ANOTHER YEAR IN ADMINISTRATION

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A. Rent as an administration expense: *Re Game Retail Ltd* [2014] EWCA Civ 180

1. What is the proper treatment of rent payable under a lease held by a corporate tenant which has entered administration or liquidation? Until February this year, authority[1] suggested that if a quarter's rent (payable in advance) fell due during a period in which office holders were retaining the property for the purposes of the administration, the whole of the quarter's rent was payable as an administration expense even if the administrators were to give up possession later in the same quarter. The corollary of that was that where a quarter's rent payable in advance fell due before entry into administration, none of it was payable as an administration expense, even if the administrators retained possession for the purposes of the administration[2]. Unsurprisingly, this frequently lead to manipulation of the date on which the relevant insolvency procedure was initiated and the date on which administrators ceased to use the premises.

2. The decision of the Court of Appeal (Patten, Lewison and Sharp LJJ) in *Re Game Retail Ltd* [3][2014] EWCA Civ 180 on 24 February has now clarified that the office holder's liability to make payments at the rate of rent for the duration of any period during which he retains possession of the demised property for the benefit of the winding up or administration (as the case may me) is confined to the actual period of beneficial retention, unaffected by when the relevant rent quarter days fall.

3. Although the clarification removes the arbitrariness inherent in the previously prevailing understanding of the law, a number of issues are left open by the Court of Appeal for future argument.

Facts

4. Within the administration of the Game group of companies, one company was the tenant of many hundreds of leasehold retail outlets from which the company traded. In relation to most of those properties rent was payable quarterly in advance on the usual quarter days (25 March, 24 June, 29 September and 25 December). On 25 March 2012 some £10m in rent fell due under the relevant leases but was not paid. The group companies entered administration on 26 March 2012. Although some stores closed immediately, trading continued from others which were included in a swift sale of the business and assets of the group to Game Retail Ltd, which was not part of the group. Some £3m remained outstanding in relation to March rent in respect of those stores.

Common Ground

5. Before addressing the parties' respect arguments, Lewison LJ (who gave the only reasoned judgment) identified the following as common ground:

   - At common law rent (whether payable in advance or in arrears) is not apportionable in respect of time
   - Rent payable in advance is not apportionable under the Apportionment Act 1870
   - Whether rent is payable as an administration expense is not a question of an exercise of the court's discretion – either it counts as an expense, or it does not
   - If rent falls within the principle known variously as the "salvage principle", "the liquidation expenses principle" or "the *Lundy Granite* principle[4]", it is deemed or treated as an administration expense. If not within the salvage principle, it is not treated as an administration expense.

[1] *Goldacre (Offices) Ltd v Nortel Networks UK Ltd* [2009] EWHC 3389 (Ch); [2010] Ch 455.
[2] See *Leisure (Norwich) II Ltd v Luminar Lava Ignite Ltd* [2012] EWHC 951 (Ch); [2013] 3 WLR 1132.
[3] Aka *Pillar Denton Ltd v Jervis*
[4] See *In re Lundy Granite Co, ex p Heavan* (1870-71) LR 6 Ch App 462.

6. Lord Justice Lewison went on to refer to the definition of "debt" in r 13.12 of the Insolvency Rules 1986 ("the Rules"), observing (at [12]) that on the face of it, liability to pay rent as it accrues under a lease taken by the relevant company before its entry into administration (or liquidation) was within that definition, with the consequence that it was provable (see r 12.3).

7. He also noted the terms of r 2.87 of the Rules which makes special provision for rent and other periodical payments when it comes to proving.

8. Rule 2.67 of the Rules contains the hierarchy of administration expenses (a rule modelled on r 4.218 which applies in the case of liquidation). In Re Toshoku Finance Ltd [2002] UKHL 6; [2002] 1 WLR 671, Lord Hoffmann explained that the court would interpret r 4.218 of the Rules to include debts which, under the Lundy Granite principle (i.e. the salvage principle), are deemed to be an expense of the liquidation. It followed, said Lewison LJ in Game Retail (at [17]) that the salvage principle would also apply to r 2.67. That the salvage principle and the right to prove for a debt are not mutually exclusive was also said by him to be "common ground". So, the mere fact that a debt is a provable debt, does not mean that the salvage principle cannot apply.

The salvage principle

9. After a review of a landlord's remedies for non-payment or rent and in cases of insolvency, Lewison LJ went on (at [33] et seq) to the origin and extent of the salvage principle by reference to previous authority. Following a review of 19th century cases, he turned his attention to modern authority, noting (at [71]) that the interplay between the salvage principle and apportionment arose in Re Atlantic Computer Systems plc (No. 2) [1990] BCC 454 in the context of rents payable under computer leases. In that case Ferris J held that the relevant payments should be apportioned as if the underlying liabilities accrued on a day to day basis.

10. As to how the salvage principles works, Lewison LJ (at [76]) quoted Lord Hoffmann in Toshuku (at [27]):

> "My Lords, it is important to notice Lindley LJ [in *Re Oak Pits Colliery Co* (1882) 21 ChD 322] was not saying that the liability to pay rent had been incurred as an expense of the winding up. It plainly had not. The liability had been incurred by the company before the winding up for the whole term of the lease. Lindley LJ was saying that it would be just and equitable, in the circumstances to which he refers, to treat the rent liability ***as if*** it were an expense of the winding up and to accord it the same priority. The conditions under which a pre-liquidation creditor would be allowed to be paid in full were cautiously stated. Lindley LJ said . . . that the landlord "must shew why he should have such an advantage over the other creditors". It was not sufficient that the liquidator retained possession for the benefit of the estate if it was also for the benefit of the landlord. Not offering to surrender or simply doing nothing was not regarded as retaining possession for the benefit of the estate."[5]

11. Lord Justice Lewison also accepted ([77]) that whether the salvage principle applies is not a matter of discretion. In order to rank as an expense a liability must fall within the rules as interpreted in the light of the salvage principle. What Lewison LJ also made clear is that the application of the salvage principle is not confined to the factual situations faced by our Victorian forebears. The rationale of the principle is a judge-made deeming provision under which the office holder is deemed to have incurred the liability in the course of the winding up or administration. The foundation of the principle is the application of equity.

12. The fact that rent payable in advance is not apportionable under the Apportionment Act 1870 did not lead inevitably to the conclusion that the salvage principle does not apply ([80]). The distinction between the two is important. As Lewison LJ explained, a true apportionment either relieves the tenant from part of the liability for rent, or transfers liability from one tenant to another. Where the salvage principle applies, there is no termination of the lease and no

[5] The important words are "*as if*" which are emphasised by Lord Hoffmann in italics. We have highlighted those words further in bold and underlining. If the salvage principle applies the rent, whilst not strictly an expense of the winding up is deemed or treated to be an expense of the winding up because it is just and equitable to do so.

change of tenant. It must be remembered that the whole of the instalment of rent that falls due is a provable deb, so the tenant remains liable to pay it. The application of the salvage principle merely affects how that liability is to be satisfied. To the extent that the salvage principle applies, the liability must be discharged in full as an expense. Any balance of the liability to which the principle does not apply (because it relates to a period outside the period of beneficial retention by the office holder) will be satisfied by way of dividend.

13. As to the decision in *Goldacre*, it is important to understand the apparent facts[6]. The rent was payable in advance on, probably, the usual quarter days[7]. Following the company's entry into administration, the administrators retained possession of part of the property for the benefit of the administration. Parts of the property were sub-let to others. The landlords served notices under the Law of Distress (Amendment) Act 1908, the effect of which was to transfer to the landlords the right to receive the rent from the sub-tenants. That meant that the landlord was recovering part of the rent in full. The case concerned instalments of rent that fell due in the period during which the administrators retained possession for the benefit of the administration.

14. His Honour Judge Purle QC held (correctly) that he was not exercising a discretion as either the rent was payable as an expense or it was not. He also held (again correctly) that in principle rent was an administration expense because of the salvage principle. What was relevant for the purposes of the appeal in Game Retail was the extent to which rent is payable as a result of applying the salvage principle.

15. Judge Purle QC in Goldacre rejected the administrators' argument that the liability for rent should be tailored to their use of the premises. He held that rent payable in advance was not apportionable under the Apportionment Act 1870 but as Lewison LJ explained in Game Retail, that does not necessarily oust the salvage principle. Insofar as Judge Purle had relied on the concept of "adoption" of contracts explained in *Powdrill v Watson* [1995] 2 AC 394, he had formulated the principle in a way which was inconsistent with authority (Re HH Realisations Ltd (1975) 31 P & CR 249, a decision which had been expressly approved by Lord Hoffmann in Toshoku).

16. In *Luminar* His Honour Judge Pelling QC had, according to Lewison LJ (at [96]), fallen into error in his analysis of *Toshoku* insofar as he had concluded that Lord Hoffmann's speech did not support the proposition that the salvage principle did not extend to debts that had already become due at the date of the commencement of the liquidation or administration.

17. *Goldacre* and *Luminar* had, according to Lewison LJ ([100]), left the law in a very unsatisfactory state:

    "If rent is payable in arrear then the office holder must pay the rent as an expense of the liquidation or administration (as the case may be) for any period during which he retains possession of the property for the benefit of the insolvency process. If appropriate that liability will be apportioned so as to reflect, as precisely as possible, the true extent of the benefit. If, by contrast, the rent is payable in advance no such apportionment is possible. In some cases this will result in the office holder paying more than the true benefit (as in *Goldacre*). In other cases it will result in his paying less (as *in Luminar*)."

18. The true result of the principle, according to Lewison LJ ([101]), is that the office holder must make payments at the rate of the rent for the duration of any period during which he retains possession of the demised property for the benefit of the winding up or administration (as the case may be). The rent will be treated as accruing from day to day. Those payments are payable as expenses of the winding up or administration. The duration of the period is a question of fact and is not determined merely by reference to which rent days occur before, during or after that period.

19. Goldacre and Luminar were expressly overruled by the Court of Appeal ([102]).

[6] Apparent because, as Lewison LJ observed in *Game Retail* (at [85]), they are "not readily discernible from the report".
[7] 25 March, 24 June, 29 September and 25 December.

Scope for future argument

20. The salvage principle only applies for such period as the office holder retains or uses the relevant property for the benefit of the insolvency process (winding up or administration). Lord Justice Lewison refers to this as the period of beneficial retention.

21. What is, however, clear is that what might be termed passive (or formal[8]) retention is not enough for application of the salvage principle, nor it appears where the landlord derives some benefit. As Lord Hoffmann observed in Toshoku (at [27]):

> "It was not sufficient that the liquidator retained possession for the benefit of the estate if it was also for the benefit of the landlord. Not offering to surrender or simply doing nothing was not regarded as retaining possession for the benefit of the estate."

22. As illustrations of the limits of the principle, Lord Hoffmann referred (at [28]) to In re *ABC Coupler and Engineering Co Ltd* (No. 3) [1970] 1 WLR 702 and In re HH Realisations Ltd (supra). In ABC Coupler, the liquidator on appointment closed down the company's business which had been conducted on the premises, had the company's plant and machinery valued and thought about what he should do. It was only from the time that he was retaining the premises for the benefit of the winding up that he was liable to pay the rent in full. For the period the liquidator was making up his mind, the landlord could not show that the premises were retained for the benefit of the winding up[9]. As to whether or the property had been retained for the joint benefit of the landlord and the company, Plowman J said this (at p 721 D-F):

> "But none of the cases, in my judgment, goes to the length of deciding that once one can find a benefit to the landlord, however insubstantial, he is necessarily precluded from receiving payment of his rent in full, irrespective of the nature of that benefit, the intention of the parties and the circumstances of the case. One must, I think, look at the matter from a broad commonsense point of view . . ."

23. For an example of retention of premises for the joint benefit of the landlord and the company, see In re Bridgwater Engineering Co (1879) 12 ChD 181 (advertisements issued with consent of landlord offering machinery for sale and that landlords willing to grant purchaser fresh lease).

24. In re HH Realisations Ltd, Templeman J held that a company ceased to be liable to pay the rent in full from the time it gave notice to the landlord that it was seeking authority to disclaim the lease, even though it remained in occupation for 2 months longer. It was common ground that the landlords were entitled to rent in full from the date of liquidation down to the date upon which the landlords received notice of the summons for leave to disclaim (see p 251), presumably on the basis that during that period the liquidators were actively trying to dispose of the lease for value.

25. Those acting for landlords may be advised to press the office holder for an early decision as to what he intends to do with the relevant lease.

26. In circumstances where the office holder is only using part of the premises for the benefit of the insolvency process, it is not clear from Game Retail whether all of the rent due under the lease is payable as an expense. Where, as was the case in Goldacre, the landlord was receiving full rent from the sub-tenants for those parts of the premises occupied by them, presumably any liability on the part of the office holder for beneficial retention of the balance is capped. Where, however, part only is beneficially retained but no sub-lease is possible, it is arguably unfair to confine the landlord to a proportion of the full rent. Retention of demised property by the administrator for storage purposes (e.g. plant, machinery or stock) will usually trigger an obligation to pay rent as an expense even where the whole of the premises is not so used.

[8] As opposed to actual possession: see *In re Progress Assurance Co* (1870) LR 9 Eq 370, at 372 per Lord Romilly MR.
[9] See *Re HH Realisations Ltd* (1975) 31 P & CR 249, at 253.

27. Where in the hierarchy of priority of expenses set out in r 2.67 of the Rules rent falls was also left somewhat unclear in *Game Retail*. Lord Justice Lewison referred (at [16]) to both r 2.67(1)(a) ("expenses properly incurred by the administrator in performing his functions") and r 2.67(1)(f) ("any necessary disbursements by the administrator in the course of the administration"). In *Toshoku* Lord Hoffmann observed (at [38]) that rent would ordinarily fall within paragraph (a) of r 4.218 (in the case of a liquidation)[10].

28. Rent is, however, not the only liability arising under most commercial leases. Game Retail does not expressly seek to address the proper treatment of claims for insurance, utilities, dilapidations etc. In Goldacre Judge Purle QC address this issue in passing at [20]:

> "The fuller citation of authority in *In re Levi & Co Ltd* [1919] 1 Ch 416, and its approval in *Powdrill v Watson* [1995] 2 AC 394, establishes that a liquidator electing to hold leasehold premises can do so only on the terms and conditions contained in the lease, and that any liability incurred while the lease is enjoyed or retained for the benefit of the liquidation is payable in full as a liquidation expense. The same principle in my judgment applies in an administration."

29. It is submitted that, consistently, with the treatment of rent in Game Retail as payable as an expense only for the period of beneficial retention, other periodic liabilities will only be payable in like manner insofar as they relate to such period of beneficial retention. The position may be otherwise where the relevant lease expires during the period of beneficial retention and any covenant to deliver up the premises in a good state of repair is thereby triggered, potentially exposing the office holder to liability in full for any dilapidations irrespective of when the deterioration occurred. Plainly, an office holder facing such a situation should seek to disclaim the lease in good time. Even where the lease does not expire during the period of beneficial retention, depending upon the repairing covenants in the lease, a landlord may seek to make a dilapidations claim in respect of the period of beneficial retention. Prudence would dictate that the administrator obtain evidence of the state of repair and decoration of the premises at the commencement of the administration and the end of beneficial useage.

30. Finally, some commentators have raised the prospect (in light of the decision in Game Retail) that:

    (1) landlords might seek to pursue office holders for rent not paid in reliance on the decision in *Luminar*; and

    (2) office holders might seek to recover overpayments of rent paid to landlords in reliance on *Goldacre*.

31. The declaratory theory of judicial decision making11 certainly lends scope to such possibilities. Successful claims by landlords might lead to repayment by office holders of their remuneration (which ranks in the hierarchy of expenses below rent etc)12. Any claims for recovery of overpayments against landlords will presumably be restitutionary in nature (based on mistake of law) and therefore potentially subject to the defence of change of position.

B. A wider principle of "treating" as an administration expense?

32. Attempts to push the boundaries of the Lundy Granite principle into a wider ability of the court to "treat" liabilities, which otherwise do not come within r 2.67, as administration expenses have not been successful.

[10] The wording of para (a) in r 2.67 is not, however, identical with that used in para (a) of r 4.218, something perhaps explained by the different functions of each office holder.

[11] By which appellate decisions overruling lower court decisions are treated as declaring law, which therefore has a retrospective effect, rather than making new law with prospective effect only. See *National Westminster Bank v Spectrum Plus Ltd* [2005] UKHL 41; [2005] 2 AC 680 paras [4]-[43], [65-[74], [121]-127. Similar concern was expressed following *Spectrum* but in fact the flood of claims never happened. HMRC issued a policy statement, principally directed at recouping distributions from charge holders since the *Brumark* Privy Council decision on 5 June 2001.

[12] Cf. *Re Pacific Coast Syndicate Ltd* [1913] 2 Ch 26 in the context of the priority of adverse costs orders against office holders.

33. In *Neumans LLP v Andronikou, Re Portsmouth City Football Club Ltd*[13] Morgan J rejected an application by solicitors that their fees and disbursements to counsel in acting for the Club in opposing and unsuccessfully applying to strike out a WUP by HMRC should be paid as an administration expense. The WUP was suspended by the appointment of administrators out of court by a secured creditor but following a failed CVA, on the application to terminate the appointment of the administrators, a winding up order was made on the original HMRC petition. Neumans successfully obtained an order that certain of their fees and disbursements (which totalled a mere £267,000) be paid as a liquidation expense pursuant to r 4.218(3)(h)[14]. However Neumans wished to obtain an order that they we paid as an administration expense, as (i) it was unlikely that they would receive payment in the liquidation even as an expense creditor as there were no realisations and (ii) there had been substantial realisations in the administration with substantial payments made by the administrators in respect of their own remuneration[15]and to their solicitors[16], which the administrators would have to pay back if Neumans were an administration expense creditor.

34. One of the arguments by Neumans was that their fees could be treated as an administration expense. Morgan J rejected that argument, restricting the ability of the court to "treat" a liability as an administration expense to liabilities falling within the Lundy Granite principle and analysing Toshoku as follows:

> "[90] Taken literally, the references to expenses being "treated" as liquidation expenses, or the list of such expenses being "enlarged", might suggest that it is open to the court to hold that certain matters can be liquidation expenses even when they do not fit within the lists of such expenses. I do not consider that Lord Hoffmann had such a possibility in mind. It seems to be that there is a ready explanation for the language he used in describing the way in which liabilities under the *Lundy Granite* principle are to be fitted into the list of liquidation expenses without going so far as to hold that the court has a power as it considers appropriate, to "treat" something which is not in the list of expenses as nonetheless qualifying as such an expense and thereby acquiring a priority as regards its payment.
>
> [91] If the company is under a liability to pay a sum under the *Lundy Granite* principle, then it seems to me that, as a matter of fact, payment of such a sum will be a necessary disbursement within r 4.218(3)(m). Similarly, one might say that such a liability is "treated" as an expense under that paragraph. Paragraph (a) of r 4.218(3) refers to expenses "incurred" by the office holder. Technically, because the contract in question, such as a pre-liquidation lease, was entered into by the company before the commencement of the liquidation, the liability was incurred by the company when it entered into the lease and the liability was not incurred by the liquidator. However, as explained in *Re Oak Pitts Colliery Co*, as regards the liability to pay under the contract the benefit of the contract is retained for the purposes of the winding up, the position is to be "regarded" in just the same way as if the contract had been entered into by the office holder for the purposes of the liquidation. In that way, the liability is to be "treated" as a liability incurred by the office holder. Similarly, the court will "interpret" the word "incurred" as extending to a case where the action of the liquidator, in retaining the benefit of the contract for the purposes of the liquidation, has resulted in a liability to pay in full the sums due under the contract.
>
> [92] If *Re Toshuku* is understood in this way, then the *Lundy Granite* principle does not involve a qualification of the conclusion that the list of expenses in r 4.218 is indeed an exhaustive list."

35. The judge went on to hold that the Lundy Granite principle had no application and did not assist Neumans, para [95]

> "For present purposes, it is sufficient to describe the *Lundy Granite* principle as applying to a case where: (1) the company entered into a contract with a third party before the commencement of the insolvency process; (2) the contract continued to have effect after the

[13] [2012] EWHC 3088 (Ch), [2013] Bus LR 374, [2013] 1 BCLC 572
[14] Applying *Record Tennis Centres* [1991] 1 WLR 1003.
[15] £1,027,936.50
[16] £1,036,421

insolvency process; and (3) the office holder elected to retain the benefit of the contract for the purposes of the insolvency process. On that basis, the *Lundy Granite* principle does not apply in the administration in the present case. The company's contract of retainer of the solicitors was ended by the company on 12 February 2010. The company entered administration on 26 February 2010. The contract of retainer did not have any continuing effect after the company entered administration. The administrators did not do anything to elect to retain the benefit of the contract of retainer for the purposes of the administration. Further, if they had so elected, they would only have been liable for charges in relation to the period from the time of such election."

36. The Court of Appeal[17] dismissed Neumans' appeal and adopted without reservation (or needless repetition) the judgment of Morgan J (para [39]), Mummery LJ commenting (para [36]) "What sensible purpose could be served by this court repeating in its judgments detailed discussions of every point raised in the grounds of appeal and the skeleton arguments when they have already been dealt with correctly and in detail in the judgment under appeal? No purpose at all, in my view"[18].

37. As an aid to practitioners and courts, Mummery LJ provided a brief summary of Morgan J's judgment, setting out short relevant legal propositions and conclusions (para [41]), sub-paragraphs (6)-(7) and (10) of which deal with the "treated" argument.

"[41] I would summarise the legal position here as follows:

(1) Fees owed to solicitors by a company, for which they have acted in unsuccessfully opposing a winding up petition against it, may be payable as an expense of the subsequent liquidation of the company.

(2) There is no general principle of law or statutory provision making those fees payable as an expense of the administration of that company out of court.

(3) The Insolvency Rules 1986 are the source of the provisions permitting payment in full of certain liquidation expenses and certain administration expenses ahead of the payment of ordinary unsecured creditors.

(4) They expressly provide that, where the court makes an administration order, the costs of the applicant and the costs of any person appearing that are allowed by the court are payable as an expense in the administration: rule 2.12(3).

(5) They do not provide that solicitors' fees for acting in connection with the opposition of a client company to a winding up petition are payable as an expense of an out of court administration of the company that may precede its ultimate insolvent liquidation. Those fees may be payable as an expense of the liquidation of the company: rule 4.218(30(h).

(6) The matters listed as administration expenses in rule 2.67 of the 1986 Rules are a complete list of the expenses allowed in the case of an administration by administrators appointed out of court. The solicitors' fees in dispute do not fall under the list of administration expenses and costs in rule 2.67 of the 1986 Rules.

(7) The court has no power to direct the administrators to "treat" those solicitors' fees as an administration expense. Those solicitors' fees were not incurred in connection with the performance of the administrators' functions. Payment of them would not be necessary or incidental to the performance of their duties within paragraph 13 of Schedule B1 to the Act nor were they for the purpose of the administration, being directed at preventing the company from being wound up compulsorily: see paragraph 66 of Schedule B1 to the Act.

[17] [2013] EWCA Civ 916; [2014] 1 BCLC 1

[18] Permission to appeal to the Supreme Court was refused on 10 March 2014, as raising no arguable point of law.

(8) The court has an inherent jurisdiction to give directions to administrators as officers of the court, but it would not be a correct exercise of that jurisdiction to direct the administrators to pay those solicitors' fees as an expense of the administration. That would be inconsistent with the 1986 Rules listing those items that are payable as expenses of an out of court administration. Solicitors' fees are not in that list.

(9) The court has no power under s. 51 of the Senior Courts Act 1981 to make an order that would, either directly or indirectly, result in the payment of the solicitors' fees as an expense of an out of court administration of the company. The solicitors' fees are not "costs" within s.51: they are unpaid fees owed by the company and the claim by the solicitors is for them to be paid as expenses of the insolvency process of liquidation and/or administration. The court has no power under s. 51 to order either the company or the administrators to pay the solicitors' fees as expenses of an out of court administration.

(10) In any event the court would not exercise jurisdiction to direct administrators to pay the solicitors' fees in this case as if they were an expense of the administration: the retainer of the firm had been terminated prior to the administration, and payment of the expense would not benefit the administration process and would adversely affect the position of unsecured creditors or of others with claims for expenses of the administration.

(11) The court has express power to allow certain solicitors' fees as expenses of the liquidation within rule 4.218(3)(h) of the 1986 Rules.

(12) The court may exercise that power to allow payment of particular items of solicitors' fees as expenses of the liquidation, whether they were incurred by the company in unsuccessfully opposing the winding up petition or in unsuccessfully seeking to strike it out."

38. In UK Housing Alliance (North West) Limited19 the court held that final purchase price payments due to a vendors/tenants under sale and leaseback agreements did not fall within the Lundy Granite principle and could not be treated as administration expenses. The company carried on business providing an equity release scheme to residential property owners, whereby (i) the company entered into a sale and purchase agreement ("SPA") with a property owner by which the company paid immediately c 70% of the purchase price and acquired legal title to the property, the vendor waiving any proprietary rights to the property including any unpaid vendor's lien, (ii) the company granted to the vendor an assured shorthold tenancy ("AST") for 10 year at a rent to be paid to the company, the company being liable to repair, maintain and insure the property and (iii) provided the vendor/AST tenant paid the rent under the AST at the expiry of 10 years or death of the vendor/AST tenant, the remaining 30% of the purchase price would be paid by the company to the vendor /AST tenant. The company funded the purchase of the properties by a loan from Kaupthing, secured by a debenture over the Company's assets and first legal mortgages granted by the company over the properties as they were acquired.

39. The company went into administration and the administrators continued to receive rents from the AST tenants totalling £4,547,000, which were agreed as floating charge realisations. The administrators calculated that there was a contingent liability to make final purchase payments under the SPAs to vendors/AST tenants of £8,749,722. They applied for directions as to whether the liability to make final payments of the purchase price under the SPAs were an administration expense. The administrators were concerned that the vendors/AST Tenants might contend that by collecting the rents and performing obligations under the AST, the administrators had adopted the SPA. The application was opposed by Kaupthing.

40. Martin Mann QC concluded that the liability to make final payments of the purchase price under the SPAs were unsecured liabilities, were not administration expenses and could not be treated as administration expenses under the Lundy Granite principle:

[19] [2013] EWHC 2553 (Ch), [2013] BCC 752

(1) The administrators had not been using any third party property to the advantage or convenience of the administration. Legal title to the properties was held by the company and the AST tenants were not entitled to an unpaid vendor's lien. The administrators had therefore been using or turning to account the company's own property by the receipt of the rents [46 -47].

(2) Neither the AST not the SPA imposed any obligation on the company to apply the rents collected in satisfaction of the final payments under the SPA [47].

(3) It would be contrary to the *Lundy Granite* principle, would be unfair and inequitable and re-write the parties arrangements to promote the vendor/AST tenants interest and treat the liability as an administration expense [48]

(4) In response to the argument that the SPA and AST contracts were in substance one contract and should be considered together, such that the benefit of the AST (rents) could not be taken by the administrators without suffering the extant burden of the SPA and liability to make the final payments [61], the judge held [66]

> "…even if there were in substance just one contract it would plainly be a divisible contract and even if not a divisible contract the outgoings connected with possession under the AST, in the sense employed by Astbury J, plainly cannot, on any reasonable construction, include those payments, not least because capital payments cannot without indulging [in] absurdity be characterised as "outgoings")."

C. Entry

41. The deluge of cases concerning the validity of appointment of administrators and defects has abated following the more benign attitude to construction and classification as procedural defects in Re Ceart Risk Services Ltd20, Re Care People Ltd21 and Re Harlequin Management Services Ltd[22].

42. As a consequence there have been relatively few cases relating to entry to administration. The trend to use English insolvency law and practice as part of complex European restructurings continued with *Re Christophorus 3 Ltd*[23], where the company was specifically incorporated in England and Wales as part of a group restructuring as the vehicle for disposing of the assets of the group via an administration and pre-packaged sale (para [17]). The court granted the administration and provided a reasoned judgment on the construction of an inter-creditor agreement ("ICA") to enable a security agent to give the necessary releases for the sale of the company's assets. Henderson J as a matter of construction of the ICA held that the proposed pre-pack sale by the administrators would be "implemented under any court approved process". However in case he were wrong on that he was willing to grant the proposed administrators liberty to enter into the pre pack as the only way forward that offered any realistic prospect of saving the business of the group as a going concern (para 44), applying the guidance given by Lewison J in *Re Hellas Telecommunications (Luxembourg) II SCA*[24]:

> "At the other end of the spectrum it may be that it is obvious that a particular pre-pack is on the evidence the only real way forward, in which case the court could give the administrators liberty to enter into the pre-pack, leaving open the possibility that a sufficiently aggrieved creditor could nonetheless challenge the administrator's decision ex post facto".

43. At the more provincial end of the spectrum, the recent decision of His Honour Judge Simon Barker QC in Re Brown Bear Foods Ltd [2014] EWHC 1132 (Ch) on 10 April 2014 has served to underline the importance of full disclosure in the context of applications for court appointed administrators.

[20] [2012] EWHC 1178; [2012] 2 BCLC 645
[21] [2013] EWHC 1734 (Ch) [2013] BCC 466
[22] [2013] EWHC 1926 (Ch)
[23] [2014] EWHC 1162 (Ch)
[24] [2009] EWHC 3199 (Ch), [2010] BCC 295 at para [8]

44. On 4 April 2014 the sole director of the Brown Bear Foods Ltd ("the Company") issued an application under para 12(1)(b) of Sch B1 to the Insolvency Act 1986 seeking the appointment of joint administrators. An out of court appointment was not possible, having regard to an outstanding creditor's winding up petition (presented on 21 February 2014 by the Company's landlord). The qualifying floating charge holder appeared not to be owed any secured debt but it or a group company was owed substantial sums under one or more HP agreements.

45. Although the application was not opposed by the landlord or the QFCH and the Company was undoubtedly insolvent and the evidence of one of the proposed appointees (Damian Webb of Baker Tilly Restructuring and Recovery LLP) pointed to it being reasonably likely that the purpose of administration would be achieved, the court declined to make an administration order and instead:

(1) transferred the pending winding up petition to it and called it on for hearing;

(2) appointed Mr Webb as provisional liquidator;

(3) continued the moratorium currently in place by virtue of the administration application until the return date of the petition;

(4) fixed a return date for the petition with directions to the provisional liquidator to advertise the same (allowing a 7 day window for the Company's trade and assets to be realised in the meantime).

46. In declining to make an administration order the judge identified 4 reasons:

(1) The evidence indicated that after presentation of the winding up petition, at least £115,000 was disbursed from the Company's bank account to connected parties and/or for non business purposes and no explanation had been offered;

(2) some bank statements were not in evidence and it may be that further dispositions after the presentation of the petition might have been made;

(3) the director's acquisition of the sole issued share in the Company on 10 March 2014 cried out for further explanation. Superficially, the relevant SPA was intended to create the impression of an arm's length transaction of substantial or potentially substantial value; in fact, the impression created is of a transaction which was anything but arm's length;

(4) making allowance for the pressure of time within which the application and evidence were prepared, the judge lacked sufficient confidence in the director's evidence to regard it as reliable.

47. The moral of the story is do not treat the court as a rubber stamp and assume an unopposed application satisfying the conditions for exercise of the court's discretion to appoint administrators will be granted as a matter of course.

48. Re Closegate Hotel Development (Durham) Ltd[25] has clarified that, even after the appointment of administrators (in that case out of court by QFCH under para 14 Sch B1), the directors of the company retained the power to the cause the company to challenge the validity of appointment of the administrators. The administrators contended that para 64 Sch B1 prevented the directors from exercising that power, as it provides "A company in administration or an officer of a company in administration may not exercise a management power without the consent of the administrator …. (a) "management power" means a power which could be exercised so as to interfere with the exercise of the administrator's powers".

49. Richard Snowdon QC rejected that argument on the basis that:

[25] [2013] EWHC 3237 (Ch) Richard Snowdon QC

(1) Para 64 was intended to catch powers which, if exercised by the directors, could impede the exercise of similar powers by the administrators. It was not intended to catch a power of the directors to cause the company to make an application challenging the logically prior question of whether the administrators in fact had any powers to exercise at all [6]

(2) Directors did retain a residual power to challenge a provisional liquidation, the petition and appeal against the winding up order (*Re Union Accident Insurance Co Ltd* [1972] 1 WLR 640) and challenge the validity of appointment of a receiver (*RA Cripps & Son Ltd v Wickenden* [1973] 1 WLR 944; *Sheppard & Cooper Ltd v TSB Bank plc (No.2)* [1996] BCC 964 and there was no reason in principle why the position should be different challenging an appointment by QFCH under para 14 Sch B1 [7]

(3) If the QFCH had applied to the court for an administration order, the directors could have caused the company to resist the application [8]

50. The Judge however rejected the substantive challenge to the appointment. It was contended that the bank was estopped by reason of (i) a series of stays of a High Court action commenced by the company against the bank claiming damages of £57M in respect of the development of a hotel funded by the bank and (ii) representations made by the bank during protracted settlement negotiations. The Judge concluded that there were no clear and unequivocal statements made by the bank to the effect that it would not take enforcement action; the formal stays had expired and in any event the bank had expressly reserved its rights in correspondence.

D. Exit

51. There have been 2 interesting cases on exit, unusually by rescue of the company as a going concern and returning the company to the control of the directors.

52. In *Station Properties Ltd*[26] administrators were appointed by the directors of the company which was developing a property at Advocates' Close, Edinburgh and also owed a rented out retail premises and a hotel. The building contractor for the development claimed some £491k on a quantum meruit basis, which was disputed by the company and legal proceedings had been commenced to resolve that dispute prior to administration. The administrators in their proposals had indicated that the primary objective of the administration was (c), in order to make a distribution to secured / preferential creditors.

53. In fact the administrators were particularly successful, managed to sell the development for £7.8m, which reduced the outstanding debt to the bank to £157k, with 6 other creditors of £127k, statutory interest of £59k and administration costs of £700k. The 2 remaining properties of the company however were valued by the administrators at £2.2M. An independent expert in the legal proceedings had provided a draft report. On the basis of that draft report and advice from solicitors, the administrators considered that the sum due to the developer was likely to be about £20,000. The directors of the company had been offered funding and the administrator considered that the company had sufficient assets to meet its creditor claims, exit administration and continue as a going concern. They therefore applied seeking directions in relation to exercising their power under para 80 Sch B1 ("administrator thinks that the purpose of the administration has been sufficiently achieved").

54. Lord Hodge:

(1) Provided guidance on para 80

"an assessment of whether a company has become or remains a going concern is a matter of looking into the uncertain future and making an informed judgment" [17]

"There can be no certainty in the assessment. The task … involves an assessment of the prospects of the company trading successfully. … I do not see how an administrator can

[26] [2013] CSOH 120 Scottish Court of Session, aka *Nimmo and Fraser*

make the required assessment without obtaining a clear understanding of the directors' business plan and cash flow forecasts and forming an independent view, in the light of the best evidence reasonably available, whether that plan and those forecasts are realistic" [20]
"It would be consistent with current accountancy practice to require the directors to produce a business plan and forecasts for at least 12 months and to attempt to look into the future beyond that time to identify whether there was anything which was likely to undermine the company's viability. On the information available to me it appears that the major short term issue is the likely size of DB's claim. If DB were to be awarded a sum measured in six figures, there would be a serious question as to SPL's ability to pay its debts as they fell due, unless SPL had obtained funding to meet that debt" [22]
"DB does not have a veto to prevent the administrators' exercise of their power under para 80 of Schedule B1. But the existence of its claim is a material consideration for the administrators in considering whether SPL has been rescued as a going concern as it has the potential to undermine the cash flow solvency of the company" [23]

(2) The Judge concluded that as the expert determination of DB's claim was still in draft and DB was challenging that draft report, the administrators could either wait for the final determination or if not, then they needed to obtain (i) details of DB's challenge to the draft report and DB's best estimate of its claim and (ii) legal advice in the light of DB's response. [23]

(3) As the administrators' proposals had specified that they were pursuing objective (c), it would be necessary for the administrators to prepare revised proposals and summon a meeting of creditors under para 54 to approve the proposal to pursue objective (a) and an exit via rescue and returning the company to the directors. The hierarchy of objectives and the administrator achieving the primary objective did not prevail over para 54 and enable the administrator to bypass the requirement under para 54 when the changed objective would be a substantial change to the proposals. [28]-[29]

(4) If DB acted unreasonably at the para 54 meeting in refusing to agree revised proposals and a rescue, then it would be open to the administrators to apply under para 68(3) for the court to approval the revised proposals. [31].

55. Hotel 42 The Calls Ltd[27] involved another rescue and return of the company to its directors. Administrators had been appointed over the company which ran a hotel in Leeds by a QFCH, who was owed some £4M under a guarantee given by the company in respect of a group company's liability to a developer ("Shepherd") in respect of another hotel. Following the administration the beneficial owners of the company had paid off from third party funds the Shepherd debt and all other known creditors. There was a substantial dispute however in respect of the administrators' remuneration and disbursements by way of legal fees. There were no realisations in the administration from which to pay that remuneration and disbursements. The beneficial owners applied to bring the administration to an end under para 74(4)(d) Sch B1 or the inherent jurisdiction of the court as the purpose of the administration had been achieved by the rescue of the company. The administrators resisted the application, (i) as they feared from a past history of non-payment of the Shepherd debt that the company would not pay their remuneration alternatively (ii) they sought authorisation from the court for them to cause the company to grant a specific legal charge over the hotel to the administrators to secure their remuneration.

56. HHJ Purle QC

(1) Brought the administration to an end and removed the administrators from office, holding [30] that it was not appropriate to defer the termination of the administrators' office simply to await the outcome of the dispute over remuneration, even if there was a poor payment history in respect of the Shepherd debt and a concern by the administrators that the beneficial owners would put every obstacle in the way of the administrators receiving their remuneration.

[27] [2013] EWHC 3925 (Ch)

(2) Refused to authorise the administrators to grant a charge to themselves over the hotel [29]. The administrators had the benefit of a para 99 charge to protect their claim for remuneration, which charge could be protected at HM Land Registry by an agreed notice [26] – [28].

(3) Whilst the IA 1986 did not provide an express machinery for enforcement of the charge, the judge had no doubt that the court would enforce the charge by way of the appointment of a receiver or by an order for sale [12].

E. Proposals

57. *Station Properties Limited* (above) addressed the need for revised proposals and a meeting of creditors to consider the same, in the event of a change in the objective of the administration. In *Parmeko Holdings Ltd*[28] the administrator had circulated proposals but no creditor had attended the creditors' meeting in person or by proxy, so the proposals were not approved. The administrator reported the outcome to the court and applied to court for it to approve the proposals under para 55(2) Sch B1. The Court distinguished *Re BTR (UK) Ltd*[29], where HHJ Behrens had held that the administrator was obliged to apply to court for directions under para 55(2), where the creditors had rejected the proposals. In the present case there had been no rejection of the proposals, no creditor had suggested that the company should be placed into liquidation and the administrator's view was that it was not in the best interests of creditors for the company to be placed into liquidation. In those circumstances, unless and until creditors approved proposals or directions were given by the court, the administrator was entitled to exercise is powers in such manner as he considered to fulfil the purpose of the administration. Furthermore the court was not willing to direct the administrator to carry out proposals which were drafted in an unspecific and/or permissive fashion. The court did however approve the basis for the administrator's remuneration.

58. HHJ Purle QC in UK Coal Operations Ltd30 unusually dispensed entirely with the need for proposals or the holding of an initial creditors' meeting. The administration of the 4 companies was part of a proposed restructuring whereby within a matter of days the companies would be placed into CVL pursuant to para 83 Sch B1, to enable the liquidators to disclaim onerous liabilities. The judge followed his own earlier decision in Re Advent Computer Training Limited (No. 2)31 and dispensed with the need for proposals or a creditors' meeting on the basis of commercial necessity and that it would be pointless to send out proposals or summon a meeting of creditors given the proposed CVL and restructuring.

F. Para 74 challenges to administrator's conduct of company

59. Paragraph 74(1) Sch B1 provides that:

"A creditor or member of a company in administration may apply to the court claiming that:

(a) the administrator is acting or has acted so as unfairly to harm the interests of the applicant (whether alone or in common with some or all other members or creditors) or

(b) the administrator proposes to act in a way which would unfairly harm the interests of the applicant (whether alone or in common with some or all other members or creditors)."

60. That provision has been considered in 2 recent cases, both in the context of applications by creditors under para 74 challenging a refusal by administrators to assign a cause of action to the creditor. In Sheridan Millenium Ltd32 Mrs Curistan sought an assignment from the administrator of the company, appointed by Anglo Irish Bank Resolution Corporation Ltd ("IBRC") of a cause of action by the company against IBRC in respect of which a writ had been

[28] HHJ Cooke 6 Sept 2013
[29] [2012] EWHC 2398 (Ch)
[30] [2013] EWHC 2581 (Ch)
[31] [2011] BCC 52
[32] [2013] NICh 13

issued in June 2010 claiming damages for loss of an opportunity to sell the Odyssey Pavillion which was being developed by the company with £50m from IBRC, overcharging of interest and an unlawful SWAP transaction. The administrator declined to grant the assignment unless Mrs Curistan provided a contingent costs indemnity in a cash sum of £250,000. Mrs Curistan applied under the equivalent of para 74 Sch B1 (confusingly the application was in fact made under para 75 Sch B1 of the Insolvency (Northern Ireland) Order 1989) for a declaration that the administrator was acting so as to unfairly harm her interests contrary to para 74 and a direction pursuant to para 74(4)(a) or (b) for the administrator to assign the cause of action to her.

61. McCloskey J in the High Court of Justice of Northern Ireland refused the application on the following grounds:

(1) He adopted and followed a comment made by Norris J in *Re Coniston Hotel (Kent) LLP*[33]: "Paragraph 74 does not exist to enable individually disgruntled creditors to pursue administrators for compensation. Its focus is "unfair harm": and that, I think, will ordinarily mean unequal or differential treatment to the disadvantage of the applicant (or applicant class) which cannot be justified by reference to the interests of the creditors as a whole or to achieving the objective of the administration. (The reference to an administrator acting unfairly to harm the interests of "all other members or creditors", so that unequal or differential treatment had not occurred, would (I think) only arise in relation to issues concerning the expenses of the administration, or whether the administrator was also an office holder in another insolvency and acted unfairly prejudicially as regards the stakeholders in Company A in promoting the interests [of] the stakeholders in Company B)".

(2) Applying that test, the Judge concluded that a refusal of the assignment would not constitute "unfair harm" within the meaning of para 74 as:

"She will be no worse off than any other creditor or member of the company. The impugned decision does not discriminate against her. It entails no differential treatment of creditors or members of the company."

(3) There was a theoretical possibility that in the event of an assignment and loss of the writ action the administrator could incur a liability for costs but the extreme caution by the administrator based on his assessment of risk could not be dismissed as frivolous or non-existent.

62. In complete contrast is Re London & Westcountry Estates Ltd34. The company carried on business owning and letting commercial property, had secured bank lending of £55m from RBS and administrators were appointed in March 2012. Mr & Mrs Hockin claimed that the company's demise was due to the mis-selling to the company of an interest rate swap by the bank. Mrs Hockin as a creditor of the company applied to the court for an order under para 74 that the administrators assign to her the cause of action against the bank.

63. The Judge granted the application:

(1) He rejected a submission by the administrators that the court should only intervene if the administrators' decision was perverse (see *Re Edenote Ltd*[35]). Whilst that might be the test to apply under s.167/168 IA 1986 to a decision by a liquidator or under s. 303 IA 1986 to a decision by a trustee in bankruptcy, the wording of para 74 precluded it, as it applied its own test of unfair harm.

(2) He rejected a submission by the administrators that para 74 could only be invoked by an applicant complaining of some discrimination between creditors. The administrators relied

[33] [2013] EWHC 93 (Ch); [2013] 2 BCLC 405. For subsequent decisions eventually leading to the summary dismissal of the para 74 and 75 claims in *Coniston* see [2014] EWHC 397 (Ch) Morgan J and [2014] EWHC 1100 (Ch) Morgan J
[34] Aka *Hockin v Marsden* [2014] EWHC 763 (Ch) Nicholas Le Poidevin QC
[35] [1996] 2 BCLC 389

upon the passage from *Re Coniston Hotel (Kent) LLP*, Norris J para [36] and *Sheridan Millenium Ltd* (above).

(3) That submission had to get over the express wording of para 74(1) which twice refers to harming "the interests of the applicant (whether alone or in common with some *or all* other members or creditors".

(4) "Paragraph 74 requires unfair harm, not merely harm, and the requirement of unfairness certainly prevents a creditor complaining of a disadvantage to his own interests when the disadvantage is justifiable by reference to the interests of the creditors as a whole. But I do not myself see why the requisite unfairness must necessarily be found in an unjustifiable discrimination. A lack of commercial justification for a decision causing harm to the creditors as a whole may be unfair in the sense that the harm is not one which they should be expected to suffer. I am not sure that Norris J had such a case in mind in the passage quoted from *Coniston*. In *Coniston*, the applicants (who appear to have been acting in person earlier in the proceedings) had muddles claims for professional negligence against the administrators for acts before the administration commenced with claims for harm suffered by them as members or creditors and the decision, given on a striking-out application, was one of case management." [19]

(5) The court was required to take into account whether the proposed claims were frivolous or vexatious[36]. The judge therefore scrutinised the merits of the proposed claims. He concluded that there was merit to the claim based on misrepresentation that the company had a right under the swap agreement to terminate it without cost on its third anniversary and that such misrepresentation would not necessarily be corrected by a reference in the 150 pages of ISDA definitions which indicated that the company had no right to terminate at no cost. [40]-[48]. He regarded 2 other claims (duty to advise and representation as to future rates) as vexatious.

(6) The judge therefore concluded that the assignment should be directed as (i) the limitation period would soon expire and the claims would be lost, (ii) it was proposed that the assignment be on terms that the administrators receive a lump sum of £5,000 and 10% of any recoveries, so that creditors would benefit if assigned and the claim succeeded, (iii) whilst the consideration was small it was not derisory [51]

(7) As to the terms of assignment, (i) notwithstanding the Judge's views as to the lack of merit of 2 of the claims, as the claims were closely bound up with each other, the assign should not restrict the claims assigned but should assign generally all claims arising out of the mis-selling [56] (ii) the administrators had expressed concern as to their exposure to a third party costs order. The Judge considered that risk as "very remote", however he considered that the proposed written indemnity by the applicants to the company against any third party costs order should be extended to the administrators. He also held that the administrators and the company were entitled to be satisfied that the indemnity was worth something and that the applicants had the means to meet any liability. The applicants had provided evidence of their means by way of a witness statement shortly before the hearing and had subsequently provided greater details. [61]

64. The swaps mis-selling theme also featured in *Holgate v Dawson*[37], where application was made under para 74 seeking a direction preventing the administrators selling the business and assets of the company (a caravan park near Dumfries in Scotland), revoking the deemed approval of proposals and requesting a creditors meeting to be held to consider revised proposals for the rescue of the company. The applicants contended that the company had a viable business, with a manageable debt, that creditors were supportive of rescuing the company and that the ostensible debt to the bank arose wholly or largely due to an interest rate hedging product taken out in 2007 in respect of which there was a mis-selling claim.

[36] *Re Papaloizou* [1999] BPIR 106; *Cummings v Official Receiver* [2002] EWHC 2894 (Ch)
[37] [2013] EWHC 4630 (Ch)

65. HHJ Hodge QC refused the application:

(1) It was not possible for the court to conclude on the evidence filed that the caravan park was a viable business or that the company could be rescued as a going concern. The evidence from the administrators was that the company could not trade profitably and the evidence from the applicants was inadequate without even historic management accounts being produced [33]-[34]

(2) The letter sent by the applicants canvassing support for rescue of the business and a CVA was misleading and it was impossible to predict how unsecured creditors would respond if they knew the true position [35]

(3) Based on the unchallenged evidence of the administrator, he has at the time of the formulation of the proposals genuinely held the opinion that the company had insufficient property to enable a distribution to be made to unsecured creditors under para 52(1), so that no initial creditors' meeting was required to be called [37]

(4) When the applicant had requested a creditors meeting, the administrator had been entitled to request an undertaking to meet the costs and whilst the estimate of costs may well have been exaggerated, it was not done deliberately with a view to deterring the applicant [38]

(5) The restriction in para 74(6)(c), which prevents an order being made which would impede or prevent the implementation of proposals approved under paras 53 or 54 more than 28 days before the application under para 74 equally applied to proposals deemed approved under r 2.33(5) [39] That paragraph was fatal to the application as it would impede the proposed sale by the administrators of the caravan park [45]

(6) Even if that restriction did not apply, the court would probably have refused the application in the exercise of discretion on the basis that the applicant had acted unreasonably in not pursuing the requisition for an initial creditors' meeting.

Jeremy Bamford & Richard Ascroft
Guildhall Chambers
May 2014