AMB LAW

INSOLVENCY UPDATE

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Welcome to the 30th Edition of **AMB Law's** ***Insolvency Update*** and Happy New Year to all. Like Trump's White House, this publication is a Covid-free zone. Not that the pandemic is not important but everything to do with CIGA, pre-packs and Crown preference has been better covered – *ad nauseam* – elsewhere so we shall largely leave well alone.

There is no doubt that work levels and enquiries from distressed businesses are picking up slowly – the profession seems to be busier than it was at the time of our previous ***Insolvency Update*** but the Tsunami has yet to hit the shore. It will – of that there can be little doubt – but its arrival will be delayed for so long as we remain in lockdown and the CIGA restrictions are in force and financial assistance is readily available. The problem is that the longer that olive branches and free money (up to about half of which will turn out to have been wrongfully claimed) continue to be doled out, the worse the problem will ultimately be and the fewer options will be available for restructuring or turnaround. The Tsunami is likely largely to consist of liquidations whose only asset is claims against the directors rather than turnarounds or administrations with scope properly to restructure businesses.

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COVID-19 TIMETABLE

Dates for Suspension of Statutory Provisions

Winder based on a stat demand stayed until ...	31/03/2021
Other winders stayed until	31/03/2021
Commercial property recovery stayed until	31/03/2021
Small suppliers' s.233B carveout until	‡30/03/2021
Company Meetings etc relaxation until	‡30/03/2021
Wrongful Trading suspended until.....	30/04/2001

‡- sic. Note to HMG: "30 days hath November, April, June and September, all the rest … "

MISCELLANEOUS

Assignment of Officeholders' Claims
Re Totalbrand Ltd

The liquidator of a company assigned to a third party various claims that he had against the former directors. The company was then dissolved. The defendants to the litigation applied to have the claims against them struck out on the [somewhat dubious] basis that s.246ZD of the Act did not make provision for the payment of any award to an assignee and therefore any award or costs order would still need to be in favour of the company which no longer existed. On this basis there was no-one in whose favour the court could make an award of damages or costs and, accordingly the claims should be struck out.

Snowden J gave this argument short shrift: it was axiomatic that an assignment of a claim must also include an assignment of any proceeds of that claim otherwise s.246ZD would be completely pointless.

Mortgagee's Rights Survive Disclaimer
Re Buzzline Coaches Ltd

The company was struck off the register and, as a consequence, its leasehold property subject to a mortgage vested *bona vacantia* in the Crown. The Crown disclaimed the lease. The mortgagee issued an application for directions regarding its interest and, in the meantime, the director had the company restored to the register.

The court held that disclaimer did not extinguish third party rights and, accordingly, the mortgagee's interest survived. Furthermore, upon restoration, the Crown's disclaimer was deemed not to have happened.

Failure to Comply With Directions
Re Wolf Rock (Cornwall) Ltd

Paul Matthews J held, on appeal, that where a party wished to deviate from directions given by the court, it was required first to apply for relief from sanctions under CPR3.9. The County Court had refused to admit three witness statements that had been served late. The High Court upheld this

decision on the basis that it was implicit that sanctions would apply to a failure to comply with the directions order.

This is a topic that keeps coming before the courts and litigants would be well advised to assume that they cannot treat court-imposed deadlines just as a rough guide as to when it might be nice for them to do something.

Unpaid Share Capital is a Debt
Re Taunton Logs Ltd

Claims by officeholders for unpaid share capital have been increasingly common in recent years as the profession casts around for ways to earn a crust. In this case, the court held that the company's articles required shares to be paid for in full upon issue and, accordingly, the company's claim was a simple debt action to be brought under Pt7 of the CPR. Whilst the instant proceedings had been incorrectly commenced as an insolvency application within the administration, the court held that no prejudice would be suffered by its ordering the matter to proceed as though begun with a Pt7 claim.

ADMINISTRATION

Failure to Serve Notice of Intention I
Re Tokenhouse VB Ltd

In this case, the directors purported to file a Notice of Appointment without first having served a NOI on the QFCH as is required by para 26(1). The appointment was challenged by the QFCH who sought the appointment of its choice of IPs as administrators. One question before the court was whether this omission rendered the appointment void or voidable; ie as to whether the omission could be remedied by the court.

ICCJ Jones held that the failure to give notice to the QFCH was merely procedural and that it could be remedied by the court. The court's answer was to terminate the original administration and order a new administration (not backdated) with one new and one old administrator.

Failure to Serve Notice of Intention III
Re NMUL Realisations Limited

In this case, it was a second QFCH that failed to give notice to the prior charge holder. ICCJ Frith followed ICCJ Jones' decision in *Tokenhouse*. He made clear, however, that whilst failure to give notice to a prior charge holder was a curable defect, the court would only cure the defect if so doing would not cause any *'substantial injustice'* to any party. In this case, the prior charge holder had in fact been dissolved and the prior charge marked as satisfied at Companies House so, unsurprisingly, the judge allowed the appointment to stand.

We question whether the requirement is give notice to the QFCH is really just 'procedural'. The lender's lending strategy and pricing will in part be predicated on the knowledge that, under para 26 (and s.84(2A)), it can largely control the insolvency process. If the QFCH's position is to be ignored, what is the point in putting it in the legislation?

Failure to Serve Notice of Intention II
Re ARL 009 Ltd

A QFCH purported to appoint administrators without giving notice to prior charge holders as required by a deed of priority. The High Court held that the appointment was VOID because the underlying charge was unenforceable at the time of the appointment.

Importantly, the court found that a QFCH's appointment constituted enforcement of its security and, in this case, the charge was not enforceable because certain contractual obligations (to which the debtor company was not party) were unenforceable.

The failure of the appointment was void *ab initio* and not capable of being remedied by the court.

Failure to Obtain FCA Consent to Admin
Re MTB Motors Ltd

This was another of those cases in which no-one remembered to obtain consent from the FCA under s.326A FSMA 2000 before appointing administrators. Easily done, no doubt, and *But for the Grace of God …*

In this case, the High Court did not follow *Re Ceart Risk Services Ltd* and found that the failure to obtain FCA consent was a fatal flaw that rendered the appointment a nullity *ab initio*. However, the court found that the breach had been inadvertent and that no hardship was caused so felt able to cure the breach by making a retrospective admin appointment. Different approach, different reasoning, same ultimate outcome.

So, how on earth does one reconcile the above four decisions? Sometimes, procedural failures are fatal and sometimes they are mere glitches to be swept away. Much probably depends upon the cut of the appointor's jib when he arrives art court. Perhaps the better outcome in NMUL would have been a decision that there was in fact no need to give notice.

No Compensation Claim After Discharge
Re Glint Pay Ltd

Three companies sought to bring claims under para 75 for compensation against their former purported administrators following a finding that the appointments were void because the QFC had been unenforceable at the time. The companies had since been returned to solvency and the administrators given their discharge.

The court held that the applicants were no longer in administration and could not rely on the provisions of Sch B1 for a remedy. Despite the carve out in para 98(4) (which maintained the court's power to examine an administrator's conduct even after discharge) the court's power under para 75 could only be exercised whilst the company was in administration.

Potentially, the companies might have had a claim in tort but that was not how it had been pleaded and the court could not just deem the applications to include a tortious claim.

LIQUIDATION

Court's Inherent Power to Make Winding Up Order
1. Re Burningnight Ltd

Administrators sought an extension of their 12 month initial term. The sole creditor, however, wanted the company to go into liquidation amid concerns over an asset sale conducted by the administrators.

The court held that there were no actions that could not be taken by a liquidator rather than the administrators and also that a liquidator would be better placed to investigate the administrators' assets sale. Accordingly, compulsory liquidation was ordered to take effect from the expiry of the administration.

2. Re Fortuna Fix Ltd

Administrators applied for directions following rejection of their proposals. The court determined that the appointment of administrators should cease and that its power in para 55 "*to make any other order … that it thinks appropriate*" included the power to make a winding up order if one of the grounds in s.122 was proven. The court did, however, stress that the power should be exercised cautiously but it nonetheless ordered the compulsory liquidation of the company.

Timing Really Does Matter
Re CGL Realisations Ltd

As part of a corporate transaction, Comet was required to repay a loan to a third party shortly *after* that party sold its shares in Comet. As things turned out at completion, the loan was repaid about 20 minutes *before* the transfer of shares.

Regardless of the parties' intentions, the court was unable to look behind the registers which recorded that, at the time of the same, the party whose loan was repaid was a member of the company entitled to vote and was, accordingly, a connected person. This meant that the loan repayment was vulnerable as a preference – had the court found otherwise, the repayment would have been outside the relevant time. Oops!

Avoiding An Arbitration Clause
Re Telnic Ltd

The court will not allow parties to invoke insolvency jurisdiction in order to bypass an arbitration clause.

The creditor presented a petition based on unpaid service and the petition was stayed pending arbitration with the creditor required to pay money into court to cover the company's costs. The company appealed the stay and the creditor appealed the security for costs order.

The High Court found that it was correct to stay the petition where the debt was not admitted and was subject to a binding arbitration clause and the court was not required to consider whether the debt was disputed in good faith or on substantial grounds.

In this case, the stay was appropriate to encourage the company to engage with the arbitration process and to protect creditors from the disposition of assets.

DIRECTORS

Director's Failure to Produce Records
Re Wow Internet Limited

A case involving some pretty woeful practice by a director who had used company funds for all manner of things including some fairly hefty cash withdrawals. The director had failed to produce any contemporaneous documentary evidence to support any of the payments.

Deputy ICCJ Frisk found that it was incumbent upon a director to produce such evidence when requested by the liquidator and a lack of documents would not reduce the burden on the director. In this case the director was found liable for breach of duty on all counts of funds having been inexplicably paid away.

Director's Failure to Produce Records
Re BM Electrical Solutions Limited

The director here had caused the company to pay to himself or on his behalf £273,631 in the 3½ years leading to its liquidation. There was no documentary evidence to support the payments and no accounts had been prepared for the period.

Predictably, the director claimed that the sums paid to him should have been classified either as salary or dividends – obviously there was no contractual entitlement to a salary nor any resolution to pay dividends.

Deputy ICCJ Ashworth found that the director could not rely on a lack of documentation to cast a retrospective version of events. There was no entitlement for him to receive a salary or dividends and accordingly he acted in breach of his statutory duties to the company in effecting such payments.

Para 3 Purpose Required for Para 35 Appointment
Re High Street Rooftop Holdings Limited

The case involved an admin application under para 35 by a QFCH (ie one which did not rely upon the company's being insolvent). The Company averred that there had been no event of default so the QFCH's power of appointment had not arisen. It relied on an alleged oral variation of the contract.

The court rejected the Company's claim to variation on the basis that there was no evidence of it. In respect of the QFCH's application, it held that the QFCH needed to demonstrate that one of the para 3 purposes was likely to be achieved – it was not enough merely to show that there had been an event of default and that the putative administrators consented to acting.

RECEIVERSHIP

Receivers Must Be Noted On The Register
Ghai v Maymask

Section 26 Land Registration Act 2002 provides that an innocent buyer need not be concerned with any limits on the registered proprietor's power of sale.

In this case, receivers had been appointed over a parcel of land but the directors of the proprietor nonetheless entered into an agreement to sell it to a third party. The register made no mention of the receivers and, accordingly, the court held that good title was transferred to the buyer.

Whilst the property will remain subject to the mortgage which will still need to be redeemed, all may not be lost but receivers should, immediately upon their appointment ensure that their interest is noted on the register.

Alistair Bacon
21 January 2021

Statutory Demand and Winding Up Petitions under the Corporate Insolvency and Governance Act 2020

Individuals

This is the easy part. There are, perhaps surprisingly, no Covid-based restrictions in respect of the service of stat demands on individuals or the subsequent presentation of bankruptcy petitions. Obviously, because of the Covid restrictions, matters will proceed differently in court with the hearing of the petition being dealt with remotely.

Companies

Pursuant to Part 1 of Schedule 10 to CIGA, no petition may be presented based upon a statutory demand served between **1 March 2020** and **31 March 2021** ("relevant period"). Any petition that is presented during the relevant period will simply be dismissed. Notwithstanding that no-one who *really* wants to pursue a corporate debtor should actually bother serving a stat demand anyway, it is absolutely clear that there will effectively be no such thing as a stat demand at least until 1 April 2021 (assuming even then, that the relevant period is not further extended).

The majority of winding up petitions are presented on the basis of the debtor company's inability to pay its debts, not on a statutory demand. Such petitions may only be presented if one of the conditions in section 2(2) of Schedule 10 is satisfied which that the petitioner has reasonable grounds to believe that *either:*

(a) coronavirus has had no financial effect on the company; *or*

(b) that the company would have been unable to pay the petition debt anyway (ie regardless of coronavirus).

There has been surprisingly little judicial authority on this issue – two of the three reported cases were in fact decided before the Act even came into force. Anecdotally, it would seem that the majority of putative petitioners have come to the conclusion that it will be all too easy for the debtor company to hide behind CIGA and they have, accordingly, not bothered. There have, however, been many instances where petitioners have successfully pursued winding up petitions so we should look at the relevant criteria to be applied and that essentially means looking at the judgment of ICCJ Barber in *Re A Company [2020] EWHC 1551 (Ch).*

First, the petitioner must prove that coronavirus has had no financial effect on the company. As was conceded by counsel in the case, this is a test that the petitioner could almost *never* be in a position to satisfy given the absolute language of the section. In the overwhelming majority of cases, one must assume that the first limb of section 2(2) will be made out in the company's favour.

Moving to the second limb, the burden of proof will be on the petitioner to persuade the court that the coronavirus has made no difference to the fact that the company cannot pay its debts. In *Shorts Gardens LLB v London Borough of Camden* the petition related to business rates that had lain unpaid for years. In that case, and in the *Re A Company* case, the court found that the test in section 2(2)(b) was made out in the petitioner's favour – ie the company was insolvent even before coronavirus came along.

There is, however, a third limb of the test which is in section 5 of Schedule 10 – the court can only make a winding up order if it appears that coronavirus has not had *any* financial effect on the company prior to the petition's being presented. Although the burden of proof here is on the company, the bar is set very low. ICCJ Barber felt that, as the bar was so low, it was unlikely that any court would make a winding up order and, accordingly, she had no option but to grant an injunction restraining the petition.

Obviously every case will fall to be judged on its own merits but creditors need to be very aware that, if the company can show that it has in some way been affected by coronavirus, any petition is liable to being kicked into touch. It may be that petitions can only be considered in cases which are (i) for a substantial sum and (ii) a shoo in.

AMB Law Limited
46 New Broad Street
London
EC2M 1JH

T: +44 (0)20 3651 5646

office@amblaw.co.uk

AMB Law Limited
Epsilon House
West Road
Ipswich
IP3 9FJ

T: +44 (0)1473 276103

Alistair Bacon
Principal

T : 020 3651 5647
M: 07881 554062
abacon@amblaw.co.uk

Matthew Rice
Paralegal

T : 020 3651 5704
01473 276181
mrice@amblaw.co.uk

Stephen Carter
Consultant

T : 020 7329 4242
scarter@amblaw.co.uk