AMB LAW

INSOLVENCY UPDATE

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Welcome to the 23rd edition of **AMB Law's *Insolvency Update***. Apologies for the delay since the 22nd edition – we've been busy! Welcome too to our newest recruit, **Matthew Rice** (pictured), who joined us in June as a paralegal specialising in commercial litigation and insolvency. Matthew was previously with a large, global firm specialising in insurance litigation. Matthew will divide his time between our Ipswich and City offices and we look forward to introducing him to our clients and contacts.

Since our last *Insolvency Update,* GDPR has firmly established itself as a complete and utter waste of time serving no purpose at all. The Court system continues to crumble – the Paris Bar's attempt to usurp our jurisdiction has failed as French law requires all pleadings to be in French. We understand that Amsterdam, Antwerp and Frankfurt are all planning common law, English language courts in the near future. Any of them is likely to be better than our own.

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MISCELLANEOUS

No Variation Clauses

MWB Business Exchange v Rock Advertising

This is not an insolvency case but it is one that is of universal relevance so we have included it. Eager readers with elephantine memories may recall this case from Insolvency Update #16.

The Supreme Court has held that, where a contract contains a provision prohibiting any variation of its terms otherwise that in writing signed by the parties, that prohibition can be lawful and enforceable. In other words it has implicitly upheld the 'entire agreement' clause which has recently been discredited by the courts.

This is all very well but it rather overlooks the situation common to almost all commercial situations in which the parties take no notice of the contractual terms but develop, through practice, a common *modus vivendi*. In such cases, the parties' common practice must surely constitute an implied variation of the contract between them. This point was not lost on Lord Briggs who partly dissented. We can see how it might be different if the contract were a deed although the Common Law rule that a deed could only be amended by another deed was dispensed with by the Senior Courts Act 1981.

Revised Chancery Guide

https://www.gov.uk/government/publications/chancery-guide

A revised Chancery Guide was published on 4 September 2018. The changes from the previous edition are minor and essentially tidy up errors in the 16 May 2018 version. You can click the above clink to have a look.

LIQUIDATION

Failure to Notify QFCH of members' resolution

Re Domestic & General Insulation Limited

CVL liquidators sought a declaration as to the validity of their appointment as no notice of the members' resolution had been given to the floating charge holder under s84(2A).

It was held that notice was required to be given regardless of whether the floating charge was enforceable or not. However, a special resolution would be effective validly to put a company into liquidation, If dissatisfied, the charge holder's remedy would be either to petition for a compulsory or to seek a stay of the CVL in order to appoint administrators. If this is the correct reasoning one wonders what was the point of s84(2A)!

Adjudication References

Re Bresco Electrical Services Ltd

A company in liquidation cannot refer a dispute to construction adjudication if that dispute includes any claim for monies by the referring party from the responding party. We always rather thought that that was the case in any insolvency in which there was the prospect of an insolvent party not being able to repay an award if required.

Transaction at an Undervalue

Re Whitestar Management Ltd

The case involved a complicated set of facts following a falling out between the two director shareholders which

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resulted in the business and assets being sold to a third company by way of settlement between the two of them. The subsequently appointed liquidators challenged the transfer as a TUV.

The court's findings were:

1) There was clearly a TUV and consideration provided by the company to a third party was irrelevant;

2) The criteria in the good faith defence is s.238(5) were cumulative. It could be said that the sale was in the ordinary course of business if the very business had been sold.

Adjudication Referral In Liquidation
Re Bresco Electrical Services Ltd

A company in liquidation (or, by analogy, administration) cannot refer a dispute to adjudication where the dispute includes any monies claimed to the referring party. All such claims are covered by rule 14.25 of the Insolvency (England & Wales) Rules 1986 which deals with compulsory set off of mutual debts and credits.

The TCC also rejected a challenge by the company to its jurisdiction to deal with a matter that was subject of an adjudication.

De Facto Directors
Re MSD Cash & Carry plc

This was a preference claim brought by the liquidators in relation to shenanigans involving various transfers of stock and shares between directors. One issue related to whether one of the respondents was a de facto director.

The test for being a de facto director is threefold: (1) whether he was the sole person directing the company or whether there were others; (2) whether he was held out as or called a director and (3) whether he was part of the 'corporate governing structure'.

In this case, only the first test was satisfied. However, the respondent was not held out as a director only because of his criminal record and his disqualification from being a director. It was not possible to discern what was the 'governing structure' of the company.

The respondent had assumed a role and acted on his own authority such as to impose fiduciary obligations on him and as such had acted as a de facto director.

ADMINISTRATION

Court Cannot Appoint Additional Administrators
Re Zinc Hotels (Holdings) Ltd

Disgruntled shareholders did not like the QFCH's choice of administrators and issued proceedings for them to be replaced on the basis of the IPs close relationship with the QFCH.

Whilst the main dispute was progressing, the applicants sought the appointment of additional administrators *pro tem*.

Carr J held that the court had no jurisdiction to effect the appointment of administrators other than under para 103 which would have required the consent of the QFCH.

Administration on Disputed Debt
Re Berkshire Homes (Northern) Ltd

The liquidators of Newbury VC Ltd sought an admin order against the company relying on a debt of £4.9 million. The company challenged the application on the basis that it claimed not to be insolvent and it produced accounts showing that it was in fact balance sheet solvent to the tune of £332,000.

Much of the decisions is always fact dependent. The interesting point here, however, is the judge's comments in relation to the test for insolvency on an admin application which is less stringent than that used on a winder.

All the admin application has to show is that *on a balance of probabilities* the company is *likely* to become unable to pay its debts and one of the para 3(1) purposes was *likely* to be achieved.

In this case, the court found that, on a balance of probabilities, the company probably was a creditor of the applicant and the liquidators' application was made out even though the debt was disputed by the company.

Application of Para 71
Re Birchen House Ltd

The administrators applied for leave under para 71 to dispose of a partly developed property free of the various charges attaching to it (which included 54 estate contracts registered by potential purchasers who had exchanged contracts pre-administration. The court allowed the application as it effectively allowed the property to be sold and development completed. Given that the sale proceeds would be entirely swallowed up by the main mortgagee 51 potential purchaser ranking below them could not be said to be prejudiced.

Administrators' Duty to Third Parties
Fraser Turner Ltd v PwC

The claimants sued administrators on the basis that their causing the company to sell its business and assets had procured a breach of the claimant's contract with the company which caused substantial loss to the claimant.

Philip Marshall QC gave the claim short shrift. The administrators owed no duty to the claimant and the fact that they suffered a loss in the company's insolvency was not a ground for unfair prejudice.

RECEIVERSHIP

Mortgagee's Duty of Good Faith
Standish v RBS

It is established that receivers and mortgagees in possession owe equitable duties to the mortgagor. Here the court rejected the mortgagor's claim that such duties

applied even where the mortgagee was not in possession – ie they applied to any lender holding security. Such duties, deriving from *Medforth v Blake,* arise only once the mortgagee takes steps to enforce his security.

BANKRUPTCY

Too Poor To Be Bankrupt?
Re Lock

A bankruptcy order was set aside on the basis that it ought not to have been made given the bankrupt's impecuniosity. In this case, the bankrupt was unemployed and lived in social housing depending on her daughter for financial support. The judge held that no amount of investigation by a trustee would change that and, accordingly, the bankruptcy served no useful purpose. The court held that there was a burden on a public authority to ensure that bankruptcy would achieve some useful purpose.

This requirement is not contained in the Insolvency Act 1986. Whilst it might've made sense in this particular case, it potentially sets a dangerous precedent and puts an onerous burden on petitioners by introducing another level of uncertainty into a court system that is already a lottery.

Restitution under s.284
Re Eaitisham Ahmed

Shares in his family company had been transferred by the bankrupt after the presentation of the petition against him. After more than eight years' toing and froing, the trustee managed to recover the shares. The trustee's application therefore concerned a monetary claim for recovery of the value of the shares at the date of their transfer.

The Court of Appeal held:

(1) that the shares were held on trust pending the making of the bankruptcy order;

(2) that the valuation of the shares was by reference to a fair value not the market value, and

(3) that the valuation date in this case would be the date on which the trustee would most likely have tried to sell the shares not the date on which they were transferred.

Right to Fair Hearing
Black v Sale Service & Maintenance Limited

The Court was wrong summarily to dismiss an application to set aside a stat demand at a 15 minute directions hearing. The judge's decision was in any event wrong because he had relied on evidence of the debtor's offer to settle the demanded sum without considering the debtor's counterclaim.

An application's appearing unlikely to succeed is not the same thing as there being no triable issue.

Validity of Bankruptcy Regardless of Underlying Debt
Re Brown

Mr Brown was declared bankrupt based upon unpaid costs order arising in earlier litigation. That litigation had been rejected by Mr Brown as being invalid and he consequently did not recognise the bankruptcy.

Mr Brown had refused to provide any assistance or information to the O.R. or to his subsequently-appointed trustee and made accusations of conspiracy against them, their lawyers and HHJ Barker QC. Brown's discharge was suspended until he agreed to cooperate which he still refused to do and was found to be in contempt of court. At a subsequent hearing in the High Court intended to allow him to purge his contempt, Brown gave false and misleading information. The judge halted proceedings and committed Brown to 8 months' inside. This sentence was subsequently upheld by the Court of Appeal – the fact that Mr Brown challenged the orders on which his bankruptcy was based was irrelevant as there remained in place valid orders of the court which had neither been challenged nor complied with.

Barrister's Fees Do Not Vest
Re George

Where a barrister has been made bankrupt his right to receive fees from those instructing him do not constitute 'property' and accordingly do not vest in his trustee in bankruptcy under s306. The distinction here was that the barrister acted on the express term that there was no contract with those instructing him.

There would be nothing to stop the trustee claiming any fees paid post-bankruptcy as either after-acquired property or pursuant to an income payments order.

EMPLOYMENT

Minimum Wage Following TUPE

With effect from 2 July 2018, HMRC will, following a TUPE transfer, seek to enforce all national minimum wage liabilities, including penalties against the transferee. Previously HMRC would have apportioned pre-transfer penalties to the transferor.

CROSS-BORDER

Extra-Territorial Effect of s423
Orexim v Mahavir

The jurisdictional gateway in CPR PD6 para 3.1(20)(a) does include a claim under s423. At first instance it had been held that s423 was not covered by the gateway because section did not refer to proceedings being brought against overseas respondents.

The decision is, however, obiter because leave to serve out was refused as the claimant liquidator failed to demonstrate any real nexus between the respondents and England & Wales.

Alistair Bacon
17 September 2018

Time to Audit Your Admin Appointments

It is trite law that an administration, however commenced, will automatically come to an end under paragraph 76(1) on the first anniversary of the appointment unless it has been extended. It is also trite law that the administration may be extended once by the creditors for a maximum of one year (it used to be six months) and thereafter, as often as you like, by order of the court.

We have recently had several cases acting for a number of different IPs in which it has transpired that the creditors' consent had not been properly obtained in accordance with paragraph 78 and, accordingly, the administration appointment had expired at the end of year 1. Difficulties will arise if the administrators nevertheless continue to deal with the company's business and affairs in the mistaken belief that the admin was extended and that they continue in office.

Invariably this issue only comes to light once the administrators apply to the court for a second extension. The court appears to be very alive to this issue and seems actively to be rooting out vulnerable cases – we have even seen instances of judges conducting their own company searches to ascertain the number of secured creditors. Obviously, where the first attempt at extension was ineffective, there can be no further extension of the administration as, in the words of one judge, '*there is nothing to extend*'.

We very much doubt that the cases that we have seen are unique. In the good old days of administration petitions, the issue was not such a problem as the court could extend the administration and backdate the order to the day of expiry which was an application that we made on several occasions. In the current age of tick-box legal practice no amount of creative applications can get round the point – in any event, paragraphs 77(1) and 78(4) expressly prohibit *any* extension once the administration has expired.

The practical solution to this problem may depend on timing. If the problem is discovered less than twelve months before the expiry, it may be possible to make a new administration application and ask for the appointment to be backdated to the day of expiry. There will need to be numerous directions in relation to the protection of preferential creditors (as the relevant date will be a couple of years later) and also to deal with any actions by the administrators during the period in which they were out of office. If the error is discovered at a later stage, it might still be possible to effect a second administration appointment (*quaere* who has jurisdiction?) but it may prove much more difficult to correct any irregularities. Either way, it is likely to be messy and expensive.

It might therefore be sensible for IPs to carry out a quick audit of any administrations that have been extended by consent and to check that the procedural requirements have all been complied with precisely. Particularly, read paragraph 78 very closely and ensure that all the necessary consents have been obtained exactly as prescribed. That means <u>all</u> secured creditors – including any who have no tangible interest in the outcome of the administration. It also means <u>all</u> the prefs, not just the IPS – so including all those employees whose total preferential claims exceed the IPS limits.

Administrators who are confident that they will not need to extend there appointments may wish to take no action. Otherwise, if there is any potential 'issue' with a consensual admin extension, administrators would be well advised to take urgent legal advice certainly not wait until the matter is scrutinised by the court.

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