CONTINGENCIES POST *NORTEL* IN THE SUPREME COURT

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Introduction

1. Debts are such an integral part of the insolvency and restructuring system that it is easy to overlook the many complexities which lie concealed within such a disarmingly simple notion. X owes Y money; that is a debt. Of course, all practitioners will be aware that for the purposes of the Insolvency Act 1986 and the Insolvency Rules 1986, the term debt is intended to encompass near enough any form of liability imaginable, which, in the time-honoured phrase, is "present or future, certain or contingent, ascertained or sounding only in damages". If X might (or might not) owe Y money, that is also a debt, albeit a different type of debt.

2. Contingent debts, which are the main focus of this paper and the talk which this paper supports, are an interesting (and difficult) sub-species of debts. The phrase "contingent debt" does not itself appear anywhere in the Insolvency Act 1986 or the Insolvency Rules 1986. The same is effectively true of the phrase "contingent liability"[1]. Notwithstanding that surprising state of affairs, insolvency litigation has given rise to numerous reported cases which all address, in some respect or other, the concept of a debt that is contingent. One of the reasons for which contingent liabilities are so fascinating is because they purport to cover a known (and therefore present) potential liability which may or may not be triggered and crystallise in the future (an unknown). The phrase recently made famous by a former US Secretary of Defence is perhaps an apt label for such debts: they are a form of "known unknown" (not to be confused with "unknown unknowns" which would be a future liability that is not just future, but also contingent!).

3. Happily, as a result of the co-joined appeals in the Lehman Brothers and Nortel Network insolvencies, which both arose in the context of the Pension Protection Fund's efforts at plugging the monumental pension deficits hidden within those companies, the Supreme Court had the opportunity in 2013 to refresh the law in relation to contingent liabilities. This paper will consider the decision in that case: *Re Nortel Companies* [2013] UKSC 52 [2013] BCC 624. Despite having been decided only comparatively recently, the Supreme Court's decision has itself already been applied and interpreted in at least 3 later decisions of the High Court. In chronological order, those decisions are: *Hellard and another (as Trustees in Bankruptcy for Mireskandari) v Chadwick (Trustee in Bankruptcy for Tehrani) and another* [2014] EWCH 2158 (Ch), *Laverty and another v British Gas Trading Ltd* [2014] EWHC 2721 (Ch) and *Secretary of State for Business Innovation and Skills v (1) Broomfield Developments Ltd (2) Lakeview Developments Ltd* [2014] EWHC 3925 (Ch). Those decisions will also be considered briefly in turn in due course.

4. The final part of this paper will build on the analysis of contingencies in *Nortel* and will focus on contingent assets in the context of the insolvency test set out in s.123 of the Insolvency Act 1986. That will necessarily also involve a short review of another major Supreme Court case which related to insolvency: *BNY Corporate Trustee Services Ltd v Eurosail-UK 2007-3BL plc* [2013] UKSC 28, [2013] 1 WLR 1408.

5. First though, the inevitable and necessary starting point is the provisions in the Insolvency Rules and the Insolvency Act 1986.

Statutory underpinnings

6. It is necessary to start with a reminder of the various phrases that relate to debts in the Insolvency Rules 1986 and the Insolvency Act 1986; "provable debts" are defined as:

> <u>r. 12.3 of the Insolvency Rules 1986 - Provable debts</u>
> (1) Subject as follows, in administration, winding up and bankruptcy, all claims by creditors are provable as debts against the company or, as the

[1] There is one solitary reference to a "contingent liability" in paragraph 4C(2) of Schedule A1 to the Insolvency Act 1986.

case may be, the bankrupt, whether they are present or future, certain or contingent, ascertained or sounding only in damages.

(2) The following are not provable

(a) in bankruptcy, any fine imposed for an offence, and any obligation (other than an obligation to pay a lump sum or to pay costs) arising under an order made in family proceedings or any obligation arising under a maintenance assessment made under the Child Support Act 1991;

(b) in administration winding up or bankruptcy, any obligation arising under confiscation order made under section 1 of the Drug Trafficking Offences Act 1986 or section 1 of the Criminal Justice (Scotland) Act 1987 or section 71 of the Criminal Justice Act 1988 or under Parts 2, 3 or 4 of the Proceeds of Crime Act 2002 or any obligation arising from a payment out of the social fund under section 138(1)(b) of the Social Security Contributions and Benefits Act 1992 by way of crisis loan or budgeting loan.

"Fine" and "family proceedings" have the meanings given by section 281(8) of the Act (which refers to proceedings in the family court and to the meaning of "family proceedings" in the Matrimonial and Family Proceedings Act 1984...

7. Of more central importance, however, is the definition of a "debt" and a "liability" which is contained in rule 13.12 of the Insolvency Rules 1986. That rule provides as follows:

r.13.12 of the Insolvency Rules 1986 – "Debt", "Liability"

(1) "Debt", in relation to the winding up of a company, means (subject to the next paragraph) any of the following—

(a) any debt or liability to which the company is subject—

(i) in the case of a winding up which was not immediately preceded by an administration, at the date on which the company went into liquidation;

(ii) in the case of a winding up which was immediately preceded by an administration, at the date on which the company entered administration;

(b) any debt or liability to which the company may become subject after that date by reason of any obligation incurred before that date; and

(c) any interest provable as mentioned in Rule 4.93(1).

(2) For the purposes of any provision of the Act or the Rules about winding up, any liability in tort is a debt provable in the winding up, if either—

(a) the cause of action has accrued—

(i) in the case of a winding up which was not immediately preceded by an administration, at the date on which the company went into liquidation;

(ii) in the case of a winding up which was immediately preceded by an administration, at the date on which the company entered administration; or

(b) all the elements necessary to establish the cause of action exist at that date except for actionable damage.

(3) For the purposes of references in any provision of the Act or the Rules about winding up to a debt or liability, it is immaterial whether the debt or liability is present or future, whether it is certain or contingent, or whether its amount is fixed or liquidated, or is capable of being ascertained by fixed rules or as a matter of opinion; and references in any such provision to owing a debt are to be read accordingly.

(4) In any provision of the Act or the Rules about winding up, except in so far as the context otherwise requires, "liability" means (subject to paragraph (3) above) a liability to pay money or money's worth, including any liability under an enactment, any liability for breach of trust, any liability in contract, tort or bailment, and any liability arising out of an obligation to make restitution.

(5) This Rule shall apply where a company is in administration and shall be read as if—

(a) references to winding up were references to administration,

(b) references to administration were references to winding up,

(c) references to going into liquidation were references to entering administration, and

(d) references to entering administration were references to going into liquidation.

8. Rule 13.12 applies explicitly to compulsory liquidations. That rule finds it equivalent in the bankruptcy context in s.382 of the Insolvency Act 1986, which provides as follows:

<u>s.382 of the Insolvency Act 1986 – Bankruptcy "debt", "liability"</u>
1) "Bankruptcy debt", in relation to a bankrupt, means (subject to the next subsection) any of the following—

(a) any debt or liability to which he is subject at the commencement of the bankruptcy,

(b) any debt or liability to which he may become subject after the commencement of the bankruptcy (including after his discharge from bankruptcy) by reason of any obligation incurred before the commencement of the bankruptcy,

(c) any amount specified in pursuance of section 39(3)(c) of the Powers of Criminal Courts Act 1973 in any criminal bankruptcy order made against him before the commencement of the bankruptcy, and

(d) any interest provable as mentioned in section 322(2) in Chapter IV of Part IX.

(2) In determining for the purposes of any provision in this Group of Parts whether any liability in tort is a bankruptcy debt, the bankrupt is deemed to become subject to that liability by reason of an obligation incurred at the time when the cause of action accrued.

(3) For the purposes of references in this Group of Parts to a debt or liability, it is immaterial whether the debt or liability is present or future, whether it is

certain or contingent or whether its amount is fixed or liquidated, or is capable of being ascertained by fixed rules or as a matter of opinion; and references in this Group of Parts to owing a debt are to be read accordingly.

> (4) In this Group of Parts, except in so far as the context otherwise requires, “liability” means (subject to subsection (3) above) a liability to pay money or money's worth, including any liability under an enactment, any liability for breach of trust, any liability in contract, tort or bailment and any liability arising out of an obligation to make restitution.
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> (5) Liability under the Child Support Act 1991 to pay child support maintenance to any person is not a debt or liability for the purposes of Part 8.

9. And finally it is necessary to set out the relevant provisions of the cash flow test and the balance sheet test. They are contained in s.123 of the Insolvency Act 1986. They provide as follows:

> <u>s.123 of the Insolvency Act 1986 Definition of inability to pay debts</u>
> (1) A company is deemed unable to pay its debts — ...
>
> > (e) if it is proved to the satisfaction of the court that the company is unable to pay its debts as they fall due.
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> (2) A company is also deemed unable to pay its debts if it is proved to the satisfaction of the court that the value of the company's assets is less than the amount of its liabilities, taking into account its contingent and prospective liabilities....

***Nortel* – what you need to know**

10. The Supreme Court heard the appeals in *Re Nortel Companies* [2013] UKSC 52 [2013] BCC 624 over 3 days in May 2013 and handed down its judgment on 24 July 2013. Lord Neuberger gave the lead judgment. Lord Sumption gave a short concurring judgment.

11. The appeals were made in the Lehman Brothers insolvency and the Nortel Networks insolvency. Those two insolvencies are amongst the largest insolvencies of the last 10 years and so need very little introduction. In order to understand the impact of the Supreme Court’s judgment it is however necessary to know a little in relation to the facts of both cases and the issue which the Supreme Court was considering. The cases concerned pension liabilities.

12. Each of the groups operated final salary pension schemes. By the time that the group companies entered a formal insolvency regime (in the main, this was administration), the relevant schemes had been in deficit for some time. As a result of the relevant companies going into administration, the liability owed by the relevant company to the pension scheme trustees crystallised pursuant to s.75 of the Pensions Act 1995; this is of course known as the s.75 debt. However, as a result of s.75(8), that debt was not preferential and fell to be paid *pari passu* with the unsecured creditors of the relevant company. In practical terms, that was of little utility to the pension scheme trustees.

13. The Pensions Act 2004 created a new regulator: the Pension Regulator. It also created the Pension Protection Fund (PPF). The PPF is financed by levies on all pension schemes. However, in order to avoid an incentive for groups of companies to arrange their affairs in such a way that the PPF would always be left to pick up the tab in an insolvency, the 2004 Act created a financial support direction (FSD) regime. An FSD is addressed to a fellow group company of the under-funded pension company and imposes an obligation on that target to provide reasonable financial support to the under-funded pension scheme. If the FSD is not complied with, it is open to the Pensions Regulator to serve on the target a “contribution notice” which creates a monetary liability.

14. Inevitably, whether or not the Pensions Regulator will issue an FSD or a CN depends on a large number of variables. For example, it is necessary for the Pensions Regulator to determine that the "employer" company in the group is insufficiently resourced. Next, it is necessary to identify a connected company which has sufficient assets. Those determinations are made on the basis of a "rich man / poor man" test. They are made as at a "look back date" which is selected by the regulator. There is also a "reasonableness" requirement which must be met. As Lord Neuberger said in *Nortel*, the pensions legislation lays down an "elaborate procedural code" for the implementation of the Regulator's functions. The standard procedure involves six stages as follows:

> "at which the target and others can make representations, namely (i) after a warning notice, (ii) following a determination (before the Tribunal), (iii) following a FSD, (iv) after a warning notice that a CN may be issued, (v) upon a determination that it should be issued (before the Tribunal), (vi) even after the issue of a CN, an adjustment may be asked for in the light of payments by others. At every stage, the Regulator or the Tribunal is required to have regard to the interests of the target as a person directly affected."

15. The entire issue in *Nortel* was where a liability to pay an FSD / CN which was issued *after* the insolvency event sat in the insolvency distribution waterfall. It was common ground that a CN issued in respect of an FSD which was served *before* an insolvency event would be a provable debt. In the course of his judgment in Nortel, Lord Neuberger helpfully summarised the waterfall at paragraph 39 as follows:

> "(1) Fixed charge creditors;
> (2) Expenses of the insolvency proceedings;
> (3) Preferential creditors;
> (4) Floating charge creditors;
> (5) Unsecured provable debts;
> (6) Statutory interest;
> (7) Non-provable liabilities; and
> (8) Shareholders."

16. It was common ground in *Nortel* that if a liability under the pensions regulation arose during administration and a winding-up were to follow later, that liability can be the subject of a proof of debt in the winding-up. In the case of Lehman Brothers, the s.75 debt which crystallised when the group companies went into administration on 15 September 2008 was approximately £120 million. Warning notices were issued to Lehman group companies on 24 May 2010. Those were followed by an oral hearing in September 2010. A determination to issue an FSD was made against the Lehman companies on 13 September 2010. The Nortel group collapsed in January 2009. At that time, its pension deficit was £2.1 billion. The Pensions Regulator's investigations into the Nortel group's pension scheme began in early 2009. A warning notice followed on 11 January 2010. The hearing in the case of Nortel took place on 2 June 2010. A determination notice resolving that an FSD should be issued was circulated on 25 June 2010.

17. At first instance, and in the Court of Appeal, it was held that a liability to pay an FSD and a CN would qualify as an expense of the insolvency proceedings. As Lord Neuberger pointed out, however, both lower courts felt constrained to reach that conclusion as a result of the decision of the Court of Appeal in *R (Steele) v Birmingham City Council* [2006] 1 WLR 2380. The alternatives which were argued in the Supreme Court were whether the liabilities created by an FSD and a CN were (i) expenses, (ii) unsecured provable debts, or (iii) non-provable liabilities, and (iv) if (iii) applied, whether the Supreme Court should make a direction requiring the officeholder to apply a more favourable ranking to the liabilities.

18. It seems that the "common sense" reaction of the Supreme Court was to plump for debt over expense. Indeed, Lord Neuberger said this:

> "[58]. Before I turn to examine in detail the arguments on the two issues, it is right to say that, at any rate on the face of it, the sensible and fair answer would appear to be that the potential liability of a target, under a FSD issued after an insolvency event, and in particular the liability under a CN issued thereafter, should be treated as a provable debt..."

19. Before he analysed the questions in any detail, Lord Neuberger began by making some broad and general points. For example, he made the general point that, if a s.75 debt was a provable debt in the insolvency of the relevant entity, it would be somewhat odd if a CN issued to support such a debt was treated differently in the insolvency of other group companies (para. 60). He also made the further general point that, if the liability would count as a debt if issued *before* insolvency but would count as an expense if issued *after* insolvency, that would effectively give an arbitrary power to the Pensions Regulator to "vary" the priority of a CN in an insolvency by deciding to (or, more likely holding off from deciding to) issue a CN until after the insolvency event (para. 61). He also considered that it would be odd if a liability under an FSD or a CN ranked as a non-provable liability; that is because, save in very unusual circumstances, a liability under a CN will always be issued against a heavily insolvent entity. In the vast majority of cases, by the time an officeholder reaches stage 5 in the waterfall, there will not be enough assets or funds to make a payment to all unsecured creditors. If liability under a CN sat at stage 7, there would never be any dividend to the Pensions Protection Fund (para. 63).

20. His detailed analysis proceeded as follows:

    20.1 There was no doubt that a liability under an FSD or a CN counted as a liability for the purposes of rule 13.12(4). It was a liability under an enactment.

    20.2 The key issue was whether it fell within rule 13.12(1)(a) or 13.12(1)(b). If it didn't, it couldn't be a "debt" for the purposes of rule 13.12, and so could not be a provable debt for the purposes of rule 12.3.

    20.3 The PPF argued, in the alternative, that the liability fell within both rule 13.12(1)(a) and 13.12(1)(b). Its argument on the first ground was that a liability under an FSD was a "contingent liability" coming within rule 13.12(3) to which the company was subject at the date of the insolvency event, and so therefore it came within rule 13.12(1)(a). Lord Neuberger did not accept that argument. He did so by reference to rule 13.12(1)(b). He considered that that rule imposed a limitation on what could constitute a future debt: "by reason of any obligation incurred before that date". If the PPF's construction of sub-rule (a) was right, it would effectively over-ride the limitation contained in sub-rule (b).

    20.4 In reaching that view, he expressly concurred with the decision of David Richard J in *In re T & N Ltd* [2006] 1 WLR 1728 which had held that: "para (a) is concerned with liabilities to which the company 'is subject' at the date of the insolvency event, whereas para (b) is directed to those liabilities to which it 'may become subject' subsequent to that date, and that there is no overlap between these two categories."

    20.5 If the liability didn't fall within (a), could it fall within (b)? Was it a liability arising "by reason of any obligation incurred before that date". He considered that the meaning of the word 'obligation' in that phrase was crucial. He described it as a word which could have a number of different meanings, or nuances. He did not think that it was a simple as equating a liability with an obligation:

    > "[74] ... Indeed, in the context of rule 13.12, it must imply a more inchoate, or imprecise, meaning than "liability", as the liability is what can be proved for, whereas the obligation is the anterior source of that liability."

    20.6 He later said: "[81]... the issue of (i) what is a contingent liability and (ii) what is an obligation by reason of which a contingent liability arises, are closely related."

20.7 He drew an easy analogy with the case of a liability arising under a contract. Plainly, a contract can impose contingent liabilities and so could be said, in the words of rule 13.12(1)(b) to impose the relevant obligation. Whether the liability falls within the rule will depend on when the contract was entered into.

20.8 Lord Neuberger made the obvious point that, "the mere fact that a company could become under a liability pursuant to a provision in a statute which was in force before the insolvency event, cannot mean that, where the liability arises after the insolvency event, it falls within rule 13.12(1)(b)..." because if not, every liability would fall within the rule. Something more was needed.

20.9 At this point, it is necessary to cite directly from the judgment of Lord Neuberger:

> "[77]... However, I would suggest that, at least normally, in order for a company to have incurred a relevant "obligation" under rule 13.12(1)(b), it must have taken, or been subjected to, some step or combination of steps which (a) had some legal effect (such as putting it under some legal duty or into some legal relationship), and which (b) resulted in it being vulnerable to the specific liability in question, such that there would be a real prospect of that liability being incurred. If these two requirements are satisfied, it is also, I think, relevant to consider (c) whether it would be consistent with the regime under which the liability is imposed to conclude that the step or combination of steps gave rise to an obligation under rule 13.12(1)(b)."

20.10 That analysis built in large part on a decision of the House of Lords in *Winter v Inland Revenue Commissioners, In re Sutherland (dec'd)* [1963] AC 235. In that case, Lord Reid had said this:

> "[I]f an Act says I must pay tax if I trade and make a profit, I am not before I begin trading under a contingent liability to pay tax in the event of my starting trading. In neither case have I committed myself to anything. But if I agree by contract to accept allowances on the footing that I will pay a sum if I later sell something above a certain price I have committed myself and I come under a contingent liability to pay in that event."

20.11 Lord Neuberger's conclusion in respect of each one of the requirements which he described as (a), (b), and (c) in para. 77 is encapsulated in the following paragraphs:

> "84. As to the first requirement, on the date they went into administration, each of the Target companies had become a member of a group of companies, and had been such a member for the whole of the preceding two years – the crucial look-back period under the 2004 Act. Membership of a group of companies is undoubtedly a significant relationship in terms of law: it carries with it many legal rights and obligations in revenue, company and common law.
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> 85. As to the second requirement, by the date they went into administration, the group concerned included either a service company with a pension scheme, or an insufficiently resourced company with a pension scheme, and that had been the position for more than two years. Accordingly, the Target companies were precisely the type of entities who were intended to be rendered liable under the FSD regime. Given that the group in each case was in very serious financial difficulties at the time the Target companies went into administration, this point is particularly telling. In other words, the Target companies were not in the sunlight, free of the FSD regime, but were well inside the penumbra of the regime, even though they were not in the full shadow of the receipt of a FSD, let alone in the darkness of the receipt of a CN."

20.12 His conclusion meant that it necessarily followed that several earlier decisions of the courts in cases involving costs orders imposed on an entity after the commencement of insolvency proceedings, but in relation to litigation started before the insolvency proceedings were not provable debts, were wrongly decided: *In re Bluck, Ex p Bluck* (1887) 57 LT 419, *In re British Gold Fields of West Africa* [1899] 2 Ch 7, *In re A Debtor (No 68 of 1911)* [1911] 2 KB 652, and *In re Pitchford [1924] 2 Ch 260* and of course *Glenister v Rowe* [2000] Ch 76 and *R (Steele) v Birmingham City Council* [2006] 1 WLR 2380.

20.13 That decision rendered it unnecessary to determine whether a liability under an FSD could be an expense, since it cannot be both a provable debt and an expense. However, Lord Neuberger went on to give his conclusions on the issue given that it was fully argued. He posed the question thus:

> "whether the liability would be within the expression "charges and other expenses incurred in the course of the … administration" within rule 12.2, and, more particularly, within the expression "any necessary disbursements by the administrator in the course of the administration", within rule 2.67(1)(f) - the equivalent provision in a liquidation being rule 4.218(3)(m)."

20.14 He expressed a "rule of thumb" on this issue as follows:

> "100. While it would be dangerous to treat any formulation as an absolute rule, it seems to me, at any rate subject to closer examination of the authorities and counter-arguments, a disbursement falls within rule 2.67(1)(f) if it arises out of something done in the administration (normally by the administrator or on the administrator's behalf), or if it is imposed by a statute whose terms render it clear that the liability to make the disbursement falls on an administrator as part of the administration – either because of the nature of the liability or because of the terms of the statute."

20.15 Lord Neuberger mentioned some examples: if an administrator enters into a transaction which would give rise to a liability to tax, or starts or adopts proceedings potentially giving rise to a liability for costs, those would be necessary disbursements. The same is true in the now notorious case of business or domestic rates following the decision in *Exeter City Council v Bairstow* [2007] Bus LR 813.

20.16 A liability under an FSD was not an expense of an administration for two reasons. Firstly, there was no suggestion in Lehman and Nortel that the liability arose as a result of an act or a decision taken during the administration (para. 105). Secondly: "The mere fact that an event occurs during the administration of a company which a statute provides gives rise to a debt on the part of the company cannot, of itself, be enough to render payment of the debt an expense of the administration. It would be a debt payable 'during the period of' the administration, but it would not be 'part of' the administration, or a payment which was one of the 'natural incidents connected with' the administration, to use the language of Lord Dunedin in *Davidson*." (para. 106).

20.17 Lord Neuberger held that the "balance of anomalies" favoured a liability under an FSD not being an expense of an insolvency. He said this: "[114]... if the liability in these cases did not rank as a provable debt, it would not count as an expense of the administration."

21. Nortel has been considered in three cases since it was decided: *Hellard and another (as Trustees in Bankruptcy for Mireskandari) v Chadwick (Trustee in Bankruptcy for Tehrani) and another* [2014] EWCH 2158 (Ch), *Laverty and another v British Gas Trading Ltd* [2014] EWHC 2721 (Ch) and *Secretary of State for Business Innovation and Skills v (1) Broomfield Developments Ltd (2) Lakeview Developments Ltd* [2014] EWHC 3925 (Ch).

<u>*Hellard and another (as Trustees in Bankruptcy for Mireskandari) v Chadwick (Trustee in Bankruptcy for Tehrani) and another* [2014] EWCH 2158 (Ch)</u>

22. *Misreskandari* is a decision of Charles Hollander QC. This was a case concerning a legal partnership trading as Dean & Dean. The partners were Messrs Mireskandari and Mr Tehrani. The latter retired from the partnership and was due to receive future fees from the partnership. By way of discharge of that liability, Mr Mireskandari assigned to Mr Tehrani the benefit of a loan agreement he had with a company of which he was the shareholder: Azadian Property Limited. In turn, Mr Tehrani assigned that right to Mrs Tehrani. After that, on 5 November 2009, Mr Tehrani was made bankrupt. A few months later, on 15 January 2010, a bankruptcy petition was presented against Mr Mireskandari, who was himself made bankrupt on 24 July 2012. In the meantime, Mrs Tehrani took proceedings against Azadian seeking the sum of £400,000 pursuant to the loan account.

23. The matter reached the courts as a result of a claim made by the trustees in bankruptcy of Mr Mireskandari under s.339 / s.340 of the Insolvency Act 1986 seeking to challenge the Mr Mireskandari assignment of his loan account. That prompted Mr Tehrani's trustees to take mirror action against Mrs Tehrani. On the first hearing of the claim, Registrar Barber raised an issue in relation to whether Mr Mireskandari's trustees' claim should be stayed as a result of s.285 of the Insolvency Act 1986. She concluded that the claim against Mr Tehrani's estate was a provable debt, and she also decided, in the exercise of her discretion, to stay the claim against Mrs Tehrani.

24. The issue on appeal was whether the claim by the Misrekandari trustees against the Tehrani estate was a "bankruptcy debt" within s.382 of the Insolvency Act 1986. The terms of s.382 are similar to rule 13.12. The issue was whether a claim under s.339/s.340 could give rise to an "obligation".

25. The judge applied *Nortel*. He concluded that the claim was a "provable debt". He expressed his conclusion as follows:

> "27. These observations show that the Mireskandari claim against the Tehrani estate is a claim within s382(1). The combination of (1) the pre-existing transaction (2) the relevant statutory scheme under ss339-340 which enables the court to impugn the transaction provide the "obligation" in the same way in which the statutory scheme and the pre-existing transaction did in Lofthouse."

<u>*Laverty and another v British Gas Trading Ltd* [2014] EWHC 2721 (Ch)</u>

26. *Laverty* is a decision of the Chancellor. It arises out of the liquidation of three companies: PGL Realisations plc, PStores Realisations Ltd and Dorsman Estates Ltd. The companies were first in administration: 19 January 2012. They entered compulsory liquidation on 19 July 2013. They were notorious because they operated the Peacock chain of clothing stores. British Gas supplied gas and electricity to stores operated by Peacock. That supply was pursuant to the terms of a contract which was for a fixed term from 1 April 2011 to 31 March 2012. It will be observed that the fixed term of the contracts ended after the start of the administration of the companies. As a result British Gas served notices terminating the contracts on 20 and 23 January 2012. However, British Gas continued to supply gas and electricity to the stores pursuant to contracts deemed to arise under the Gas Act 1986 and the Electricity Act 1989.

27. A large number of stores were sold by the administrators on 22 February 2012. Between February and March 2012, the administrators closed the other remaining stores. After the companies entered liquidation in July 2013, any leases which hadn't been surrendered were disclaimed. The administrators accepted that the price of gas and electricity supplied to the Stores during the administration while the Companies continued to trade from them was an expense of the administration. An agreed amount of £1,384,607.45 (excluding VAT) was paid in respect of that liability. There was a dispute, however, between the administrators and British Gas as regards the supply of gas and electricity to closed stores under the deemed contracts. British Gas claimed the sum of £1.2 million. A preliminary issue as to the priority of that liability was ordered. Was it an expense? Was it an unsecured debt? This was classic *Nortel* territory.

28. The Chancellor undertook a detailed analysis of *Nortel* and *Toshuku*. He expressed his conclusion as follows. He agreed

> "[81] ... with the Liquidators that liability under the Deemed Contracts is provable pursuant to r 13.12(1) (b) as a liability to which the Companies became subject after the date of administration by reason of an obligation incurred before that date. The three parts to the test suggested by Lord Neuberger in para 77 of Nortel are satisfied with the present case. As to (a) in para 77, there is a loose analogy with the position as to the costs of litigation analysed by Lord Sumption in Nortel. From the moment that gas or electricity is supplied to premises, and for the duration of such supply, the consumer (in the case of gas) and the owner or occupier (in the case of electricity) becomes bound by the statutory framework of the Gas Act and the Electricity Act, as the case may be, which includes a present or future, actual or contingent liability to pay for the supply pursuant to a deemed contract where the supply is otherwise than in pursuance of an actual contract. In the words of Lord Neuberger in para 73 of Nortel, from the moment the supplied commenced the consumer, occupier or owners "fell within the scope of the regime".
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> [82] As to (b) in para 77 of Nortel, immediately prior to their administration the Companies were, in the words of Lord Neuberger in para 77, "vulnerable to the specific liability" under a deemed contract since there was then a high probability or at the very least a distinct possibility that BGT would terminate the 2011-2012 Contracts pursuant to the provisions enabling it to do so in the Terms. Accordingly, prior to administration the Companies came under an "obligation" within r 13.12(1)(b). That obligation was necessarily (in the words of Lord Neuberger in para 75 of Nortel) more inchoate or imprecise than the "debt or liability" within r13.12(1)(b). It was (again in Lord Neuberger's words) the anterior source of that liability.
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> [83] As to part (c) of Lord Neuberger's test in para 7 of Nortel, the above analysis of the application of r13.12(1)(b) to the facts of the present case is entirely consistent with the regime in the Gas Act and the Electricity Act. Nor do I accept Mr Trower's submission that uncertainty over the amount of the future debt in relation to the future supply of gas and electricity to the Stores rendered the liability of the Companies to BGT unprovable. BGT was entitled to prove from time to time for the charges incurred following the commencement of the administration for supplies actually made to the date of proof. There is nothing in Park Air Services which states otherwise."

Secretary of State for Business Innovation and Skills v (1) Broomfield Developments Ltd (2) Lakeview Developments Ltd [2014] EWHC 3925 (Ch)

29. *Broomfield* is a decision of Mr Tim Kerr QC. This was a s.124A winding-up petition presented by the Secretary of State against Broomfield Developments Ltd and Lakeview Developments Ltd. The basis of the petitions was that the companies engaged in objectionable trading practices and alleged making of misleading and/or unfounded statements, and secondly, the provision of credit to customers without a consumer credit licence. The companies sought to restrain the advertisement of the petitions. The relevant trading practices involved a land banking scheme: buying up plots of agricultural land, dividing them up, and then re-selling them for profit. *Nortel* only arose very peripherally and because, in considering whether to restrain advertisement, Mr Tim Kerr QC was referred to and applied the decision of Nourse LJ in *In re a Company (No. 007923 of 1994)* [1995] 1 WLR 953 that contingent creditors are a class of creditors to be taken into account. The judge applied the decision of *Nortel* in that context. In the end, he refused to restrain the advertisement.

Contingent assets

30. The question of contingent or prospective assets does not ordinarily arise in the context of the cash flow insolvency test: such assets are unlikely to be material to the question of whether or not a company is unable to pay its debts “as they fall due”. However, when considering the balance sheet insolvency test, even post *BNY Corporate Trustee Services Ltd v Eurosail-UK 2007-3BL plc* [2013] UKSC 28, [2013] 1 WLR 1408 (“Eurosail”) which encourages some blurring of the edges between the two tests, the question may arise as to whether or not assets which might be viewed as being contingent or prospective assets can be taken into account.

31. The balance sheet test is stated in s. 123(2) IA 86 and provides that a company is deemed unable to pay its debts “if it is proved to the satisfaction of the court that the value of the company’s assets is less than the amount of its liabilities, taking into account its contingent and prospective liabilities”.

32. The question is, do “assets” include “contingent or prospective assets”, as is provided for in relation to liabilities? The short answer is they probably (at least ordinarily) cannot. The reason for that is two-fold:

    a. In *Byblos Bank SAL v Al-Khudhairy* (1986) 2 BCC 99, 549 it was held that in assessing the balance sheet test the court cannot take into account contingent or prospective assets, such as the prospect of receiving further injections of cash or other assets. That authority and proposition was referred to without criticism in paragraph 37 of Eurosail;

    b. The statutory language of section 123(2) specifically provides for the inclusion of contingent and prospective liabilities, but provides no similar words for contingent and prospective liabilities.

33. This approach can be reconciled with the decision in Eurosail to the effect that the balance sheet test is to be viewed as an extension of the cash flow insolvency test by allowing the court to look further ahead than the present or near present, as the cash flow test encourages.

34. That said there are some qualifications to this approach which need to be considered, both legal and practical.

35. The first is that it is necessary to distinguish stand alone contingent or prospective assets and those which are in some way interlinked with the assessment of a contingent liability. The example given by Goode in Principles of Corporate Insolvency Law (4th Edn) is the contingent liability of a surety, who should be entitled to take into account the value of the any assets which may be acquired by way of subrogation. It may be said however that in reality what this is doing is setting a net figure for the liability as opposed to taking into account a future asset. However the point is worth having in mind: contingent liabilities should not be taken into account blind, or without netting off any benefits which might reasonably be said to acquire with such liabilities, so as to reduce their effect.

36. The second is simply because a company may not have in its hands an asset, or its current directors are not cognisant of its true value, should not result in its being ignored and treated as a future asset out of the balance sheet equation.

37. Practical issues relating to evaluation of assets, and assessing whether they are future in whole or in part, can and does arise in many claw back claims without either the claimant or defendant giving it full or due consideration. It is intended to consider some of those issues in the context of a case example during the seminar.

38. So to take a classic example of a claim brought by an insolvency practitioner: Co A enters into administration on 1 March 2010. Dividends totalling £500k were paid out by the directors in the period from 1 March 2008 to 1 March 2010. £250k of those dividends were paid in the period to 1 March 2009. The directors also paid out £500k on 1 March 2009 to themselves to repay loans they had made to the company when it started out in life, and following what they described as a very successful period of trading. The IP decides to bring two claims:

a. A claim challenging the dividends totalling £500k on the grounds that they were unlawful dividends for the period from 1 March 2008 to 1 March 2010 because they were not made in accordance with the statutory procedure for paying out dividends under the Companies Act 2006 and there were insufficient distributable reserves; and

b. A preference claim against the directors for repayment of their loans totalling £500k, relying on the fact that the company was balance sheet insolvent as at that date by some £200k and on a downward spiral, albeit that it was not then cash flow insolvent.

39. Can the IP bring both those claims to a successful conclusion?

40. If not, why not?

41. Would there be a better way of formulating the claims?

42. It is intended to consider those questions further during the seminar.

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January 2015