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Although many still believe the worst of the slowdown is over, recovery is likely to be slower and more painful than predicted.

As my thoughts turn to my summer sailing holiday, I was reflecting upon the prevailing wind that appears to be blowing a more ethical and puritanical mood across businesses and professions.

The FT reported (29 June 2009) that G8 is set to push for a return to 'ethics';

"Flawed markets and fundamental weaknesses in the world economic system demand adoption of a "global standard" of norms and principles and a return to ethics in business.

Voters are angry at bailing out companies seen as victims of their own reckless greed, and some government officials under fire for their lack of standards, the moralistic tone captures a newfound interest in the importance of ethics."

There was unprecedented social opprobrium over the MP's expenses debacle. According to the Future Foundation,

"...we are increasingly curbing our enthusiasm for profligate consumption, and health and environment-threatening behaviours. Gone is the guilt-free pleasure-seeker, to be replaced by the model well-meaning citizen, the New Puritan."

Anyone who knows me knows I like to splice the mainbrace and may have once or twice been three sheets to the wind, but there does seem to be a mood of disapproval to be seen having fun. Many businesses have had to make redundancies but, having made people redundant, should one therefore be out and about marketing?

At the weekend I was speaking to a well known nightclub owner who said that people were just not going out and spending money or if they were out their spending was measured; *"they do not want to be seen flashing the cash."*





The press have called for much tightening of regulations over the financial services industry. We have already seen more and more regulation of the insolvency profession.

Despite the recent governmental debate over pre-packs and the report by the Insolvency Service there have been calls once again for further regulation.

The ABI has called for a series of new measures to put an end to what it said were ongoing abuses of the system. [Click Here](#) for the link to their letter to the Insolvency Service.

Insolvency Practitioners seem to be caught between the devil and the deep blue sea in trying to be commercial and uphold Insolvency Law and yet are criticised by all and sundry.

Rather than more rules and paperwork which drown the good guys should we just not look at who we do business with? What are their morals and ethics?

Is it worth sailing too close to the wind. The solicitor with their “manageable” or “irrelevant” conflict...!

At Geldards the BRI team has worked together for a long time, probably because we work to the same high ethical standards. We are very commercial but we also take the view that sometimes it is better to watch a ship sail than worry about the risk.

Upholding principles and standards I have no problem with, but I do miss the lavish marketing..but, whoops, is that not the attitude what contributed to record debts on credit cards.

Official figures out last Friday show that a record number of people in England and Wales were declared insolvent during the second quarter of the year. Is this the start of the deluge that Personal Insolvency Practitioners have been forecasting?

We will have to wait and sea and maybe, by toeing the line, my ship will come in.



Deborah Jenkin Jones,
Partner

Adrian Slater,
Partner





➔ Pre-Packs: For Whose Benefit?

Re. Kayley Vending Limited (in administration) [2009] EWHC 904 (Ch) – HHJ David Cooke sitting in the Birmingham District Registry on 15 May 2009.

Paragraph references are to the judgment.

Background

Now that possibly everything that could be written about *Re. Innovate Logistics Limited* has been written, the insolvency community were eager for a new decision relating to pre-packs.

Their prayers have been answered by HHJ David Cooke's decision in *Re. Kayley Vending Limited* ("KV"). Luckily HHJ Cooke was clearly more familiar with the mechanics and rationale for pre-packs than HHJ Simon Brown QC, being the judge who gave the much criticised decision at first instance in *Re. Innovate Logistics Limited*, which was also heard in the Birmingham District Registry.

The facts are unremarkable. KV was a cigarette vending machine company whose business had suffered following the smoking ban. It was the subject of a winding up petition presented by HMRC relating to a liability of some £79,000. HMRC had apparently already vetoed a CVA.

A pre-packaged sale of the business to one of two unconnected third parties (one of its competitors) was agreed. Due to the petition there needed to be an in-court application of the administrator. Possibly still smarting from *Re. DKLL Solicitors* HMRC did not seek to resist the pre-pack and were not in court.

The insolvency practitioner (who is not named in the judgment) is a Michael Durkan of the firm Durkan Cahill in Gloucester. His case is now the leading discursive authority on pre-pack sales.

This was an uncontested hearing. HHJ Cooke's detailed judgment is in response to an

"invitation by [counsel] to give some guidance to the profession as to the approach of the court to what have come to be called "pre-pack" administration applications, in the light of the recently promulgated Statement of Insolvency Practice 16 entitled "Pre-Packaged Sales in Administrations"." (para. 1)

Clearly the intention behind the judgment was to benefit the insolvency profession, which is commendable.

The Judgment

The judgement sets out in detail the differing views of pre-packs. There is a detailed discussion of SIP 16 (paras. 4 and 12). It cites in detail the work of Dr Sandra Frisby commissioned by R3, being a detailed and meticulous analysis of available data on pre-packs and their outcomes for creditors (paras. 7 to 9).

It also quotes from Jon Moulton's article in *Recovery* dating from 2003 entitled *'The Uncomfortable Edge of Proprietary Pre-packs or Just Stitch-ups?'*, which has both a more colourful and critical take on the whole concept





(para 10).

There is also detailed discussion of the purpose of administration, administrators' reports, the two alternative routes to an administration order and the power to sell the company's business and how unsecured creditors are kept in the dark (paras. 13 to 19). *Re. T&D Industries PLC* [2001], *Re. Transbus International Limited* [2004] and *Re. DKLL Solicitors* [2007] all get name-checked.

IP's Reports

It is at paragraph 20 where things start to get more interesting...

HHJ Cooke contemplates the detail that the IP needs to put in his evidence before the court. He concludes that Insolvency Rule 2.4(2) requiring

"...any other matters which, in the opinion of those intending to make the application for an administration order, will assist the court to make such an order, so far as lying within the knowledge or belief of the applicant",

would require all relevant details of the pre-pack and its effect for creditors.

Any information, favourable or not, which might assist the court in exercising its discretion to make the administration order should be included. The court will be reliant upon;

"the professionalism of the applicants and their legal advisers to ensure that the information is sufficient but not excessive, appropriately selected and fairly presented" (para. 22).

HHJ Cooke appears to suggest that if the report is materially defective then that could potentially lead to the administration order being set aside (para. 23), although that report is only ever likely to be read by (a) the court and possibly (b) a petitioning creditor.

In addition, the information required by SIP 16 should also be included (para. 24) as that information will be known at the time the application is made as a result of the pre-pack negotiations being at an advanced stage.

Any reasons for not providing that information, "can be explained".

The information should not only be provided once the application for the administration order is known to be opposed, presumably by the petitioning creditor (para. 25). It will be a matter for each judge on each application as to what amounts to sufficient information (para. 26).

"In exercising its discretion in pre-pack cases, the court must be alert to see, so far as it can, that the procedure is not being abused in any of the ways outlined above [i.e. in the criticisms in Jon Moulton's article, in particular where the existing management of a company use administration as a means to shed old debt and carry on running their business as before]. If it is, or may be, the court may conclude that it is inappropriate to give the pre-pack its apparent blessing conferred by making the administration order." (para. 24)

Commercially Sensitive Information

In cases where there is commercially sensitive information IR 7.31(5) can be used to prevent that information being inspected on the court's file and





contained within separate exhibits (para 28).

If appropriate the practice common in London can be adopted whereby the solicitors for the officeholder undertake to hold the evidence that would otherwise be on the court's file and to lodge it again if ordered to do so (para. 29).

Costs

This is the most significant bit.

The IP sought an order that their pre-appointment costs be an expense of the administration. Importantly it is not 100% clear from the judgment if those costs included their time and legal costs working on the sale of the business, or just the application for the administration order. The application for costs was put on two alternative legal bases:

First, under IR 2.67 and following an unreported decision of HHJ Norris QC in *Re. SE Services Limited* (9 August 2006) which was effectively affirmed by an unreported decision of HHJ Purle QC in *Re. Aldersely Battery Chairs Limited* (Birmingham, No. 9003 of 2008 - 14 January 2008). *Re. SE Services Limited* concerned the costs of and occasioned by "the proposed administrat[or] pre-appointment in considering and completing form 2.2B" which had effectively replaced the report prepared pursuant to Insolvency Rule 2.2.

The costs of and occasioned by the '2.2 Report' were usually ordered to be treated as an expense of the administration, under the pre-Enterprise Act regime.

IR 2.67(1)(c) provides that;

"the costs of the applicant and any person

appearing on the hearing of the application and where the administrator is appointed otherwise than by order of the court, any costs and expenses of the appointor in connection with the making of the appointment and the costs and expenses incurred by any other person in giving notice of intention to appoint and administrator."

However, the Insolvency Service's 'Dear IP' letter to practitioners dated September 2005 states very clearly that;

"costs incurred prior to the administration [such as advice regarding the company's financial predicament] are essentially a matter between the insolvency practitioner and the party instructing them... any fees outstanding, at the date the company entered administration, would, in our view, rank as an unsecured claim."

The alternative basis was under paragraph 13(1)(f) of Schedule B1, which provides that on hearing an administration application the court may;

"make any other order which the court thinks appropriate."

HHJ Cooke felt that "any other order" included an order for the costs of an administration application (para. 31). He then went on to quote with approval and at length from a barrister's note of the unreported decision of HHJ Norris QC in *Re. SE Services Limited*:

"In the present case, [it] seems to me that the Insolvency Practitioner has put together a form of administration that is plainly for the benefit of creditors. [That] might not always be the case. It is the experience of the court that, although there is a more





beneficial outcome, the thrust of the administration proposal is [sometimes] that the existing management should be able to buy the company shorn of the burden of its historic debt.

In such cases the balance of advantage between existing creditors and the existing management appears to be heavily with the managements.

In such circumstances, it is wrong for creditors to bear the burden of a choice which might give benefit to them, but more benefit to the management.

To construe 2.67(1)(c) as covering these costs would mean that in every case the pre-appointment costs could be charged wherever the balance lay.

Use of the power in paragraph 13(1) of Schedule B1 enables the Court to approach the matter on a case by case basis.

...The appropriate power is paragraph 13 of schedule B1.

Whether in a less meritorious case, the administrators would cover pre-appointment costs should await an application in the appropriate factual context."

HHJ Cooke agreed that the paragraph 13 of Schedule B1 approach is the correct one, thereby retaining control by the court. He concluded his judgement by saying:

"HHJ Norris QC further held that it was appropriate in the exercise of his discretion to make the order sought where the court is satisfied that the balance of benefit

*of arising from the incurring of pre-appointment costs is in favour of creditors rather than (in a pre-pack case) the management as potential purchasers of the business. In my judgment it is appropriate that the court should continue to follow this practice, as HHJ Purle QC also did in the **Aldersley Batteries** case."* (para 33)

He also said:

"In the present case the evidence showed a potential benefit to creditors, and there was no question of purchase by the management, and accordingly I approved the proposed order." (para 34)

Commentary

The clarification of what should be included in the IP's evidence in support of the administration order is helpful, particularly in relation to commercially sensitive information, which will be of benefit to judges and any petitioning creditors brave enough to try to resist an in-court administration order. HMRC tried and failed in **DKLL Solicitors**.

It is clear that Mr Durkan's pre-appointment costs were ordered to be paid as an expense of the administration. What is not clear what those pre-appointment costs included. Did they include any work done in preparing and negotiating the sale of the business (with two prospective purchasers), or the legal work pertaining thereto, as opposed to just the court application and supporting evidence?

The option of IR 2.67(1)(c) as a rationale for getting pre-appointment costs appears to be well and truly closed. In administrations requiring a court application the applicant must rely upon the judge's discretion (exercised upon the perceived merits of the administration vis-à-vis





unsecured creditors) under paragraph 13 of schedule B1.

The idea that the court should have and use a discretion to award costs and in doing so consider if the pre-pack is really of benefit to unsecured creditors of the Company (as opposed to only its management) is laudable.

However, it is far from clear upon what basis if any pre-appointment costs in administrations not requiring a court application (i.e. the vast majority) can be claimed as an expense of the administration. In that regard the position would appear to be as stated in Dear the IP Letter to practitioners dated September 2005 i.e. costs should be obtained from the company in advance.

For a pre-pack including a potentially complicated asset sale agreement those costs (including legal costs and possibly negotiation with multiple interested parties) could be substantial.

The idea of using what little money the company has left to fund a potentially abortive pre-pack might not have sat well with HHJ Cooke.

At paragraph 8 of his judgment he said (having run through the list of possible shortcomings of pre-packs as identified by Dr Frisby):

“To these I might add a concern that is the corollary of one of the advantages claimed for the pre-pack. It is said that there may be difficult obtaining funding in order to enable the administrator to continue to trade while he negotiates a sale of the business.

If the negotiation process takes place before his appointment, and the business is continuing to trade in that period, there is an obvious risk that credit incurred in that period will not be paid so that the negotiation takes place at the expense of

creditors.”

Clearly, if a substantial sum of money is paid by the company up front to fund the preparation of the pre-pack (which may fail) then creditors will have paid for the failed attempt to rescue the business.

In this case there appear to have been negotiations with two prospective purchasers, one of whom was successful. At least if the costs can be reimbursed as an expense of the administration then:

- ➔ the administration and, presumably therefore, the pre-pack has taken place, so the creditors’ money has given benefit (to the extent that a liquidation has been avoided); and
- ➔ the amount of those costs will be subject to the scrutiny of creditors and the court within the administration regime, rather than being simply a payment made by the company to a contractor prior to it entering formal insolvency.

So unfortunately, while seeking to benefit practitioners by offering guidance in how to make applications for in-court administration orders in the future, the judgment in some respects leaves the law unclear.

The idea that the court should look at the true merits of pre-pack coming before it on the in-court route is eminently sensible and may serve to clean up the reputation of pre-packs generally. However, those cases will be comparatively rare.

Upon that basis, who is the main beneficiary of HHJ Cooke’s decision?





→ Small Company CVAs And Enforcement Of Adjudication Awards

[The names of the parties have been changed to preserve client confidentiality]

Company Voluntary Arrangements are back! With no reliable asset valuations and no finance to “pre-pack”, CVAs are enjoying something of a renaissance.

Reform of the administration procedure stole the insolvency limelight in the Enterprise Act 2002. However, at the same time both section 1A and Schedule A1 were shoe-horned into the Insolvency Act 1986, to provide a statutory moratorium for small companies that propose a CVA.

That regime has been hardly used, due the onerous obligations upon the IP to monitor the company’s affairs and to form an opinion whether the proposed arrangement has a reasonable prospect of being approved and implemented, including whether or not the company is likely to have sufficient funds available to it to enable it to carry on its business during the moratorium period.

Until recently any insolvent company with a viable business has been “pre-packed” instead; this is far less risky from the IP’s point of view.

A Bit of Insolvency Law

All paragraph references are to Schedule A1 of the Insolvency Act 1986 (as amended).

Schedule A1 provides a mechanism for a “small company” (as defined) to obtain a statutory moratorium analogous with administration, simply by filing the relevant CVA papers (see para. 7(1)) at the relevant court. The CVA proposal is in the usual form but with various extras to ensure that the Schedule A1 para. 7(1) criteria are met.

The moratorium commences when the papers are accepted by the relevant court (para. 8(1) - hopefully having been checked as compliant by the court staff). Those papers include a statement by the nominee that the company is eligible for a moratorium - para. 7(1)(c). The moratorium lasts until the meeting of creditors (para. 8(2)) unless extended.

A small company was defined in section 247(3) of the Companies Act 1985 (which is now section 382(3) of the Companies Act 2006) and must fulfil two or more of the following requirements:

- Turnover not more than £5.6 million;
- Balance sheet total not more than £2.8 million; and
- Having not more than 50 employees.

For a non-small company to achieve a moratorium prior to the CVA being approved it is of course necessary to use administration, with all that entails. However, as we wrote in our last newsletter in relation to the Budget, the Insolvency Service’s consultation will include assessing the merits of extending the automatic CVA moratorium regime to cover medium and large companies.





For the reasons given below (see final paragraph) we are not entirely convinced that this change would cause there to be significantly more CVAs.

Adjudication

Adjudication is a rough and ready dispute resolution procedure aimed at the construction industry. It was introduced by section 108 of the Housing Grants Construction and Regeneration Act 1996, which is sometimes referred to by construction lawyers (with suitable mirth) as the Hugh Grant Act!

Adjudication is intended to provide an expeditious and cost effective way for contractors working on building projects to resolve disputes over payment or work quickly, so that the project as a whole is not delayed while the dispute is resolved. That is the theory.

Adjudication is therefore run on a tight timetable. An adjudicator gives his decision which is legally binding on the parties with very limited rights of challenge.

However, the adjudicator's award is not capable of enforcement in the same way that a court judgment is. In the event of non-payment the successful contractor must take steps to commence civil proceedings, usually in the Technology and Construction Court, being a division of the High Court.

The standard practice is then apply for summary judgment on the basis that the adjudicator's award in binding upon the debtor.

There are very limited grounds to resist summary judgment.

Loose -v- Chitty

Geldards acted for Loose. Loose were successful before the adjudicator. Civil proceedings in the Birmingham District Registry were commenced to convert the adjudicator's award into an enforceable judgment. Chitty filed a thin defence. Loose then applied for summary judgment.

Chitty then claimed that it was unable to pay, due to insolvency. Nevertheless offers of settlement were made backed up by a threat that if they were not accepted then Chitty would have no alternative but to propose a CVA. Those offers of settlement were such that they would barely cover the cost of the adjudication and Loose's liability for the adjudicator's fees, for which Loose was jointly and severally liable with Chitty.

Because Chitty was a small company as defined it was eligible for a moratorium under Schedule A1 of the Insolvency Act 1986. The moratorium takes effect as soon as the papers are lodged with the court. Paragraph 12(1) (h) of Schedule A1 provides that:

"no other proceedings and no execution or other legal process may be commenced or continued, and no distress may be levied, against the company or its property except with the leave of the court and subject to such terms as the court may impose."

(emphasis added)

So lodging a proposal for a small company CVA could thwart the summary judgment application. That would then give rise to a problem about whether Loose's claim in the CVA would only be valued at amount of the adjudicator's award, because the costs of the subsequent proceedings in the Technology and Construction Court would not have been determined or awarded in Loose's favour.





What Was To Be Done?

Clearly under the wording of paragraph 12(1)(h) the court has a discretion to allow proceedings to continue under certain terms. Loose accepted that it would not be appropriate for it to actually enforce its claim against Chitty under the CVA, assuming there was one. Consequently Loose was asking the court to give judgment for the amount of the adjudicator's award, the interest that had accrued on the adjudicator's award and the costs of the civil litigation. That judgment would then form the basis for Loose's claim in the CVA.

There then followed a period of brinkmanship whereby Chitty's settlement offers were increased incrementally and the threat to obtain a CVA moratorium was repeated, right up to the day before the summary judgment application.

None of those offers were acceptable to Loose and, given the level of dividend predicted in the CVA proposal (44p in the £ based upon the adjudicator's award or 37p in the £ based upon the amount claimed in the summary judgment application) Loose was prepared to participate in the CVA provided that its claim included interest and costs.

On Friday 22 May His Honour Judge David Grant, sitting in the Technology and Construction Court in the Birmingham District Registry granted judgment in favour of Loose (to include costs and interest arising since the adjudicator's award).

He agreed that it would not be appropriate to allow Loose to enforce its judgment, due to the CVA, although he did give liberty to apply back to the court if required.

However, given that at the time of the hearing there was still no tangible evidence of the CVA proposal having been presented to the Derby County Court, he ordered that the prohibition on enforcement was subject to

Chitty producing evidence of the CVA actually having been presented, thereby bring about the statutory moratorium.

Conclusion

As far as we are aware this is the first case concerning paragraph 12(1)(h) of Schedule A1 of the Insolvency Act 1986. Loose was successful in persuading the judge to exercise his discretion under that paragraph to allow judgment to be entered, thereby quantifying Loose's claim in the CVA so as to include the costs of the civil proceedings and interest since the adjudicator's award was made.

The CVA was ultimately rejected by Loose's Creditors.

Geldards' Experience

Anton Smith provided insolvency law advice to Geldards' construction team (and construction counsel) regarding the procedure and effect of the small company CVA proposal, as well as the test that the court should apply when exercising its discretion to lift the statutory moratorium and enter judgment.

Deborah Jenkin Jones acted for a nominee in what is believed to be one of the very first small company CVAs following the procedure becoming available on 1 January 2003.

However, this was not a decision that was taken lightly by the IP. Any creditor who is dissatisfied with any act/ decision/omission of the nominee can apply to court. This includes a specific right to apply to recover any damages/ loss suffered as a result of the conduct of the nominee.





Therefore any nominee who does not properly monitor the company's performance during the CVA moratorium period, and/or does not report/act accordingly, could be personally liable.





→ The 'No Sanction' Sanction

Re. Gresham International Limited (in liquidation) **[2009] EWHC 1093 (Ch) (Peter Smith J.)**

Notes: Quotes and paragraph references are from the judgment.
"IA 1986" means the Insolvency Act 1986 (as amended)
"IR 1986" means the Insolvency Rules 1986 (as amended)

No summer would be complete without a judgment from Peter Smith J.; he of *Da Vinci Code* encrypted judgment fame, *Re. UIC Insurance Company Limited* on IP's time costs and other colourful judgments. His latest is the above, dealing with the issue of sanction for a liquidator to bring proceedings.

The issue of sanction should never be too far away from IP's minds as it determines whether or not they are acting lawfully and entitled to be indemnified out of company assets if it all goes a bit pear-shaped. In particular, sanction is apt to get over-looked if limitation is becoming a problem, as appears to have happened in this case.

Some Law

Where a company has been compulsorily wound up by the Court the liquidator's powers are governed by Parts I and II of Schedule 4 to IA 1986.

Under Schedule 4, Part I, paragraph 3A, power to bring legal proceedings under section 213, 214, 238, 239, 242, 243 or 423 (that is proceedings in the liquidator's name) requires sanction.

Sanction is either by the Court or the liquidation committee if any.

Paragraph 3A was not in the original IA 1986 but was inserted by Enterprise Act 2002 section 253, which came into force on 15 September 2003.

Prior to that it was considered that commencement of proceedings in the liquidator's name was covered by Part III paragraph 13 which did not require sanction.

Rule 4.184 of IR 1986 provides as follows:

- Any permission given by the liquidation committee (or if there is no such committee, a meeting of the company's creditors) or the court under section 165(2) or section 167(1)(a), or under the Rules shall not be a general permission but shall relate to a particular proposed exercise of the liquidators power in question; and a person dealing with the liquidator in good faith for value is not concerned to enquire whether any such permission has been given
- Where the liquidator had done anything without that permission, the court or the liquidation committee may, for the purpose of enabling him to meet his expenses out of the assets, ratify what he has done; but neither shall do so unless it is satisfied that the liquidator has acted in a case of urgency and has sought ratification without undue delay. (emphasis added)

Under Schedule 4, Part II, paragraph 4 there is a similar requirement for sanction for the bringing of





any proceedings in the name of and on behalf of the Company.

Incidentally, section 314 of IA 1986 (in relation to bankruptcy) is in corresponding terms IR 4.184(2) (relating to companies) but there is no equivalent section in IA 1986 for companies.

It is well established that lack of sanction does not render proceedings invalid.

Sanction is not required for a claim under section 212 of IA 1986.

The Gresham Case

Gresham went into compulsory liquidation in May 2003. As at November 2007 Gresham's assets were £18K although €654K was received from a related insolvency by way of dividend in 2008.

Proceedings for substantive relief were issued in May 2007. They were said to be worth up to £4 million. There were problems with the liquidation committee becoming inquorate.

An application was then made to the Secretary of State for sanction under section 141(5) IA 1986, which was granted in August 2007 (i.e. 3 months after the application was issued).

The application to the court for sanction was issued in December 2008. It appears to have been necessitated in part by concerns on the part of the liquidator regarding whether the Secretary of State's sanction was effective (due to what are described as "accidental omissions" in the information provided) but also in relation to fresh claims.

In the view of Peter Smith J. it was plain that the Secretary of State thought he was considering an application for a prospective commencement of proceedings. That was apparently confirmed by the text in the application for sanction.

The Secretary of State gave sanction for the commencement of legal proceedings for the specific purposes as set out in the liquidator's application for sanction but subject to and express condition:

"costs to be (sic) charged on a conditional fee arrangement and not to exceed £150,000 exclusive of 75% uplift, VAT and disbursements".

Peter Smith J. found the estimate of £150,000 specified in the application to be "unrealistic" and added:

"It therefore follows that the Secretary of State did not sanction that which had actually happened namely a retrospective sanction of the commencement of the proceedings. He could not do so because that is what was plainly not asked for.

In any event for him to be in a position to grant retrospective sanction he is prevented from doing so unless the liquidator has acted in case of urgency and has sought ratification without undue delay." (paragraph 29).

The Secretary of State indicated later that if he had been aware that the sanction being applied for was retrospective it would not have been granted. Furthermore, a delay of only five working days would normally not amount to "without undue delay".

Interestingly, Peter Smith J. stated that while lack of sanction does not confer any right upon the respondent





to object to unsanctioned proceedings, the Respondents were entitled to investigate the sanction position because:

“The liquidator as an officer of the Court owes a duty to the Court and those participating in it to ensure the litigation is conducted in accordance with the rules”

and

“As creditors they have a right to prove in the liquidation. If the liquidator’s costs are disallowed out of the assets available for distribution there will be an increase in sums available for distribution (inter alia) to them” (paragraph 38).

He went on:

“If the Respondents are successful they will seek costs from the liquidator personally in respect of the sanctioned actions...” and in *“that eventuality the liquidator without sanction will not be able to recover any of her costs from the [company’s] funds.”* (paragraph 40)

He added:

“The normal position in conducting litigation is the liquidator may recoup his costs out of the assets of the company pursuant to Rule 4.218(1)(a) IA 1986.

If he was unsuccessful in proceedings in his own name he is ordinarily personally liable to the successful Defendant for any order to costs. He is ordinarily entitled to indemnity out of the assets of the company in respect of his personal liability unless he is guilty

of misconduct... The successful litigant is entitled to his costs in priority to the liquidator....” (paragraph 41)

Peter Smith J. doubted whether the five days referred to by the Secretary of State was an appropriate timescale in all cases and that “without delay” must be judged on the circumstances of the case.

Furthermore, having held that the sanction given by the Secretary of State was ineffective he granted retrospective sanction only to the date of the liquidator’s application to court for sanction (December 2008). The proceedings were issued in May 2007, over a year and a half earlier.

He also invited the parties:

“to consider whether or not the sanction should be open ended to trial and all costs incurred thereunder or whether there should be some cap with liberty to make further applications or whether there should be a limit to some stage in the proceedings and whether it should include a possibility of mediation.” (paragraph 81)

Lessons

There are serious financial consequences for not having sanction, especially if the claim goes wrong.

An IP risks inability to recover costs not paid by the Respondents if they win; and personal liability for the other side’s legal costs if they lose, with no indemnity from the company’s assets in either case. In a catastrophic case that could lead to the IP being declared bankrupt, absent an indemnity from their firm.





Consequently, sanction should always be handled very carefully and as early as possible.

An unsanctioned claim provides opportunity for a determined respondent to cause mischief and force otherwise un-necessary application(s) to court, potentially using up resources that could have otherwise been used for prosecuting the claim.

It is not known from the judgment how the costs of the application (which lasted no more than a day but the Respondents were represented by a QC) were dealt with.

Costs are always at the court's discretion and this issue was clearly preventable by the liquidator, so there may have been a costs penalty or no order as costs.

It is also not known what the costs incurred in the un-sanction period were (the proceedings appear to be substantial with multiple claims against multiple respondents and therefore expensive to prepare) which could not presumably be paid for out of company assets, although the existence a conditional fee agreement may have postponed that problem to the conclusion of the liquidator's claim in any event.

Legal input into the sanction application, given its close relation with the format of the proceedings themselves, is well advised, not least because an assessment of the legal merits of the claim will need to be given.

One further interesting aspect of the judgment is that the liquidator agreed to Gresham providing a bond as security for the Respondent's costs in respect of the claims brought in the name of the company, pursuant to an application issued by the Respondents.

The Respondents were seeking security in the sum of £469,783.

These were not unusual antecedent transaction

claims and were estimated to be worth £4 million in total. The value of that bond, which was accepted by the Respondents, is not stated, but was presumably substantial.

Our Experience

David Griffiths and Anton Smith acted for a local liquidator who obtained both prospective and retrospective sanction from Peter Smith J. in relation to a section 213 IA 1986 claim for fraudulent trading back in 2006.

The sanction given was to close of evidence or close of pleadings (if ordered). The claim settled before the sanction expired.



Anton Smith

Senior Associate Solicitor
Geldards' Business Recovery and Insolvency Team.





→ The Lewis Case

That puts an end to that little wheeze....

Lewis v Metropolitan Property Realisations Limited [2009] EWCA Civ 448

On 12 June 2009 the Court of Appeal handed down a judgment reversing the decision of Proudman J.

He held that the sale by a trustee in bankruptcy of the debtor's interest in his dwelling house for deferred consideration constituted "realisation" for the purposes of section 283A of the Insolvency Act 1986; the so-called "use it or lose it" rule.

On the day before the third anniversary of the bankruptcy the joint trustees of Mr Lewis had assigned the debtor's interest to Metropolitan. The terms provided immediate consideration of £1 together with 25% of any future proceeds of sale.

Proudman J had held that this amounted to a realisation of the debtor's interest and accordingly it did not re-vest in the bankrupt.

The decision was appealed by the bankrupt and when finding in his favour the Court of Appeal considered the meaning of the term "realise".

It concluded that "realisation" involved the conversion of the property into full cash consideration and that this was inconsistent with leaving any part of its value outstanding in an unfulfilled monetary obligation.

The Court found that within the meaning of section 283A full cash consideration had not been obtained. The debtor's interest had not been realised and thus it reverted to him.

Thoughts

The Court of Appeal's decision appears to rule out transactions in which the trustee agrees to sell his interest in a property in return for a percentage of any onward sale price (overage provisions).

However, it should be remembered that section 283A only applies to an "interest in a dwelling-house" which was, on the date of the bankruptcy order, the "sole or principal residence" of the bankrupt or a current or former spouse. Commercial property and second homes are not affected.

As the equity in property has reduced (because the housing market has fallen) and the ever present issue of the prohibitive cost of litigation to resolve complex issues of ownership and rights in the family home, many trustees in bankruptcy have taken the view that a sale to the bankrupt's spouse is the best that can be achieved.

However, the credit crunch and the inability to re-mortgage has meant that we have seen trustees in bankruptcy giving the buyer (usually the bankrupt's spouse) the ability to buy out the trustee's interest over a period of time.

What therefore would be the case if the buyer failed to





pay all of the instalments before the third anniversary?
“Realises” in section 283A of the 1986 Act means getting
in the full cash consideration for the deal.

The position is unclear, but until it is, keep a very close
eye on any payments by instalments!





→ Court Of Appeal Muddies The Waters On Business Sales By Administrators

The Court of Appeal has considered the decision of the Employment Appeal Tribunal (which upheld the decision of the Employment Tribunal) in *R Oakland -v- Wellswood (Yorkshire) Limited*. At the time of writing the full reasoned judgment of the Court of Appeal is not yet available.

The first two decisions in this case came as a surprise to IPs and insolvency lawyers. The ET and the EAT both held that the sale of a business by an administrator was excluded from the Transfer of Undertakings (Protection of Employment) Regulations 2006 (“TUPE”) by virtue of regulation 8(7).

Regulation 8(7) of TUPE provides that the other regulations that protect employment rights in a transfer of a business do not apply to

“any relevant transfer [of the business] where the transferor is the subject of bankruptcy proceedings or any analogous insolvency proceedings which have been instituted with a view to the liquidation of the assets of the transferor and are under the supervision of an insolvency practitioner” (emphasis added).

Very briefly, Mr Oakland was employed by a company that went into administration. The administrator sold the business and assets and Mr Oakland’s employment transferred over to the purchaser, Wellswood. He was dismissed within one year.

Under TUPE his employment with his former employer pre-transfer would count towards his continuity of employment with Wellswood because his contract of employment would transfer over to Wellswood. He claimed unfair dismissal.

Surprisingly, and seemingly going wholly against the rationale behind TUPE (which is to protect employees’ when businesses change hands), the ET decided that a sale out of administration did not fall within the statutory requirements for a TUPE transfer because administration was covered by regulation 8(7).

The EAT agreed.

So Mr Oakland had less than the required one year of continuous employment with Wellswood and was consequently unable to claim unfair dismissal.

Prior to *Oakland* it was assumed, based upon the rationale behind TUPE and very clear indication from the Secretary of State, that TUPE would apply in an administration sale, that all employees and employee liabilities (including any claims accrued by the employees against their old employer) were transferred to the purchaser. That was one of the risks of buying the business, for which the purchaser could at least plan and cost.

The first two decisions in *Oakland* suggested that the TUPE rights did not transfer after all when the sale was by an administrator.

The Court of Appeal has now decided Mr Oakland’s





appeal. Unusually the appeal was allowed based upon an entirely new legal argument (section 218(2)(b) of the Employment rights Act 1996) that was not advanced before the ET or the EAT. The decision (dated 30 July) confirms that there was a clear transfer of the insolvent company's business to the purchaser.

Consequently section 218(2)(b) was engaged and Mr Oakland's continuity of employment was preserved in the transfer to Wellswood. He did have sufficient continuity of employment to bring an unfair dismissal claim against Wellswood.

The Court of Appeal declined (due to lack of full argument on the point) to determine whether the fact that a company was in administration necessarily meant that regulation 8(7) of TUPE applied. That would have involved finding that the ET and the EAT had got the law wrong. However, the Court of Appeal did say that was a "strong argument" that regulation 8(7) did not automatically apply i.e. administration is not liquidation and so TUPE may well apply!

It was arguably the concepts of "liquidation of the assets" and "bankruptcy proceedings or any analogous insolvency proceedings" that the ET and the EAT apparently misconstrued (at least in the eyes of insolvency lawyers) as encompassing administration.

The administrators had concluded that the insolvent company could not be rescued as a going concern (which very rarely happens, absent a CVA and is even less likely where the insolvent company's business is being transferred, leaving no "concern" for the insolvent company to keep "going") and so "liquidated" its assets by selling the business. They also stated intention to move from administration into creditors' voluntary liquidation.

Indeed, this case has certain similarities with the first instance decision in *Re. Innovate Logistics Limited*,

where the court at first instance misunderstood the concept and purpose of administration. In that case the judge concluded erroneously that the purpose of an administration had been fulfilled when the business was sold on day one. Fortunately the Court of Appeal was able to put things right there.

This particular issue is now resolved as far as Mr Oakland is concerned - all he needed was continuity of employment to bring his unfair dismissal claim. Section 218(2)(b) of the Employment Rights Act 1996 only deals with continuous employment, not transfer of other employment rights.

Conversely, TUPE transfers the employees' contracts and their accrued rights, including continuous employment. In *Oakland* the wider TUPE position is now left unresolved as far as purchasers of businesses, IPs and their advisers are concerned.

The practical consequence of the Court of Appeal's decision is that a purchaser of a business from an administrator will now not know to what extent he will be taking on liabilities under TUPE. And an administrator will now not know for certain whether they transfer or remain to be dealt within the administration or any subsequent liquidation. Will regulation 8(7) of TUPE apply or not? At least under the EAT ruling the position was clear - TUPE liabilities would not transfer automatically to a purchaser; following the Court of Appeal's decision in *Oakland* the position is significantly less clear.

Either way it remains to be seen as to when the TUPE position on sales by an administrator of the business of an insolvent company will be put beyond doubt.

