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INSOLVENCY LAW FIRM

UPDATE

December 2018

Welcome to the CRI Insolvency Law Update, a summary of recent judgments and insolvency related reports and news items which we hope you will find of interest

Happy New Year to all

We take this opportunity of wishing everyone a prosperous 2019

2018: The year of the CVA

2018 has seen a number of high profile company voluntary arrangements ("CVAs") with many well known high street brands making use of this restructuring tool. CVAs are very flexible procedures and can be used to compromise any unsecured debts of a company. However, the current trend in the market has been a sharp increase in the amount of "landlord-only" CVAs. These are CVAs which compromise a company's leasehold liabilities to its landlords, whilst often leaving other creditors' claims untouched.

Whilst there has been some criticism of the growing number of CVAs, particularly from larger, institutional landlords who are seeing their returns fall as a result of them, it seems likely that, unless some of the structural issues in the retail and leisure sectors can be resolved soon, there will be more CVAs in 2019. CVAs could continue to be particularly prevalent in the consumer sectors of retail, leisure, and casual dining, being sectors where companies typically have large real estate portfolios and are increasingly experiencing a simultaneous rise in operating costs and a downfall in trading performance.

Moving forward, might we expect to see more challenges to CVAs? Following approval by the requisite majority of creditors there is a 28 day statutory challenge period which provides creditors the opportunity to challenge the CVA

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on the basis of: having unfairly prejudiced their interests and/or assert and/or that there has been a material irregularity in relation to the creditors' decision? The House of Fraser CVA was challenged by a group of landlords, albeit was settled before it reached a Court hearing leaving potential points of issue yet to be determined by the Courts.

Adjudication v the Insolvency Rules

In a potentially significant ruling for the construction sector and insolvency practitioners, Fraser J in the TCC has held that: *"A company in liquidation cannot refer a dispute to adjudication when that dispute includes (whether in whole or in part) determination of any claim for further sums said to be due to the referring party from the responding party."*

This judgment is significant because liquidators often refer disputes to adjudication to recoup sums allegedly owed to an insolvent company. However, this type of claim cannot be referred to adjudication and any adjudicator faced with such a claim has no jurisdiction.

Michael J Lonsdale (Electrical) Ltd v Bresco Electrical Services Ltd [2018] EWHC 2043 (TCC) (31 July 2018).

Assignment of cause of action

The High Court dismissed an appeal that administrators had unfairly harmed the interests of a creditor by refusing to assign a claim to it. The claim had been made under paragraph 74 of Schedule B1 to the Insolvency Act 1986 alleging unfair harm, and the court found that the creditor's appeal hadn't appealed the original finding meaning that the appeal had to be dismissed. However, the court considered in some detail the approach and procedure that should apply: 1. When an administrator is considering whether to assign a claim by the company in administration against a third party. 2. In applications under paragraph 74 of Schedule B1 where the issues concern the merits of an action against a third party who wishes to be heard on the paragraph 74 application.

LF2 Ltd v Supperstone and another (Administrators of Pennyfeathers Ltd) [2018] EWHC 1776 (Ch).

Bankruptcy order set aside for serving no useful purpose (High Court)

The High Court (Judge Hodge QC) has set aside a bankruptcy order based on a petition presented in respect of unpaid council tax on the basis that the debtor had no assets to satisfy her liability in bankruptcy and no investigation of her affairs would bring anything to light and so there was no benefit in making her bankrupt.

The debtor had served evidence showing she was living in social housing and had been dependent on financial support from her daughter. She had argued that as she had no assets there was no useful purpose in making a bankruptcy order against her. The district judge made the bankruptcy order on the basis that there had been liability orders which had not been set aside or challenged. The debtor (successfully) appealed the bankruptcy order relying on section 266(3) of the Insolvency Act 1986 (the court's general discretion to dismiss a petition).

The case demonstrates that local authorities must show a benefit in making someone bankrupt where petitions are based on unpaid council tax.

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Lock v Aylesbury Vale District Council [2018] EWHC 2015 (Ch) (9 July 2018) (Judge Hodge QC).

Court of Appeal overturns non-party costs order due to a "failure to warn"

The Court of Appeal has overturned a High Court decision granting a non-party costs order against an insolvent company's director and majority shareholder.

The court cited the claimant's failure to warn the non-party of its intention to seek such an order as fatal to the application. This decision illustrates that a failure to warn will be a material factor in some cases when considering whether a non-party costs order is appropriate. The practical message is obvious: where a litigant may wish to pursue a non-party for costs, in the event that the losing opponent does not pay them, it would be well-advised to warn the non-party of that possibility as early as possible in the proceedings.

The decision is also of interest in suggesting that the Arkin principle, which has been held to restrict a third party funder's adverse costs liability to the amount of funding provided, has no application outside the realm of professional litigation funding.

Sony/ATV Music Publishing LLC v WPMC Ltd (in liquidation) [2018] EWCA Civ 2005

Discharging freezing & charging orders

Joint Trustees in Bankruptcy of Vincent Mascarenhas (deceased) successfully applied to discharge Freezing Orders, an Interim Charging Order and an Interim Third Party Debt Order obtained by creditors of the late Bankrupt in 2014. The Joint Trustees were not a party to either of the original proceedings. It was held that the present application was a freestanding application which the trustees were entitled to make, following *Cretanor Maritime Co v Irish Marine Management Ltd [1978] 1 WLR*.

The Respondents were held to be unsecured creditors of the bankruptcy. The Freezing Orders created no proprietary interest, and as the Charging Order was not made final prior to the bankruptcy, were not entitled to retain the benefit of the interim order. The assets had vested in the Joint Trustees and the late Bankrupt has died, and therefore it was held that there could be no risk of dissipation.

The decision shows the Court was able to assist office holders in connection with their statutory duties to realise assets, by discharging Freezing Orders that were of no benefit to the parties who had sought them given they were now unsecured creditors of the estate.

Ambey Capital Private Ltd & Ors v Mascarenhas & Ors (2018)

Recovering from an insolvent employer: claims against directors

It is not uncommon that, after performing works, a contractor finds out that the employer is insolvent. This may have serious consequences as the contractor will be most likely ranked behind other categories of the employer's creditors in any insolvency process. In this situation, what are the contractor's other options? One option may be for the contractor to try to pierce the corporate veil and prove that the employer's shareholders should be accountable for the company's breach of contract.

While such claims are possible, the English courts will normally allow them to succeed only in an extremely limited number of scenarios. These include using a company as a sham,

fraudulent misrepresentation and personal injury cases, which usually require a high evidentiary threshold. Another option is, instead of arguing that the shareholders should be responsible for the company's actions, to make a claim in tort based on the directors' own conduct. The decision in Palmer Birch v Lloyd is important as it highlights that the contractor's options are not limited to piercing the corporate veil to go after the employer's shareholders.

If the breach was induced or influenced by the employer's directors or shadow and de facto directors, the contractor may be able to make claims against them.

Palmer Birch (A Partnership) v Lloyd & Anor [2018] EWHC 2316 (TCC)

The Crown – Preferential creditor

The Chancellor announced in his budget that the Crown is to be re-instated as a preferential creditor in insolvency, reversing the changes brought in by The Enterprise Act 2002.

From 6 April 2020, HMRC will become a secondary preferential creditor in insolvency (principally behind employees and the Redundancy Payments Office) for pre-insolvency tax liabilities including PAYE, employee NI, VAT and Construction Industry Scheme deductions. This will cover all pre-collected taxes (so will not include corporation tax or employer NI) for which HMRC will rank ahead of floating charge holders and unsecured creditors.

The motivation behind the policy is to ensure that taxes paid in good faith by employees and customers, which the company holds in trust before paying across to the government, go towards funding public services as intended rather than to settling other creditors' debts. However, there is concern that the overall effect on the economy could be that borrowing is both harder to come by and also more costly, as lenders may consider increasing rates and/or reducing the loan amount to mitigate the potential additional risk.

Further, there exists the possibility that the changes will make business rescue much more challenging and also that the Treasury losses will be transferred to the private sector.

Unpaid barrister's fees under non-contractual engagement do not vest in trustee in bankruptcy (High Court)

The High Court (Davis-White QC J) has held that a barrister's unpaid fees as at the date of his bankruptcy order, arising under a non-contractual honorarium engagement, were not property within the definition in section 436 of the Insolvency Act 1986 (IA 1986) and therefore did not automatically vest in his trustee in bankruptcy on appointment.

While narrow in applicable scope, this case presents a salutary reminder that not all of a bankrupt's non-excluded assets are necessarily property which vests in their trustee. The persuasive factor here was that a moral right to fees is not a recognised form of property: it cannot be sold, assigned or factored and, as such, the bankrupt has a real personal inability to realise the expectation of payment.

Once payment has subsequently been made, however, a trustee should be able to recover it for the estate creditors as after-acquired property (under section 307, IA 1986) or using an appropriately drafted income payments order (under section 310, IA 1986).

Gwinnutt (as the First Defendant's Trustee in Bankruptcy) v George and another [2018] EWHC

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2169 (Ch), [2018] All ER (D) 86

Out of court appointments of administrators:

When appointing administrators out of court, there is requirement to specify the date and time the appointment is made.

This is a development arising since April 2017 as a result of the Insolvency Rules 2016 coming into force. Given that appointments are generally effective at the point of filing, it has been unclear how (absent a crystal ball) practitioners should address the requirement when preparing the Notice of Appointment form.

A recent High Court decision, revisiting the earlier 2018 NJM Clothing decision, resolves the issue, confirming that a notice making reference to a future filing is acceptable.

Orton and others v Towcester Racecourse Company Ltd (in administration) [2018] EWHC 2902 (Ch)

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The contents of this Update provide only a brief overview of the more important cases and reports. If you should require any detailed advice concerning these changes then please do not hesitate to contact us.