was in breach of section 127.

The Supreme Court held that trustee could not have transferred the equitable interest because it was not his to transfer. His transferring the legal interest had, however, extinguished the beneficiary's equitable interest altogether.

Whilst section 127 is almost limitless is in its breadth, it obviously only applies to the company's property. The shares were never the company's property so could not be protected by s.127.

Directorless Company
Re Sherlock Holmes International Society Ltd

The appellant claimed to have been appointed a director of the company but his appointment was contrary to a membership requirement contained in the articles and was made by an inquorate meeting.

The Court of Appeal rejected a suggestion that the company had amended its articles by a course of dealing. The director's appointment was invalid and he was not therefore able to cause the company to oppose a petition.

BANKRUPTCY

Statutory Demand Set Aside
Dowling v Promontoria (Arrow) Limited

At one level this was a fairly hum-drum case on the enforceability of PGs and the creditor's stat demand failed on several grounds. There are, however, a couple of points that are noteworthy as reminders even if they do not constitute new law.

First, the PG liability failed because the underlying debt was time barred; if the principal obligation failed so too must the subsidiary, secondary obligation.

Secondly, as a matter of law, an action under an indemnity is an unliquidated claim and, as such, could not, without a judgment, form the basis of a bankruptcy petition.

Thirdly, although the PG was an all monies indemnity a subsequent facility was not within the '*general purview*' of the original facility and so could not be said to be covered by the original PG.

The latter point at least should be borne in mind when seeking to amend or extend liabilities that are covered by PGs.

Costs of Stat Demand
Dunhill v Hughmans

The court will always have regard to the parties' conduct in assessing the question of costs when a statutory demand is set aside. In this case, the registrar had looked only at whether the debtor had been entitled to serve a stat demand when considering the question of costs. On appeal, the High Court held that it was necessary also to look at the parties' conduct and found that the debtor's service of a stat demand had been premature and aggressive in the context of wider litigation between the parties and, as such, costs would be awarded to the creditor in respect of her successful set aside application.

Privilege a Fundamental Right
Re Lemos

Legal privilege is a fundamental human right over which the court had no jurisdiction. To the extent that the decision in *Schlosberg v Avonwick Holdings* suggested that privilege passed to a trustee in bankruptcy, it was wrong. The bankrupt's obligations to his trustee to cooperate and to provide information (s.333) were subject to any legal privilege as was the court's ability to control the bankrupt contained in s.363(2).

This *has* to be right: legal privilege should be absolute to be interfered with by the court only in the most exceptional circumstances, if ever.

Failure to Cooperate is Contempt
Re Pearce

A bankrupt had serially failed to cooperate, had lied on oath and had concealed assets from his trustee. The High Court held that the trustee had acted quite properly in certifying the bankrupt's behaviour as being in contempt of court and applying for his committal under CPR 81.15. The procedure under CPR 81.15 is sufficiently wide to cover any contempt of court by a bankrupt and all applications should be made to the Chancery Division.

In this matter the 83 year old bankrupt was sentenced to 12 months' imprisonment – 6 to be served and 6 ti be suspended.

Occupational Rent Claim
Davis v Jackson

The trustee sought to claim an occupational rent from the bankrupt's wife on the basis that she lived in a property that was in the joint names of her and her ex-husband (who did not, never had and never would live in the property). Snowden J refused to order that an equitable account be taken – to make the wife pay rent to the trustee would be unjust and result in little more than a windfall to the husband's creditors.

Postponement of Possession Unjustified
Re Constable

The bankrupt's only asset was her 50% share in her house which she shared with her husband. The husband was in his 60s and ill and the district judge postponed the trustee's order for possession until his death or his permanently leaving the property.

On appeal, the High Court accepted that the husband's condition constituted an *'exceptional circumstance*' but held that the district judge should have considered a shorter period of postponement. Accordingly, the court gave the husband a stay of execution of 12 months with liberty to him to apply for further variation.

Bankrupt Has No Property Interest
Re Frosdick

The bankrupt's trustee disclaimed certain causes of action as onerous property. The bankrupt had previously offered to buy the causes of action and now contended that his requests amounted to the serving of a notice under s.316 so that the purported disclaimer was invalid.

Mr Frosdick's claim was struck out – since any rights to litigation that he might have had now vested in his trustee, he cannot have been a '*person interested*' in the causes of action and was not therefore able to serve a notice under s.316 anyway.

No Annulment Even Where Debt Set Aside
Re Yang

The Court of Appeal has reaffirmed the notion that council tax bills remain fully enforceable debts until such time as they are set aside. In this case, the debtor had been made bankrupt following service of a stat demand in respect of a council tax assessment that had been subsequently set aside. The bankrupt had, not surprisingly, sought annulment of her bankruptcy on the ground that it ought not to have been made in the first place.

It is difficult to feel too much sympathy in this case for Ms Yang (who owned four properties) given (i) that the council tax was little more than £1,102, (ii) she had not applied to have the stat demand set aside and (iii) she did not turn up nor was she represented in the Court of Appeal. However, we are deeply troubled by the idea of winding up and bankruptcy orders being made based upon disputed assessments - especially given the statistics relating to the number of mistakes and wrong assessments made by HMRC.

CROSS-BORDER

Dealing with Overseas Property
Mageira v Mageira

This was actually a divorce case concerning an investment property in London owned by a couple living in Poland and subject to divorce proceedings in France. H challenged the English court's jurisdiction over the proceedings relating to the London property.

The Court of Appeal dismissed H's appeal holding that, given that the proceedings related to rights *in rem* over a property situated in London, the English court had exclusive jurisdiction to deal with it under the Brussels Convention.

The Court of Appeal effectively overruled a previous decision in *Ashurst v Pollard* which had allowed a trustee to obtain an order for possession and sale of a Portuguese property in the English court. A trustee's ability to deal with real property situated in another member state could now be much reduced.

Scottish Court Cannot Make Admin Over English Company
Bank Leumi v Screw Conveyor

The Court of Session does not have jurisdiction to make an admin order in respect of an English company.

The applicant had argued that s.120(6) of the Act extended the court's jurisdiction by enacting Article 3 of the Recast Insolvency Regulation, which gave the courts of a member state jurisdiction over companies whose COMIs were in its jurisdiction. The effect of section 120(6) was to protect the Scottish court's jurisdiction over a Scottish company whose COMI was in another member state.

Alistair Bacon
12 December 2017

Best Endeavours v Reasonable Endeavours

We lawyers have always been taught never to accept an obligation to use *'best endeavours'* – only *'reasonable endeavours'* can ever be acceptable. But what do these phrases actually mean? What about *'all reasonable endeavours*' – would that be any better?

The issue comes down to what can be expected of the obligor and the extent to which he may be required to put himself out in order to discharge his obligations.

Whilst many contracts include terms such as 'best endeavours', 'reasonable endeavours', or 'all reasonable endeavours' it is not always clear what these terms mean and they are often misunderstood. As a general rule, the terms are used to compel a person to take action to fulfil an obligation or condition that might be, to some extent, beyond that person's immediate control. As with any contractual obligation, the devil is in the detail. Courts are often called upon to determine what is actually required of the person under the obligation.

Best Endeavours

A 'best endeavours' obligation is more onerous on a party than an obligation of 'reasonable endeavours'. It would oblige a party to take all available steps to fulfil the obligation that a prudent, determined and reasonable person would take. This would include spending money or issuing proceedings if that were a reasonable thing to do.

Reasonable Endeavours

An obligation to use 'reasonable endeavours' is slightly less onerous. It is usually defined by reference to what an ordinary, competent and reasonable person might be expected to do in the same circumstances. Under an obligation of 'reasonable endeavours' the obligor can balance his obligations against his own commercial interests. This means that he will not be required to take any course of action that might prejudice its own position – he may not be required to incur expenditure or to issue proceedings.

All Reasonable Endeavours

This is often drafted to represent a middle ground between reasonable and best endeavours. However, recent court decisions have suggested that *'all reasonable endeavours'* in fact amount to exactly the same thing as 'best endeavours'.

An obligor required to use 'all reasonable endeavours' may be required to sacrifice his own financial interests in order to deliver on his obligation and that would include the spending of money or the issuing of proceedings. In short, the party must take every step that is reasonably within his control regardless of his own interests.

Whenever a contracting party is asked to use best endeavours, he should not only insist on a dilution of the obligation to 'reasonable endeavours' but he should also set out clearly whether he is required to spend his own money or to issue proceedings to do whatever needs doing. Any specific steps that are to be required or any timescales or time limits should be expressly spelt out so that the thing does not end up in court.

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