AMB LAW

INSOLVENCY UPDATE

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Welcome to the 31st Edition of ***AMB Law's Insolvency Update*** which will provide some light relief during the periods when the R3 Conference is offline. Full lockdown has now been lifted, the pubs are open and people are starting to head back to the office. It isn't entirely clear what those people are actually doing in their offices as insolvency work appears to be at an all-time low. Whilst it is generally acknowledged that the Tsunami *has* to hit the shore soon, there is currently barely a ripple on the ocean. Hopefully Mr Sunak will not be extending the reach of his Magic Money Tree which has now tipped the balance between short-term benefit vs long-term disaster.

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MISCELLANEOUS

Action for Rent Stayed Pending Pt. 26A Scheme
Riverside CREM 3 Ltd v Virgin Active Health Clubs Ltd

The landlord issued proceedings for arrears of rent. The tenant sought a stay of proceedings on the basis that it had issued proposals for a Pt. 26A Restructuring Plan – the landlord had made clear that it would vote against the plan.

The court stayed the landlord's claim on the basis of a balancing exercise between the rights of the landlord and the rights of the creditors as a whole. It was clear to the court on the evidence before it that more than 75% of the creditors would vote in favour of the Plan and it accordingly found that the rights of the creditors took precedence over the proprietary rights of the landlord.

Bank's Duty of Care
Re Stanford International Bank Limited

The liquidators of Stanford issued proceedings against HSBC for damages for not freezing Stanford's accounts and also for compensation for dishonest assistance in a fraud.

The damages claim was struck out on the basis that HSBC only owed a duty to Stanford, its customer, and it did not owe a duty to Stanford's creditors. As regards Stanford itself, the bank's actions were neutral. The dishonest assistance claim was also struck out on a pleading technicality.

It has long been the case that a bank owes a duty of care to its customer and not to any third parties.

The Registrar's Discretion
Re Peter Jones (China) Limited

Administrators wrongly filed details of claims by employees and consumers annexed to the statement of affairs. The more geekish readers will know that filing of this information is expressly prohibited by rule 3.2(2). Realising their error the administrators asked the Registrar to remove the offending schedules from the filing. Predictably, the Registrar refused (*More than my job's worth, Guv …)* and the administrators applied to court. The court found that it was within the discretion of the Registrar to remove the offending schedules and, given that the Registrar's refusal to exercise that discretion was perverse, ordered the Registrar to pay the administrators' costs of the application.

Insolvency Applications Not For Debt Claims
Re Taunton Logs Limited

The liquidators of a company that had previously been in administration issued an application against the shareholders for an order that the shareholders pay in full for their unpaid share capital. The shareholders challenged the application on the basis that it had been wrongly brought as an insolvency application.

Two things were clear: first, that the obligation to pay for shares creates a simple debt between the shareholder and the company and, secondly, that insolvency applications are limited to claims brought under the Act – they cannot be used for simple debt actions.

On the above basis, the claimants were bound to succeed and the court agreed that the application had been wrongly brought. The liquidators' blushes were saved, however, by the court's ordering that the defect be cured under rule 3.10 and that the proceedings continue as though commenced as a part 7 claim under the CPR upon the liquidator's paying the appropriate issue fee (presumably, £10,000 as opposed to £280!).

In many cases, the distinction between a claim for a debt and a more substantive cause of action might be slender (eg in some misfeasance actions) but it is essential that IPs get it right otherwise they will face their claims being struck out.

ADMINISTRATION

Negligence Liability of Joint Administrators
Re Force India F1 Team Ltd

An unsuccessful bidder sought to bring negligence and breach of duty proceedings against the administrators of Force India in respect of their conduct of a bidding process. The claim was found to be without merit and dismissed on all counts.

Interestingly, the judge was at pains to state expressly that, even if he had found against the main administrator, the claim against his joint administrator (who had played almost no part in the sale process) would have failed anyway. An administrator does not incur tortious liability to third parties simply by dint of his joint office and, accordingly, the joint administrator who had played no part could not be liable in tort for the actions of his more active partner.

Good judgment this and very readable – presumably the same principles will apply *mutatis mutandis* to other office holders.

Administration Backdated One Year
Re Mederco (Cardiff) Limited

This was another of those messed-up extension cases in which it transpired that the administrators had not properly sought the secured creditors' consent to the first extension. In this case, the administrators were a tad unlucky as lienors had materialised late in the day and, as we all know, a lien is classified by the Act as a form of fixed charge.

The administrators sportingly applied to the court to make an admin order with effect from the date of the first extension – ie to backdate the admin by about 13 months.

The court however held that there was a well-established rule that an admin can only be backdated by one year (which there is) and that there was therefore a lacuna of about a month between the expiry of the original admin and the taking effect of the admin order.

This whole farrago is brought about by certain pointless provisions in the Insolvency Rules. We accept that there is an established line of authority permitting admin orders to be backdated but we have never been particularly comfortable with that either. It would be so much better if the court could just order that the first extension should stand notwithstanding any petty, procedural defect.

CVAs and Schemes

Landlords' Challenge to CVAs
1] Re New Look Retailers Limited

This case has been analysed to death elsewhere. Essentially, a group of landlord creditors challenged the CVA on the basis that it treated different classes of creditors differently and was, accordingly, unfair. Their claim based on unfair prejudice and material irregularity (connected with the reduction of their claims for voting purposes) and also that the proposal did not constitute a 'compromise with creditors' as it forcefully imposed terms on some creditors.

Zacaroli J rejected the claimants' grievances. The fact that the CVA treated different creditors differently did not mean that it was not a 'compromise with creditors' nor did it unfairly prejudice the 'crammed-down' classes. He also found that a 25% reduction on the landlords' claims for voting purposes was not an irregularity and, even if it was, it was not material.

2] Re Regis UK Limited

This case was factually similar to *New Look* with one major difference which is that the CVA had already failed by the time the case came to court. It was also heard by Zacaroli J who again rejected the material irregularity issue and the unfair prejudice issues – save for one. The court found that the treatment of two creditors as 'crucial' was not justified on the facts and that that special treatment therefore constituted an unfair prejudice to the claimants. On this basis alone the CVA was technically revoked – we say 'technically' because, of course, the thing had already collapsed in 2019 so the matter was largely about bald men fighting over a comb.

Importantly for the profession, the court also held that, having recommended an improper CVA to creditors, the nominees/supervisors were not liable to repay their fees in the absence of *mala fides*. That must be right on any basis.

Our View

It is good to have some clarity on these issues regardless of whether one likes the outcome or not. Whilst we accept that this is the direction in which the law has gone, we are probably in a minority (of one?) in thinking that this is all wrong. CVAs were intended to be an agreed compromise between a debtor and all his creditors who should all get the same treatment. The process has been corrupted over the years by very large retail CVAs being used to impose unfavourable terms on landlords through the importation of principles used in schemes of arrangements (and now Restructuring Plans). The imposition of terms on landlords to the detriment of the proprietary rights seems, to us, utterly offensive to the principles of English law. There … we've said it.

Locus Standi to Object to Scheme
Re Steinhoff International Holdings NV

The court held that it had a wide discretion to hear from parties effected by a scheme of arrangement. Here, a party who had a number of international claims against the group but was not directly a creditor of the scheme company could be heard because it would be affected by the wider restructuring of the group.

As it happened the court sanctioned the scheme notwithstanding the objections of the claimant but importantly the court claimed its discretion to hear from any party with a substantial interest in the outcome.

BANKRUPTCY

Trustees Added As Parties
Lemos v Church Bay Trust Company Limited

Section 423 proceedings had been started some years previously by a victim of a particular, fraudulent transaction. The trustees in bankruptcy had been unable to bring the

proceedings themselves as they were without funds but it was essential that proceedings be issued in order to preserve the benefit of certain freezing injunctions.

Having now obtained litigation funding, the trustees in bankruptcy applied to the court to be replaced as claimants in the application. The court held that the trustees were clearly the obvious and best placed parties to be claimants as they had statutory obligations to pursue assets and any recoveries would be for the benefit of creditors generally. In addition, the trustees could take advantage of powers contained in the Act better to prosecute the claim.

This approach could be useful for future officeholders who find themselves with a clear cause of action but no funds with which to start proceedings – especially if limitation is starting to look troublesome.

Bankruptcy Stay of Proceedings
Michael Wilson & Partners v Sinclair

MWP had obtained an interim third party debt order against the respondent but failed at the hearing for a final order. MWP appealed but before the appeal was heard the respondent was made bankrupt.

The Court of Appeal refused to hear MWP's application on the basis of the litigation stay in s.285 which was absolute unless MWP could set it aside under s.346(6) based on a completed right of execution. Given that MWP had no such right it claim must fail.

LIQUIDATION

Winders in the Time of Covid – Some Guidance
Re PGH Investments Limited

The court has issued some guidance on the interpretation of the CIGA restrictions on winders. By way of caution, the deputy judge found that the company had no contractual obligation to pay the petitioning creditor and accordingly the petition would have been struck out anyway – his comments are, accordingly, strictly *obiter*.

- The burden of proof is on the company to show that Covid has had a negative financial effect but it need only establish a *prima facie* case and the evidential threshold is low;
    - In this case, the company failed to discharge this burden because it was a non-trading, holding company and it adduced no evidence whatsoever in support of its case;
- The petitioner is then required to demonstrate that the company would be insolvent in any event even if it had not been adversely affected by Covid.
    - The judgment does not actually offer any assistance on this question although the deputy judge held that the petitioner had failed to persuade him. The petitioner's case had been on the basis that the company's obligation had been incurred *after* the Covid pandemic began so cannot be said to have been affected by Covid. The deputy judge did not accept that one was a corollary of the other.
- The above is, however, intertwined with the requirement for the court to be satisfied that, upon a substantial hearing of the petition, it would be likely (which only means '*may well')* make a winding up order.
    - Because the petitioner had failed to persuade the court that the company would have been insolvent regardless of Covid it could not be likely that an order would be made and the petitioner failed again.

We are not convinced that this judgment actually offers much assistance to those trying to decipher schedule 10 of CIGA. The truth of the matter is that CIGA is badly written and badly thought through and doesn't really work which is why there have been so few challenges by petitioning creditors. Hopefully, the relevant period will not be extended beyond 30 June 2021 and this will all soon be irrelevant.

Ex Parte Application for Contribution Call
Re Scott-Hake

The liquidators of a partnership applied to the court for permission to make a call on the partners for a contribution (of around £300K each). The partners challenged this application as being an abuse of process as they had no opportunity to challenge the call which they claimed was excessive.

Given that rule 7.88 is headed 'Application without notice' and expressly provides for the application to be made as such, it is perhaps unsurprising that the challenge failed. The court also held that if the contributions were excessive, there would be a surplus to be returned to the partners who would therefore suffer no prejudice.

CROSS-BORDER

Freezing Injunctions and Foreign Bankruptcy
Re Derev

The bankrupt was subject to a Russian bankruptcy. The Russian bankruptcy manager sought recognition of the bankruptcy in England and also the continuation of an interim freezing injunction that had been obtained in the English High Court to safeguard certain high value assets.

The recognition order was made but the bankrupt argued that the injunction was unnecessary as his estate was now subject to the usual protections as though he was bankrupt in England.

The court was concerned at the bankrupt's conduct but held that it had no jurisdiction to extend the injunction as "substantive proceeding" under s.25 of the Civil Jurisdiction and Judgments Act 1982 did not include a foreign proceeding. In any event, the injunction was not necessary as the effects of bankruptcy in the Cross-Border Insolvency Regulation were equivalent to those under the Insolvency Act 1986.

Alistair Bacon
19 May 2021

Pre-Pack Evaluation
The End of the Pre-Pack or A Fuss About Nothing?

The much dreaded new regulations took effect on **30 April 2021** but they would seem to be less Draconian than it had been feared they might be. It is, however, a misnomer to refer to these regulations as affecting pre-packs because what they regulate are not pre-packs *per se* but any sale by administrators of the business or assets to the existing management. Most of which, I grant you, are pre-packs!

As had been well rehearsed in the industry press, *The Administration (Restrictions on Disposal etc. to Connected Persons) Regulations 2021* require prior approval to be obtained of any disposal by administrators if such disposal is:

- of a substantial asset
- to a connected person
- within eight weeks of the commencement.

The concept of a substantial asset is not defined, but that ought to be fairly obvious and IPs should work on the basis that it means anything that is not trivial. The connected person is defined and is similar to the concepts with which all IPs will already be familiar so we will not expand here. Basically, it means officers or their relatives or any company controlled by any of them.

The requisite approval may either be obtained by way of the consent of the creditors or a qualifying report from an Evaluator. In the majority of cases it will not be viable to wait the several weeks that it will take to prepare the para 49 report and then go through a decision process so we do not think that the creditor consent route is even worth considering.

Much has been written about Evaluators and the lack of clarity in the regulations surrounding them and their qualification. However, a few, aside from the Pre-Pack Pool, have started to emerge and they appear largely to be either former IPs or valuation agents who specialise in distressed assets.

IPs have long justified pre-packs and sales to the management as being essential tools in their tool bags for company rescue and have rejected popular suggestions that they are, by definition, sinister or dodgy. If that is true, then IPs should continue to use pre-packs and be prepared to go through the additional hoop of getting a qualifying report. We would suggest that, whilst they are independent, many of these new Evaluators are likely to be culturally sympathetic to the concept of the pre-pack and, accordingly, administrators should not be afraid of testing the water.

We would suggest that the new regulations will do all but nothing to placate the pre-pack critics nor to satisfy the grievances of unsecured creditors. They will merely add another layer of bureaucracy and cost for no useful purpose.

There is an additional (and potentially worse) hole below the waterline in HMS Pre-Pack which is the newly re-acquired HMRC's preferential status. In most pre-packs that we have dealt with, the sums only work because the management is able to take the business leaving behind the creditors. If the buyer now has to pay off HMRC before anything can flow to the bank under its floating charge, securing the bank's support is likely to be too expensive to be attractive.

Many professionals are advocating the use of pre-liquidation sales by the directors as an alternative to the pre-pack. We would, however, urge utmost caution for any directors before entering into such an arrangement and consider whether it would be a fulfilment of their statutory and fiduciary duties or even lawful (given the purpose for which directors are given their powers). Such sales can be achieved by need careful planning and a raft of protections to prevent problems for the directors and AMB will be pleased to advise as we have in several such matters recently.

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