Newsletter September 2020

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INSOLVENCY LAW FIRM

Update

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

Corporate Insolvency and Governance Act 2020 (further temporary measures)

The temporary measures introduced by the Corporate Insolvency and Governance Act are due to expire on 30 September 2020. It has been announced that some temporary measures will be extended into the coming months as the economy continues to recover from the COVID-19 lockdown. The Corporate Insolvency and Governance Act 2020 (Coronavirus) (Extension of the relevant Period) Regulations 2020/1031 was laid 24 September 2020.

The insolvency measures that will be extended are:

-Suspension of serving statutory demands and restrictions on winding up petitions – extended until 31 December 2020
- Small business exemption from the termination clause requirement is extended until 30 March 2021
-Temporary moratorium rules – extended until 30 March 2021
 Modifications to moratoriums being extended to 30 March 2021:
-Companies subject to a winding up petition can access a moratorium by filing papers at court (rather than having to make an application to court)
-Companies which have been in a CVA or administration within the last 12 months can obtain a moratorium (usually they would not be eligible)

Carrick Read Insolvency is a specialist insolvency law practice providing legal and technical advice to insolvency practitioners, debtors and creditors involved in the insolvency process.

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The following measures are not being extended and will cease to have effect after 30 September 2020

- The suspension of wrongful trading.
- The modification to moratoriums that relaxes the criteria for the monitor to assess that the company is likely to be rescuable in order to enter a moratorium/for a moratorium to continue

Restoration Opposed

Application was made for an order to restore three dissolved companies after they had gone through a solvent liquidation process putting them back into solvent liquidation and appointing liquidators to investigate not only the affairs of the company but also the conduct of the ex-liquidators. The restoration application was made without notice to the ex-liquidators or members by two aggrieved minority shareholders who wanted the affairs of the three Core VCT companies (all venture capital trusts) to be investigated.

The High Court agreed to make an order restoring the companies and appointed new joint liquidators nominated by these minority shareholders.

The new liquidators then commenced investigations into the companies, demanding information and documents

To assist with their investigations, the joint liquidators applied to the High Court seeking an order compelling the cooperation of Mr Fakhry and Mr Edwards' who were the founders and managing partners of two fund manager companies that managed the liquidated companies and the former liquidator

Shortly afterwards a cross application was made by the former liquidator and Mr Fakhry for:

- A dismissal of the restoration orders and removal of the new joint liquidators; or,
- The removal of the joint liquidators and their replacement by the former joint liquidator; or,
- The calling of a meeting of shareholders to decide whether the companies should remain in liquidation and if so, who should be the liquidator/s.

The High Court dismissed the cross-application in its entirety. That decision was appealed

The appeal was allowed by the Court of Appeal acknowledging the sovereignty of the members by majority to decide matters concerning a company in a solvent liquidation albeit tempered by the court's ultimate power to remove and replace liquidators on an application by any person the court thinks proper. The court also

-rejected the suggestion that the minority shareholders did not have other remedies outside of a restoration procedure.
-expressed limited views on the adverse interests principle: it doubted whether it existed as a principle as opposed to a highly material factor in the exercise of discretion on a -removal application.
-considered the present liquidators should stay in office, subject to the calling of a meeting of members to vote on the restorations, the proposed investigations and whether the current liquidators should remain in office.

Core VCT PLC companies (In Members Voluntary Liquidation) [2020] EWCA Civ 1207

Swaps Claim

Rhino (and one other associated company, 'the Companies') entered administration in August 2013 following the Bank appointing administrators at a time when the Companies had substantial claims against the Bank arising from the mis-selling of interest swap products ('the Swaps')

The Companies had the benefit of advice from leading counsel, to the effect that there was a 60% chance of succeeding in a claim against the Bank based on LIBOR manipulation and mis-selling of the Swaps.

The Administrators took their own advice from solicitors, who put the prospects of success at just less than 50%.The Administrators sold the property portfolio with a shortfall of £663,000 to the Bank despite objections from the shareholders.The shareholders, the Claimants in this case, managed to persuade the Bank and Administrators to write off the £663,000 shortfall and exit the administrations through CVAs so that the Companies could proceed with the Swap Claims against the Bank.

The Administrators included a clause in the CVAs by which all creditors (which included the Claimants) and the Companies undertook not to bring any claims arising from the Administrators' acts, omissions or defaults, and further released the Administrators from such liabilities ('the CVA Release Clause'). The Claimants approved the CVA in their capacity as creditors and the Companies were returned to the control of their directors in August 2014.

The Companies issued proceedings against the Bank in 2015, which were settled that year.In August 2019 the Claimants, as contributories of the Companies, issued proceedings challenging the Administrators' conduct, seeking compensation of £18.6M.

The Claimant's major complaint was that the Administrators should not have accepted the appointment because of a close relationship with the bank but having accepted the appointment they acted in breach of good faith and duty in that their independence was compromised. The Administrators relied upon, amongst other things, the CVA Release Clause

The court considered that it was improper for an administrator to use the machinery of a CVA to exclude a liability after the event which could not be excluded before or during the event. The CVA Release Clause did not prevent the claim proceeding

The court also found that a CVA is not a contract and that the Administrators could not rely upon the Contract (Rights of Third Parties) Act 1999 to avoid liability

Re Rhino Enterprise Properties Limited [2020] EWHC 2370 (Ch)

Fine as a provable debt

The company pleaded guilty to offences under the Environmental Protection Act 1990 after an application by the liquidators to prevent the continuation of the proceedings failed. The liquidators had done no wrong as the offences arose prior to liquidation

The liquidators applied to court for directions that the liquidation funds could be distributed to floating charge holders.The liquidators sought directions that they could distribute on the basis that the liquidators had disclaimed the leases and the waste (which gave rise to the offences) and therefore nothing which happened in the criminal proceedings would impact the insolvent estate.

The Insolvency Rules 2016 expressly provide (R14.2(2)(c)(i)) that a fine is not a provable debt in bankruptcy but the Rules and the Act have never been amended and are silent on the treatment of fines in other types of insolvency proceeding.

Having considered r14.1 and the meaning of "a debt" which includes both a debt or a liability as defined in r14.1 (b), the judge concluded (applying the ratio in *Re Pascoe* [1944] Ch. 310) that a fine was a provable debt, concluding *"It seems to me that a fine, even if imposed after the onset of insolvent liquidation, is a provable debt in that liquidation where it was triggered by offences committed prior to the entry into liquidation."*

The judge allowed the liquidators application

Re Paperback Collection and Recycling Ltd [2020] EWHC 1601 (Ch),

The role of management

The court refused to grant an order sought under para74(1) Sched B1 IA 1986 by the director of a company to require the administrators to consent to the appointment of additional directors and to the completion of certain steps intended to prepare the company for the end of the administration. In order to challenge the administrators' refusal to consent to these measures, the director had to show that, on the balance of probability, the proposed steps were required to preserve the company's interests and value and so by refusing to consent, the administrators were "acting unfairly so as to harm interests as a creditor or member".

The court considered the role of management during an administration in light of the scope of the administrators' obligations, and whether the administrators had "acted unfairly".

The order was not granted, on the basis that the director did not prove on the balance of probability that the proposed steps were required to preserve the company's interests and value and so it was not made out that there was any unfairness in the administrators' refusal

Dearing v Skelton [2020] EWHC 1370 (Ch)

Wrongful trading guidance

Bowlplex Limited (Bowlplex) entered financial difficulties following the 2008 downturn. They turned to their lender, RBS, for restructuring advice. RBS provided the support of its (i) global restructuring group and (ii) asset acquisition/management division (West Register). This led to three steps:

Initial Restructure. In 2011, Bowlplex restructured its debt and relinquished 35% of its share capital to West Register. West Register appointed an observer Mr Sondhi

Company Voluntary Agreement. In 2012, Bowlplex implemented a CVA, writing off £4.5m of RBS debt and increasing West Register's share of Bowlplex to 60%. Mr. Sondhi appointed a turnaround specialist, Mr Cooper, as non-executive chair. Mr. Cooper dismissed the managing director of Bowlplex.

Sale. In 2015, Bowlplex was sold to a third party for £22.6m, £13.6m of which went to West Register.

Following the above, shareholders of Bowlplex claimed that RBS, West Register, and Mr. Sondhi had conspired to devalue Bowlplex in order to acquire its equity

Following a 2018 strike-out application, the main claim to be considered in the judgment was that West Register and/or Mr. Sondhi attempted to achieve this purpose in contravention of their fiduciary duties as shadow directors of Bowlplex.

The High Court after considering the facts of the case confirmed that the duties owed by a shadow director are limited to the subject matter of their instructions. This case is particularly relevant for distressed companies and their shareholders, as well as banks and other investors who appoint "observers" to the boards of borrower companies.

The judge was satisfied that Mr. Sondhi and/or West Register were shadow directors of Bowlplex, due to their appointment of Mr. Cooper and removal of the original managing director. Yet the court also noted that Bowlplex had entered into the restructuring steps of *"its own free will"*, by its registered directors and without instruction from Mr. Sondhi or West Register.

It was accepted that there was established law to the effect that *"duties owed by shadow directors are limited in extent"* to *"those matters where he gives instructions"*. The judge considered that *"fiduciary duties flow from relationships"*, and so when shadow directorship *"is relied on as the source…it is only the acts of instruction which can form the foundation for any fiduciary duties that he may owe.*

The judge found that there was no link between (i) Mr. Sondhi appointing Mr. Cooper as a director, and (ii) Bowlplex entering into the CVA,

NNDR scheme found lawful

This case upheld a decision that a national non-domestic rates (NNDR) mitigation scheme which utilised the exemption from NNDR available to companies in voluntary liquidation was not an abuse of the insolvency regime.

The scheme in question involved the granting by participant landlords of leases to an SPV which then entered a members' voluntary liquidation (MVL). The leases were entirely transparent as to their purpose (avoidance of the landlords' NNDR liability) and in each case contained provisions for the payment by the landlord of a determination premium to the liquidator on the determination of the lease, with the landlord having the right to determine the lease at any time. The evidence was that leases were surrendered during their term (because, for example, properties had been re-let). As a result, determination premiums were incurred and paid to the liquidator and these formed assets for the purposes of the liquidation. The validity of the scheme was upheld at trial and the Secretary of State appealed against the finding that the scheme was not an abuse of the insolvency regime. The Court of Appeal unanimously decided that even though the assets (the contingent determination premiums) were admittedly created solely for the purposes of the liquidation and were to that extent artificial, they were realised and so were genuine assets representing real money. As a result, the liquidation was a genuine process. The accepted motive for the liquidation (tax mitigation) was irrelevant and the liquidators acted properly and thus the scheme achieved its purpose and was lawful.

Secretary of State for Business, Energy and Industrial Strategy v PAG Asset Preservation Ltd [2020] EWCA Civ 1017

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