Corporate Legal Update

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Introduction

1. These notes support the talk which the author will give on Thursday 28 January 2010 as part of the Guildhall Insolvency @ the Crowne Plaza in Leeds seminar. The topic for this paper is an insolvency corporate legal update; it will cover firstly (i) a brief "where are we now" analysis on Statement of Insolvency Practice 16 in relation to "pre-pack" administrations, and secondly (ii) a review of important and recent (last 6 months) decisions which will affect the corporate insolvency world.

A year in the life of SIP 16

2. Statement of Insolvency Practice 16 ("**SIP 16**") came into force on 1 January 2009 as all the players in the corporate administration market collectively held their breath in anxious anticipation: what would SIP 16 mean for the "pre-pack" market? Would SIP 16 counter intuitively impede the rescue culture by forcing a company to reveal its precarious financial position to its prospective rescuers and creditors thereby putting at risk any fleeting value which had been preserved? In contrast, the rule makers and regulators responsible for overseeing this particular area of insolvency, confidently, quietly, and no doubt spurred on by the almost universally negative and strident reporting of pre-packs in the mass circulation media expressed their belief that SIP 16 would lead to greater transparency and would shine a bright light into the shadowy corners of this particular continent of the insolvency world.[1] A copy of SIP 16 is appended to this paper for ease of reference.

3. The provisions of SIP 16 are engaged in all cases where a "pre-pack" is undertaken by the relevant insolvency practitioner in the context of an administration under Schedule B1 of the Insolvency Act 1986. By way of reminder, a "pre-pack" for the purposes of SIP 16 is defined as:

> "an arrangement under which the sale of all or part of a company's business or assets is negotiated with a purchaser prior to the appointment of an administrator, and the administrator effects the sale immediately on, or shortly after, his appointment." (para. 1)

4. SIP 16 requires the relevant insolvency practitioner to disclose to the creditors of the company in administration a substantial amount of information concerning a variety of matters connected with the pre-pack. The disclosure requirement extends to include the source and then extent of the administrator's involvement with the company prior to the pre-pack, the steps which the administrator took in order to satisfy himself as to the value of the business (e.g. marketing and valuation), the reasons for which a pre-pack has been selected in preference to other alternative strategies (e.g. a trading administration, or a post-pack) and finally the identity of the purchaser and the consideration which the company will receive in respect of the "pre-pack".

5. Moreover, it is not sufficient for the administrator to supply the SIP 16 information solely to the creditors of the company; he must also supply the information to the Insolvency Service. Indeed, on 28 January 2009 Stephen Leinster, writing as the Director of Policy of the Insolvency Service, informed all insolvency practitioners that:

> "The Insolvency Service has determined a strategy to evidence insolvency practitioners' compliance with the letter and spirit of SIP 16 and that the desired transparency is achieved. In order to implement this strategy in a cost-efficient way, the insolvency regulators have agreed that when sending SIP 16 information to creditors in respect of a company in administration in Great Britain you should also forward a copy to: Insolvency Practitioner Policy Section, The

[1] I fully intend to duck out of answering the obvious question which is raised in this paragraph which is: looking back from the vantage point of January 2010, who was right in January 2009?

> Insolvency Service, Area 5.6, 21 Bloomsbury Street, London WC1B 3QW; or email to IPPolicy.Section@insolvency.gsi.gov.uk"

He notified insolvency practitioners that:

> "The Service will be actively monitoring the timing of the notification to creditors. Any failure to provide the required information to creditors should be the result of exceptional circumstances, and if this is the case, the reason why the information is not provided should be stated."

6. Building on the SIP 16 disclosure reports to creditors which the Insolvency Service received pursuant to Stephen Leinster's letter, in July 2009 the Insolvency Service released its Report on the First Six Months Operation of Statement of Insolvency Practice 16. A further updating report is due to be published in the early part of 2010 (likely to be in March); as at the date of writing these notes, that updating report is not yet available. In the period January 2009 to end of June 2009, the Insolvency Service received reports in relation to 572 pre-packs. The Insolvency Service Report estimates that, for the first three months of 2009, 29% of administrations involved a pre-pack. In the view of the Insolvency Service, of the 572 pre-packs which were notified, only some 370 (65%) contained compliant SIP 16 disclosure. In 17 cases, the Insolvency Service has referred the matter to the individual insolvency practitioner's regulatory body for further investigation, and if appropriate sanction. Further, the Insolvency Service Report records that 81% of "pre-pack" cases involved sales to parties connected with the insolvent company. The main areas of deficiency have been identified by the Insolvency Service as relating to disclosure being made on a bullet-point basis, or being made late. On a more specific level, the areas in respect of which the SIP 16 reports fell short concerned the extent of the insolvency practitioner's prior involvement with the company / the directors, as well as in relation to the marketing and valuation activities undertaken by the insolvency practitioner.

7. The Insolvency Service Report, in places, has identified potential amendments to SIP 16 which will be the subject of a consultation exercise. Such suggestions have included adding a mandatory requirement to provide the Secretary of State with a copy of the information. Another proposed amendment was to set out a more explicit timescale within which the SIP 16 disclosure information must be supplied to creditors. The extent to which certain creditors of the relevant company held security over the assets of the company could well become an additional area of SIP 16 disclosure.

8. In October 2009, the Insolvency Service released issue 42 in the Dear IP series of letters which was devoted exclusively to pre-packs and SIP 16. It contains additional and detailed guidance to insolvency practitioners involved in pre-pack cases. It starts with a reminder that, the whole point of SIP 16 is for creditors to be provided with a "detailed explanation and justification" of why a pre-pack was appropriate. As pointed out in the Dear IP letter, "giving a short response to the bullet point disclosure requirements … is unlikely to provide the detailed explanation and justification required…".The Insolvency Service has identified the following rule of thumb as a means of assessing the sufficiency of information disclosed by the insolvency practitioner::

> "Practitioners should aim to provide sufficient information to ensure that creditors do not need to ask further questions of the practitioner about the justification for the pre-packaged sale and details of it."

Insofar as the timing of the SIP 16 disclosure is concerned, the Insolvency Service has provided much clearer guidance than is currently contained in SIP 16 itself:

> "It is expected that in the majority of cases SIP 16 information should be sent to creditors within a few days of the practitioner's appointment or upon completion of the sale. In all but the most exceptional of cases SIP 16 information should be sent to creditors within 14 days of the completion of the sale. If practitioners have been unable to meet

this requirement they should explain the reasons for the delay in their disclosure."

The Dear IP letter also contains a substantial amount of additional guidance in respect of several of the specific disclosure headings contained in paragraph 9 of SIP 16. These are sufficiently important to be reproduced in their entirety below:

"The source of the practitioner's initial introduction

The name of any introducer and their relationship to the company and/or the directors, and the circumstances leading to the referral, form an integral aspect of the detailed explanation required for creditors to understand the circumstances leading to the pre-packaged sale and the context in which the practitioner became involved. These details should, therefore, be disclosed under this heading.

Practitioners should also disclose the date of their formal engagement by the company when detailing their involvement.

The extent of the practitioner's involvement prior to appointment

Sufficient information should be provided by practitioners to identify any previous relationship between the practitioner (which should include the practitioner's firm) and the company and/or directors.

Many creditors will have only a limited understanding of formal insolvency proceedings and an explanation that the practitioner, not the directors, has undertaken the sale negotiations with the prospective appointment of an administrator in mind, may help to avoid misunderstandings.

Any marketing activities conducted by the company and/or the practitioner

In order for creditors to understand the circumstances leading to the pre-packaged sale, the practitioner should disclose details of the process that led to the decision to sell to the eventual purchaser. It is recognised that the degree of marketing will vary on a case by case basis and that practitioners will have considered many factors in reaching the decision to conduct any marketing exercise or, in some cases, not to market the business.

Details of the nature of any marketing activities that were carried out by the company and/or practitioner should be provided or alternatively an explanation provided as to why it was decided not to undertake any marketing. If the business was marketed, and a number of expressions of interest and/or offers were received, it is important that summary information about the outcome of the marketing (such as the number of offers received, the range of consideration offered and the fact that the best offer was accepted) are disclosed, so that the outcome of the marketing exercise is clear."

"Any valuations obtained of the business or the underlying assets

Practitioners will be aware of the importance of ensuring that independent valuations are carried out wherever possible. The level of detail that practitioners will be able to provide will depend upon the the type of valuation that has been carried out and nature of the assets, but generally:

- valuations should be disclosed with sufficient detail for creditors to understand the values placed upon the various categories of assets. Where it is otherwise unclear, information should be provided as to how any value attributed to goodwill has been determined.

- the basis upon which the business has been valued. This may include valuations on a going concern or break up basis, and any valuations of the underlying assets of the business, whether in-situ or ex-situ.

- the name of the valuer used should be included in all cases.

> Where valuations have not been obtained by the practitioner an explanation should be provided as to why not. Alternatively information should be provided as to what reliance, if any, has been placed on valuations previously obtained by the company or its lender(s), such information being in the same format as above."

9. Without a doubt, the guidance contained in the Dear IP letter amounts to a considerable tightening of the SIP 16 disclosure requirements. Whereas before October 2009 it was possible, without too much imagination, to avoid complying with the spirit of SIP 16 whilst still complying with the letter of SIP 16, the same will be far harder to achieve post October 2009. The most obvious loopholes have snapped shut. Given the transparency objectives of SIP 16, Dear IP issue no 42 is to to be welcomed.

10. Thus far, SIP 16 has generated two reported decisions in the High Court. His Honour Judge Cooke handed down judgment in *Re Kayley Vending Limited* [2009] EWCH 904 (Ch) [2009] BCC 578 on 15 May 2009; David Richards J handed down his judgment in *Clydesdale Financial Services Limited & Ors v Smailes & Ors* [2009] EWHC 1745 (Ch) on 18 June 2009. The Clydesdale litigation has also spawned a further case in relation to section 423 of the Insolvency Act 1986, which was also a decision of David Richards J [2009] EWHC 3190 (Ch) handed down on 8 December 2009 and which concerns the scope of the term "victim" for the purposes of section 423, and is thus not directly relevant insofar as SIP 16 is concerned.

11. HHJ Cooke in *Kayley Vending* was invited by counsel for the applicant to supply some general guidance as to the court's stance on SIP 16 in pre-pack cases where the applicant for an administration order has decided that the company's business will be sold in a pre-pack. The judge accepted that invitation and stated:

> "24. It seems to me that in exercising its discretion in pre-pack cases, the court must be alert to see, so far as it can, that the procedure is at least not being obviously abused to the disadvantage of creditors in any of the ways outlined above. If it is, or may be, the court may conclude that it is inappropriate to give the pre-pack the apparent blessing conferred by making the administration order. In reaching that decision, it is likely to be assisted by the provision of information in relation to the pre-pack transaction and its background, and to that extent the provision of such information falls within rule 2.4(2)(e). While it is primarily a matter for the applicant to identify what information is likely to assist the court, and that information may not be limited to the matters identified in SIP 16, it seems to me likely that in most cases the information required by SIP 16, insofar as known or ascertainable at the date of application would fall within the requirement I have referred to and so ought to be included in the application. For the reasons given by Mr Morgan, it should not normally be unduly burdensome or costly for it to be so included, and no doubt if there are special reasons why it cannot readily be provided in a particular case this can be explained."

12. *Smailes* concerned the pre-pack sale of a law firm's practice to a newco in early April 2009, thus after SIP 16 had come into force. Various secured and other creditors, who were consulted only moments before the sale took effect but without enough time to participate in the sale process, made a number of applications against the administrator (Mr Smailes) and the pre-pack purchaser (Jiva). Those applications were opposed by both the administrator and by Jiva. The proceedings were, by all accounts, hotly contested. By the time of the final hearing before David Richards J, the sole substantive issue which remained live was whether or not the administrators should be replaced. David Richards' conclusion on that issue was expressed as follows:

> 30. This is not of course to say that any consideration or investigation would finally disclose that there was anything untoward in relation to the sale. It simply cannot be determined at this stage. What is, however, clear is that Mr Smailes and his firm were so closely involved in the negotiations that he cannot be expected now to conduct an independent review. His case, it should be remembered, is that the price was negotiated by Coleman Coyle acting on his instructions and subject to his final approval. In this context it should also be noted that a significant body of major creditors of LLP representing a majority of the creditors in value, have expressed a wish to see the removal of Mr Smailes and his co-administrator and the appointment of the administrator proposed by CFS. For the reasons given above the concerns of those creditors are legitimate and as creditors their views, if reasonably held, are entitled to consideration especially when it is recalled that the present administrators were appointed not by the creditors or the court but by Mr Denenza. These grounds provide in my judgment proper basis on which the court could exercise its jurisdiction under paragraph 88 to remove the joint administrators. It is not, I wish to emphasise, a basis which involves any imputation against the integrity of the administrators."

One of the grounds upon which the applicants in *Smailes* relied to secure the removal of the administrators was a failure by the administrators to comply with SIP 16. David Richards J does not address that line of attack against the administrators in any detail (because it wasn't necessary for him to do so). He did not, however, suggest that a failure to comply with SIP 16 could never be a ground for challenge. In terms, he stated:

> 32. …. As to the notification to CFS I remain puzzled as to its purpose. Mr Smailes in evidence says that he intended it to be in fulfilment of SIP16 but it does not contain all the information required by SIP 16 and it was sent to only one creditor. This does not however, as I see it, provide a ground for his removal.
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> 34. Complaint is further made of the bland notification to creditors on the 9th April 2009 by the administrators of their appointment which referred neither to the sale nor to the litigation by then underway, and of the letter sent on the 18th May 2009 in purported compliance with SIP 16. There are certainly some points to be made about these letters but they are not of a sort which could justify the removal of the administrators. In short I reject all the allegations of impropriety made against the administrators but for the reasons already given grounds do exist which would justify an exercise of the power of removal."

13. The introduction of SIP 16 has also generated a steadily growing corpus of articles and commentaries in the general insolvency press and in specialist insolvency law journals. Philip King representing the creditor's view in *RECOVERY* in Spring 2009 commented: "we believe something needs to change. Although the new guidelines introduced at the beginning of the year will help creditors understand who is involved and the nature of the difficulties the

business was facing, suppliers are not closely involved enough". He also makes the point that, SIP 16 does not require disclosure to creditors before the pre-pack; there is a risk therefore that by the time that the SIP 16 disclosure comes to be made, the pre-pack has already been completed and the creditors are left with a *fait accompli*, albeit a well informed *fait accompli*. That theme is picked up in a piece by Ben Larkin an Ben Jones in the Summer 2009 edition of *RECOVERY*, in which they make the point that, with a conventional CVA, creditors are involved at an early stage and it is in theory possible for creditors to have a determinative say as to whether the CVA is approved. On the whole, such commentary on SIP 16 as there is has been positive. Mark Parkhouse and Kerry Scott, writing in the New Law Journal on 20 March 2009 described SIP 16 as "a step in the right direction". Andrew Carpenter, writing in the In House Lawyer on 16 November 2009 saw the introduction of SIP 16 as a tacit approval by the authorities of the pre-pack process; regulation rather than restriction was thus the watchword. Dr Sandra Frisby of the University of Nottingham is currently engaged in preparing empirical research into pre-packs generally. In an article which appeared in the Winter 2009 edition of *RECOVERY* she made a number of interesting observations in relation to SIP 16. It is worth bearing in mind that the period in respect of which she has received data is from September 2001 to September 2006, thus before the introduction of SIP 16. However, she notes that, in the latter part of that period, the level of disclosure by insolvency practitioners in pre-pack cases had significantly improved, and moreover that, almost as a matter of routine, insolvency practitioners were obtaining valuations of the business prior to the pre-pack. Her conclusions support an inference that, even before the introduction of SIP 16, insolvency practitioners, presumably in reaction to media comment, had begun self-regulating and presciently taking the steps which would later be imposed on them by SIP 16.

Recent and significant cases

14. The period from July 2009 to January 2010 has generated a large volume of cases which either directly or indirectly concerned corporate insolvency procedures and laws. Time constraints do not allow for all of those cases to be digested in this paper and in the forthcoming talk; it has therefore been necessary to select only a few of those recent cases. The selection criterion which has been adopted has been to focus on those cases which appeared to be the most significant and also which haven't been analysed in other sessions being given by colleagues from Guildhall Chambers at the same seminar.

(1) Mark Richard Phillips (2) Murzban Khurshed Mehta (as liquidator of Wilson Property UK Ltd) -v- Neil McGregor-Patterson [2009] EWHC 2385 (Ch), Henderson J, 2 October 2009

15. *McGregor-Patterson* came before Henderson J as an appeal by the defendant in the case (Mr McGregor-Patterson) from the decision of Deputy Master Farrington on an application for summary judgment and / or strike out. The proceedings were started by the liquidators of Wilson Property UK Limited under Part 7 of the CPR seeking relief in respect of 3 categories of payments namely £54,700, £155,500 and £50,050. Some, but not all, of those payments had been made directly to the defendant. There was no dispute that the defendant was, at all material times, a director of the company. The cause of action upon which the liquidators relied was principally section 212 of the Insolvency Act 1986. Having said that, allegations were also made on the basis of section 239 to 241 of the Insolvency Act 1986, as well as sections 127 and 214 of the Insolvency Act 1986. The company was a property development company which renovated barns in order to sell them at a profit as residential dwellings. The defendant, although a director of the company, was not the prime mover in the business (that was Mr Wilson); in fact, the defendant contended that he had had only a limited amount of involvement in the management of the business and he was supported in that assertion by the company's accountant.

16. In addition to mounting a substantive challenge to the Deputy Master's judgment, the defendant put forward two technical arguments in support of his appeal, one of which can usefully be digested here. The liquidators' proceedings were started by a standard claim form under Part 7 of the CPR in the Chancery Division instead of by way of an ordinary application under Chapter 1 of Part 7 of the Insolvency Rules 1986. As a result, the defendant alleged that the liquidators' proceedings were irremediably and fatally flawed because the bespoke and mandatory form intended for such proceedings had not been used. Not surprisingly, the liquidators placed

reliance on rule 7.55 of the Insolvency Rules 1986 which allows the court to declare that insolvency proceedings are not invalidated by any formal defect. Henderson J accepted that the liquidators' proceedings were "insolvency proceedings" for the purposes of rule 7.55, and that the defendant had not suffered any prejudice because the wrong form was used. He waived the defect and accordingly that technical argument failed.

17. Henderson J allowed the appeal on substantive grounds. The defendant alleged that he only worked a few hours a month for the company, that he was based in London whereas the company was based in Peterborough and that he was not actually a signatory on the company's account, and that by cumulating the above, there was at least an arguable basis for asserting that the defendant had not committed a breach of any fiduciary or other duty. Moreover, although he didn't rely on it before the Deputy Master, it was argued on his behalf on appeal that the relieving jurisdiction contained in section 727 of the Companies Act 1985 was engaged in the case, and could, at least arguably, be prayed in aid. In order to resolve such issues, Henderson J was of the view that a full trial with live oral evidence was necessary. Further, and insofar as the claim under section 239 was concerned, it wasn't, in Henderson J's view, possible at a summary judgment stage to establish conclusively that the company was actually insolvent or became insolvent as a result of the payments, and / or that the defendant had failed to rebut the presumption that the company had been influenced in making the payments by a desire to prefer the defendant. For those reasons, the appeal was allowed. *McGregor Patterson* is a salutary reminder to insolvency practitioners and their advisers of the dangers of seeking to obtain summary judgment on claims alleging breach of fiduciary duty and / or preferential payments.

In the matter of Equilift Limited [2009] EWHC 3104 (Ch), His Honour Judge Purle QC, 27 November 2009

18. In late 2009, HHJ Purle QC heard an application for directions by the joint liquidators of Equilifit Limited, a company which was concerned in the supply and installation of stair lifts prior to it going into administration which was followed by liquidation. The company held several accounts into which it paid income from the business, including sums paid to it by way of pre-payment or deposits for goods which the company was due to supply. Unfortunately, it seems that the company was not particularly assiduous at keeping track of which sums related to deposits and pre-payments, so much so that, when the company eventually entered administration, there was a considerable measure of doubt as to whether particular customers could advance proprietary claims against the company. HHJ Purle QC, as well as the liquidators and their solicitors had a firm eye on the clear risk in *Equilift* that, if substantive litigation were to be initiated whereby individual customers were required to prove their claims (or appoint representative parties to do that for them), because the liquidators, as neutral parties would most likely be awarded an indemnity for their legal costs out of the estate, the sum which would be leftover for creditors would be very small indeed. According to the judgment of his HHJ Purle QC, the amount standing to the credit of the bank accounts was £171,784.35, whereas a total of 484 customers were potentially concerned. Further, the liquidators were also keenly aware that, by paying out sums from the company's bank account which might potentially be subject to proprietary claims in favour of third parties, they would be opening themselves to allegations of breach of trust.

19. HHJ Purle QC identified and then adopted a pragmatic solution to this apparent impasse. He invited Mohammed Zaman QC, who was instructed on behalf of the liquidators, to prepare and file in court a written opinion on the question of whether or not any proprietary rights actually existed in any of the funds held in the bank accounts. Upon that advice being filed in court, it would then be possible for the judge, on a non-adversarial basis, to take stock of the position. In the events which happened, counsel concluded that there were no proprietary claims (save for one small amount) and therefore the liquidators could treat the sums available in the bank account as being payable to the general body of creditors, provided that all affected customers were informed of their right to obtain and review a copy of the judgment, the application and evidence in support, including counsel's opinion. After two months elapsed from the date of such notification, and provided that no customers have written to notify any objections, then the liquidators would be empowered to distribute the sums which they held. *Equilift* is a good

example of a court seeking and implementing a pragmatic and cost effective solution to a potentially difficult situation. Moreover, there was a plain additional benefit to the office holders since, by his tacit endorsement of the strategy of obtaining and relying on counsel's opinion, the judge has made it very hard for any potentially interested third party to successfully challenge (by alleging a breach of trust) the liquidators' conduct.

Parkinson Engineering Services Plc (in liquidation) -v- (1) Julie Swann (2) Peter Yeldon [2009] EWCA Civ 1366, Court of Appeal (Lloyd, Sedley, Sullivan LJJ) 21 December 2009

20. Parkinson Engineering Services Plc was initially placed in administration by Laddie J on 7 May 2003. The two defendants, Julie Swann and Peter Yeldon were appointed as administrators of the company. Their appointment lasted only for some months since they were discharged by Park J on 14 November 2003, on terms that, provided no claims were made against them by 13 February 2004, that they should have their release on that date pursuant to section 20 of the Insolvency Act 1986. Mr Abdulali was appointed as the liquidator of the company some time thereafter. On 17 April 2009, he procured the company to commencing litigation against the two former administrators alleging negligence and seeking damages in the sum of £1,968,780. The two defendants responded by alleging that the proceedings against them were time barred having regard to the release which they obtained from Park J; this was met by an application by the liquidator to substitute himself as the claimant in place of the company since he could then rely on section 212 of the Insolvency Act 1986, which, pursuant to section 20(3) of the Insolvency Act 1986, would allow him to circumvent the release granted by Park J. At first instance, Floyd J allowed the liquidator's application. The two defendants appealed to the Court of Appeal.

21. In the Court of Appeal, Lloyd LJ dismissed the appeal and upheld the decision of Floyd J. The threshold issued was posed by a combination of section 35(5)(b) of the Limitation Act 1980 and CPR rule 19.5: is the addition or substitution of a new party necessary for the determination of the original action? The main argument put forward on behalf of the defendant was that, because the original claim was statute barred, it could not actually be maintained, and so therefore it wasn't necessary to add or substitute any party. Further, it was also suggested that the causes of action were not the same, and so therefore an addition or substitution could not be allowed. The liquidator's position before the Court of Appeal was that the negligence claim by the company and the section 212 claim by the liquidator were identical, indeed, the proposed changes did not include any amendments to the allegations of duty, breach or loss, and that it could therefore be allowed. Lloyd LJ concluded that the substitution was necessary in Parkinson *Engineering Services Plc*, and that for that reason, it was appropriate to allow the liquidator's application. Without substitution, the claim could never be determined on its merits.

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