INSOLVENCY UPDATE

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Welcome to the 35th Edition of **AMB Law's *Insolvency Update***. Workloads are definitely on the up and there is a great deal more activity in the market. Official figures show that corporate insolvencies in February doubled compared to February 2021 – hardly surprising given that the insolvency courts were essentially closed last year and many company directors were still in their jim-jams watching *Homes Under the Hammer*. Nonetheless, most IPs that we deal with seem to be much busier than they were six months ago and some are actually reporting being '*frantic*'.

One big problem on the horizon is the impending car crash surrounding meltdown of the court system – particularly, in our experience, Central London County Court which does not seem to function *at all* but to which many High Court applications are automatically delegated and then lost forever. This is not just our usual whinge – it is a very serious catastrophe waiting to happen.

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MISCELLANEOUS

Arbitration Guide for Coronavirus Rent Disputes
***Click Here* for the draft guidlines**

The Government has produced draft guidelines in respect of the new arbitration process under the Commercial Rent (Coronavirus) Act 2022 which was due to come into force on 25 March 2022.

A New *Chancery Guide* Is Published
Chancery Guide

A revised *Chancery Guide* has been published. You may click the link above to access it but don't get too excited as the only changes are:

- A new *Regional Guidance* section has been added and court contact details have been updated in para 30.8;
- Contact details for various judge's clerks have been updated;
- New rules for CE-Filing of draft orders before Chancery masters - paras 22.9 and 22.23.

Interest Required for Knowing Receipt Claim
Re Saad Investments Company Limited

Liquidators pursued a claim against Saudi National Bank for knowing receipt in respect of shares transferred to the bank by its customer which the bank knew to be in breach of trust. In order for the knowing receipt claim to work, the liquidators would have to show that the company retained an interest in the assets. The transfer was under Saudi law which does not differentiate between legal and equitable interests and, accordingly, once the transfer was effected, the company ceased to have any interest in the shares. On that basis, the liquidators' claim was bound to fail.

JCT Payment Régime Following Insolvency
Re Farrar Construction Ltd

The contractor company had entered a CVA and the employer under a JCT had submitted a proof in respect of alleged overpayments and liquidated damages for delays. The supervisor admitted the proof but it was challenged by another creditor on the basis that the JCT payment provisions did not apply on insolvency and the employer was late in submitting his proof.

The Insolvency Rules 1986 applied and under r.4.83(2) the burden of proof was on the creditor not on the person challenging the proof of debt.

The court also held that, upon the company's insolvency, the contractual payment provisions fell away and were replaced by JCT 6.5 and 6.7 which provided that nothing further was payable to the company until a final account had been taken. This applied regardless of whether the employer had terminated the JCT contract.

Vexatious Litigants
Re Paragon Offshore plc

A little used power contained in the CPR is the court's power to make a civil restraint order in respect of any applicant who has issued two or more applications that are wholly without merit – what used to be called 'vexatious litigants' when the

court rules were written in adult language. In this case, the applicant was a disgruntled shareholder who had litigated at length in Delaware to challenge the parent company's Chapter 11 proceedings and had raised many challenges in this jurisdiction including challenging the making of the administration order itself.

The current stream of applications arose out of the applicant's challenge to a proof of debt under r.14.11 which had been dismissed out of hand by the ICCJ as being wholly without merit and unarguable.

In dealing with the current round of applications, ICCJ Agnello accepted that an application's failing was not the same as an application's being totally without merit. In this case, however, the judge held that the applications were all doomed to failure and, as a disproportionate amount of court time had been allocated to the applicant and a disproportionate amount of legal costs incurred, it would be appropriate for a civil restraint order to be made under CPR23.12.

ADMINISTRATION

Administrators' Liability for Breach of Duty
Re RFC 2012 plc

The liquidators of Rangers FC alleged that mismanagement by the administrators amounted to breaches of duty and they claimed £47 million damages from the administrators.

The court found that the administrators had been negligent in a number of aspects in failing to deal properly with redundancies, failing to obtain expert advice, failing to accept a good offer for a valuable player, failing to dispose of the club's real property and failing to consider different outcomes upon exiting the administration.

However, the Outer House concluded that the administrators could only be liable for losses that resulted from their breaches which were assessed at £3 million.

Minor Defect Can Be Cured
Re Caversham Finance Ltd

The administrators' notice to creditors seeking an extension failed to state the reasons the extension was required. The issue only came to light when the administrators applied to court for a second extension.

The judge held that the failings in the administrators' para 76(2)(b) notice were merely procedural defects which could be cured and did not invalidate the consent. The court accordingly allowed a further extension under para 76(2)(a).

DIRECTORS

Directors' Duties and Dementia
Re City Build (London) Ltd

This was obviously an incredibly difficult case for the court to deal with as it involved a number of companies with next to no accounting records and two aged directors both suffering from dementia and unable to remember any real details on examination.

The liquidators' application related to a large number of payments made to the second respondent who was alleged to be the *eminence grise* behind the companies and thus either a shadow or *de facto* director. The first respondent was the *de jure* director who claimed not to have any real role in the management of the businesses.

The court found that, in respect of the second respondent, the burden of proof was on the applicants to establish that he had been either a *de facto* or shadow director and that they had failed to discharge this burden even though the respondent had clearly been involved in the management of the business.

The case against the first defendant appears to have been made out and it is clear that he failed at all times to cooperate with the liquidators and that the company had kept next to no records. Somewhat bizarrely, however, the judge declined to make a contribution order against the first defendant. The basis for this was that he had not personally benefitted and that, because there were no accounts, it would be impossible to calculate a compensation figure.

And we thought Ernest Saunders got away with it!

Nelsonian Blind Eye Was Fraudulent Trading
Re J D Group Limited

The company had originally traded in babywear but began to trade in mobile phones. HMRC had refused certain VAT reliefs in respect of related import and export trades and had urged the director to take certain due diligence steps in relation to the contractual counterparties.

The director denied knowledge of any VAT fraud but was unable to adduce any evidence of the due diligence on which he claimed to have relied.

The court found that the director's conduct was dishonest by ordinary standards and, as such, amounted to fraudulent trading. The director was ordered to contribute to the company's assets a sum equal to HMRC's VAT claim plus certain penalties.

Directors' Duties and *Ultra Vires* Distributions
Re Bronia Buchanan Associates Limited

A director had received substantial sums from the company which were recorded in the director's loan account. When it was clear that the company was insolvent, the accounts were 'rejigged' so that the monies paid to the director were reclassified as drawings.

The court held that the only two lawful ways in which a director/shareholder could take monies out of a company are salary or dividends. It was not open to a director to rewrite history and reclassify payments that had previously been shown as loans in the accounts – signed off by her. The monies could not be salary because they were way in excess of her contractual salary and the burden of proof was on the director to justify the payments as remuneration.

The director was ordered to repay £286,000 being the amount of the loans.

Re TMG Brokers Limited

Two directors had caused the company to make various substantial payments either to themselves or to other companies with which they were associated. D1 claimed to

have no knowledge of the company's affairs or the duties of a director – he merely signed everything that D2 gave him.

The court found that the payments here were distributions of capital disguised as something else. It strongly reaffirmed the principle of unlawful distributions – if a distribution is not made in accordance with the provisions of Pt 23 of the CA06, it will be *unlawful* and in breach of the directors' duties.

Further, the directors are under a duty to act *intra vires* and to promote the success of the company. A lack of knowledge of the job and what it entails is not a defence and the *Duoamatic* principle could not apply because the payments were unlawful.

These are all basic legal points that will be understood by any law undergraduate. It is good to see the points reaffirmed though as there have been cases in the recent past where the courts seem to have gone off the rails on this subject and allowed directors to help themselves under the guise of *quantum meruit*.

Wrongful Preference : Desire to Prefer
Re De Weyer Ltd

A director's honestly held belief that a creditor held security could negate any element of desire to prefer even if that belief was, in fact, wrong. In this case, the creditor had no security and, even if he had, it would have been void for want of registration.

The creditor was the director himself in respect of certain loans that he had made. The court did not believe him and held that he actually did not believe that he had security and he was ordered to repay the monies.

Whilst the decision is *obiter,* it nonetheless accords both with common sense and what we learned at law school: intention is objective, desire is subjective.

CVAs/RESTRUCTURING PLANS

Monitor's Duty Under Part A1 Moratorium
Re Corbin & King Holdings Ltd

S.A38(1)(d) requires a monitor to terminate a moratorium if he *thinks* that the company is unable to pay a pre-moratorium debt that is not subject to a payment holiday.

The court held in this case that the monitor had a wide discretion and his decision could only be challenged if it was perverse or in bad faith.

In this case, the issue surrounded the receipt of certain monies that the companies needed to receive in order to pay certain of their pre-moratorium debts. Whilst the monitor had a wide discretion and could allow a certain leeway, no-one could have said that the incoming funds would be received with any immediacy.

The court therefore found that no reasonable monitor could have concluded that the companies were able to pay their debts but they nonetheless allowed the moratoria to continue on the basis of a balance of convenience.

Disinterested Creditor Excluded From Restructuring
Re Smile Telecoms Holdings Ltd

This was the first ever application under s.901C(4) of the CA06 in respect of whether a creditor or member of a class of creditors had a *genuine economic interest* in the outcome of the plan.

In this case, the court found that there was only one class (consisting of a single creditor) with a genuine economic interest and that the others were 'out of the money'. The court held that the issue should be decided on the ordinary balance of probabilities and that the creditors' economic interests should be considered by reference to the alternative outcomes if the plan were not followed.

BANKRUPTCY

Claimant in Financial Difficulty
Re Hussain, ex p Kirklees BC

The claimant for judicial review sought to challenge his refusal of Covid funding from the Retail, Hospitality and Leisure Grand Fund.

It was a clear provision of EU law that state aid could only be granted to an applicant that was not in financial difficulty which meant either in an insolvency process or fulfilling the national criteria to be placed in one.

In this case, the claimant shop owner, had had an unpaid statutory demand in excess of £5,000 for more than three weeks and accordingly fulfilled the definition of being in financial difficulty and the local authority was right to refuse him funding.

Debtor Compelled to Draw Down Pension
Re Green

It is well established that a person's interest in an approved pension scheme does not fall within his bankruptcy estate. It was also established in *Re Horton* that a trustee could not compel a bankrupt to draw down a pension income if he had not yet done so.

Outside bankruptcy, there is a string of authority arising out of *Blight v Brewster* that allows an order compelling a debtor to take a lump sum from his pension to satisfy his creditors.

In this case, the claimants' debt was founded in fraud and so survived the bankruptcy and the discharge. The claimants sought an order that Mr Green should assign to them his right to call for a lump sum payment from his pension. The defendant argued that such an order would be an unlawful extension of the *Blight v Brewster* principle and would be contrary to public policy as set out in s.11 of the Welfare Reform and Pensions Act 1999.

The court rejected this argument and made the order sought. Whilst the case is only tangentially concerned with bankruptcy (because the debtor was discharged) it is slightly concerning that it might tempt others to try to overturn *Re Horton*. It is also not explained how the claimants were able to avoid s.283(3) which limits a bankruptcy creditor's claims to the assets comprised in the bankruptcy estate.

CROSS-BORDER

Enforcement of Overseas Judgment

Windhorst v Levy

The applicant sought to set aside the registration in England of a judgment against him made by the German court on the basis that he had entered an insolvency process in Germany. As a matter of German law, the insolvency process did not render the judgment unenforceable unless it was set aside by the court. The applicant was currently appealing the German court's initial refusal to set aside the judgment.

The High Court held that the judgment's registration in England had complied with the requirements of the EC Regulation on enforcement of judgments and there were no grounds to set it aside as it was, at the time of the registration, enforceable in Germany.

The court also considered, and refused, an application for a stay of execution as the position regarding enforceability was the same in England as it was in Germany.

Recognition of Foreign Bankruptcy

Kireeva v Bedzhamov

The Court of Appeal held that the judge at first instance had been wrong to recognise at common law a Russian bankruptcy where the bankrupt had alleged that the underlying debt, on which the bankruptcy was founded, had been procured by fraud. The judge had refused to hear the bankrupt's evidence but the Court of Appeal held that he should not have discounted the evidence without allowing the bankrupt to be cross-examined.

It was all for nought, however, as the judge had refused to allow the bankrupt's English property to vest in the Russian trustee as the property was subject to English law. The Court of Appeal held that this had been the correct approach.

Alistair Bacon
23rd March 2022

Eastern Regional Invitational Golf Day

WHEN	WHERE	TIMINGS	PRICE
Thursday 5 May 2022	**Thetford Golf Club** Brandon Road Thetford IP24 3NE	**11:00:** Meet for Coffee and bacon rolls **12:00:** First tee time **17:00:** BBQ and Prizegiving and networking	Individual Golf Ticket (inc green fees and BBQ): **£80** Individual Golf Ticket (inc green fees and BBQ) - Non-members: **£92** Fourball Ticket (inc green fees and BBQ): **£320** BBQ only ticket: **£25**

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Trust Status of VAT Rebates

It is not an uncommon event for VAT unwittingly to be charged in respect of the supply of services either at too high a rate or when the supply was, in fact, exempt from VAT. HMRC will usually refund any overpayment and the question can then arise as to who owns the monies in the hands of the VAT payer.

This situation arose in a case that came across our desk last year. The company was in the construction business and was retained by the claimant to carry out substantial development works in respect of a property in Norfolk. The company charged around £1 million plus VAT at 20% in respect of Phase I of the works and this sum was duly paid by the claimant in accordance with the contract.

The claimant subsequently realised that, under s.29A Value Added Tax Act 1994, the works in question should have attracted VAT at only 5% being renovations to a 'qualifying property'. The claimant notified the company that it had inadvertently overcharged him around £150,000 in VAT and that it agreed to seek to recover these monies from HMRC. The company duly submitted a request for a rebate on its next VAT return and, in time, HMRC paid a net rebate of £120,000 (having deducted VAT properly due).

To complicate matters, the company went into administration *after* the VAT return was submitted but *before* the rebate was received so that the £120,000 from HMRC was effectively received by the administrators.

The claimant was furious and sought to recover the monies from the company in administration on the basis that the rebate was clearly paid by HMRC to the company with view to its being passed on to him. It was conceded that there was probably a good claim against the company in respect of unjust enrichment and the claimant was invited to submit his proof of debt at the appropriate time. Given, however, that there was next to no prospect of a dividend to unsecureds, the claimant sought to state his claim on the basis of a constructive trust arising out of the unjust enrichment – ie that the administrators held the rebate monies on trust for him as the intended recipient.

The claimant's various trust claims were all soundly rejected.

The company was the taxpayer not the claimant and, accordingly, it dealt with HMRC as principal not as the claimant's agent. There could therefore be no implied trust arising out of agency.

The question then arose as to whether there could be a *Quistclose* or constructive trust as had been held to be the case in *Deluxe v SCL (2020)* the facts of which were all but identical to our own. In that case there had been a statutory undertaking by the taxpayer to HMRC to pass on to its overcharged customer the benefit of any VAT rebate. The court held that this undertaking was sufficient to found a *Quistclose* trust on the basis that the rebate monies had been paid by HMRC for the express purpose of passing on to the customer.

Unfortunately, the taxpayer in *Deluxe v SCL* did not attend the hearing and the matter was not fully argued so the court was not made aware of the leading authorities and the decision is *per incuriam**.

The next time that this issue arises, one might be tempted to advise the out-of-pocket customer to pursue the taxpayer on the basis of the VAT rebate's having been received pursuant to a constructive trust in reliance on *Deluxe v SCL* which might support such an argument. It would however be foolhardy as the court would, on hearing full argument, be unlikely to follow *Deluxe.* The VAT monies in the hands of the taxpayer are not held on trust for end customer who will have only an unsecured claim.

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