***Re Baltic House Developments Ltd* [2018] EWHC 1525 (17 May 2018)**

Samuel Parsons, Guildhall Chambers

Administration application – purpose of administration – liquidation – unnecessary harm – judicial discretion

Practical implications

Three key points emerge from *Re Baltic House*. The decision of HHJ Eyre QC (sitting as a High Court Judge) reinforces that, notwithstanding the rising popularity of administration, liquidation remains the 'default' position in insolvency in England and Wales. In particular, the case demonstrates that no matter how instinctively attractive administration might be in any particular instance, the Court will still be precluded from making an administration order if an administration might result in unnecessary harm to creditors.

Second, in coming to a conclusion on whether there is a "real prospect" of the purpose of the administration being achieved, the Court is still entitled to accept or rejected evidence, particularly if it is not corroborated or supported; a mere hope, or suggestions that the purpose of the administration will be achieved, will not be sufficient.

Third, as a point of practice, *Re Baltic House* demonstrates the impact that a liquidator's fees will have on the overall outcome of an administration order application. The Court will also not be tied to hypotheticals of what costs *might* be incurred, but will decide the matter on the basis of the *likely* outcome. In light of the general abolition of ad valorem fees in liquidations, administration orders based on Sch. B1, para 3(1)(c) may be less common, as liquidations become correspondingly less costly.

Background

Baltic House Developments Ltd (the "**Company**") carried on business as a property developer in Liverpool. It had received significant funding in the past, particularly from foreign investors. But construction had ground to a halt due to a lack of funding. The Company needed more funds to continue building.

Two of the investors had petitioned for the Company to be wound up. In response to that petition, the Company made an application for administration.

It was clear there was little difference between the outcomes for administration and liquidation insofar as the hypothetical returns to creditors were concerned. One of the key differences was that the former proposed administrator's evidence assumed that in liquidation there would be liquidator's fees of "*a touch over £300,000 being 15% of realisations.*" However, this point only arose on the basis of the Official Receiver taking over the liquidation, rather than a private liquidator being subsequently appointed.

The law

When deciding whether to make an administration order, the applicant must identify the statutory purpose of the administration under para 3(1) of Schedule B1 to the Insolvency Act 1986.

The question for the Court is whether there is a real prospect that the administration order will achieve the relevant purpose. It is not enough to show a real prospect that administration would achieve *no worse* an outcome. The prospect of a better result must be shown: see Warren J in *Auto Management Services Ltd v Oracle Fleet UK Ltd* [2007] EWHC 392 (Ch) at [3].

If there is no 'real prospect', then the court does not have jurisdiction to make an administration order. If there is a 'real prospect', then the court will move on to the question of whether to exercise its discretion to make an administration order: see *Re Baltic House* at [28]. There is therefore a parallel

with winding-up orders, in that there is a jurisdictional threshold which–if surmounted–leads to a discretionary threshold: see Insolvency Act 1986, s. 125.

Re Baltic House affirms that the court's jurisdiction is also limited by Sch. B1, para 3(4): "*The administrator may perform his functions ... only if ... he does not unnecessarily harm the interests of the creditors of the Company as a whole*".

Simon Passfield successfully argued on behalf of the petitioning creditors that, if administration was going to be more costly than liquidation, then that would amount to there being unnecessary harm to the creditors of the Company as a whole, so that the administrator would not be able to perform his functions. That being so, the administrator would not be able to achieve his objective and, therefore, there would be in those circumstances no real prospect of the objective being achieved and accordingly no jurisdiction to make the order. Secondly, even if the jurisdictional threshold is overcome, the degree of risk of a worse outcome and the extent to which a potential outcome might be worse in administration than in liquidation then become relevant to the exercise of the discretion.

While accepting Mr Passfield's argument, HHJ Eyre QC supplemented it in holding (at [30]) that the court must still take account of *potential* benefits in administration as opposed to liquidation; the test is therefore one of *overall* harm, and where there is an element of risk of harm to the interests of unsecured creditors, that appears to be insufficient by itself for the jurisdiction to be removed.

Reference was also made to the decision of Warren J in *El Ajou v Dollar Land (Manhattan) Ltd* [2005] EWHC 2861 (Ch), where there was a trivial financial benefit in favour of administration. Ultimately, the balance lay in favour of winding up rather than administration because the creditors were entitled to the advantage of "*the complete independence and objectivity of the Official Receiver*" and the small element of control by their influence over who might be appointed liquidator in succession.

Application to the facts

The application was made with reference to the purpose in para 3(1)(b) of Sch. B1, i.e. for the purpose of achieving a better result for the Company's creditors as a whole than would be likely if the Company were to be wound up. Para 3(1)(c) was relied on in the alternative.

HHJ Eyre QC was not satisfied that the jurisdictional threshold was met. The 15% realisation fee payable to the Official Receiver would only be payable from realisations actually made by the Official Receiver if the Official Receiver were to remain as liquidator, and would not be payable if a private liquidator were to be appointed in due course. The Judge thought it was unlikely that the Official Receiver would so remain, and so placed little weight on the apparent cost of liquidation.

Nevertheless, the supposed benefit of the administration was that there were, effectively, interested buyers waiting in the wings. The point was also made in the Applicant's evidence that one can move from administration to liquidation, but not the other way around: [22]. Ultimately, the Applicant failed to discharge the (relatively low) burden of there being a real prospect of the purpose of the administration being achieved: at [38] and [39]. Although it was not described by the Judge as such, the evidence appears to have been more a matter of uncorroborated assertion rather than, for example, evidence of a firm offer further to fund or purchase the semi-completed development.

The jurisdictional threshold was therefore not met. Even if he had been satisfied that the test had been met, and the discretion had been engaged, the Judge said he would have been exercised in favour of liquidation. HHJ Eyre QC commented in relation to the test under Sch. B1, para 3(1)(c) at [43] that

> The benefit in administration as opposed to liquidation is marginal at best. In my judgement that potential benefit does not outweigh the potential harm of the additional expense. Therefore that harm cannot be said to be unnecessary, such that, following the reasoning through, an administrator would not be able to carry out the 3(1)(c) purpose, and, therefore, that purpose cannot be shown to have a real prospect of being achieved.

Comment

Re Baltic House demonstrates that, in England and Wales, where all else is equal, the scales are generally weighted in favour of liquidation. The judgment is clearly correct on its facts, and is a correct statement of law, particularly with regard to the import of Sch. B1, para 3(4). The correctness of the decision is further underlined by the fact that a substantial body of creditors supported the liquidation: [43].

The reason for this can be gleaned by looking to the legislative history of this provision. Prior to the enactment of the Enterprise Act 2002, there were two separate regimes: (i) administration, which could only be pursued if one of the purposes in s.8(3) of the Insolvency Act (as it then was) could be achieved (i.e. survival of the company as a going concern, approval of a CVA, sanctioning of a scheme of arrangement or a more advantageous realisation than winding up); and (ii) administrative receivership.

Under Sch. B1, the two regimes are now incorporated into one single administration regime. The purposes in paras 3(1)(a) and (b) reflect the old administration regime and has firmly in mind the interests of the unsecured creditors. The purpose in para 3(c) reflects the old administrative receivership regime and is really there to protect the interests of the secured creditors: see *Davey v Money* [2018] EWHC 766 at [252]–[254]. Para 3(4) therefore provides a safety valve to ensure that purpose (c) cannot be pursued if it would cause unnecessary harm to unsecured creditors.

Until the recent abolition of the ad valorem fees charged in liquidation (pursuant to the Insolvency Proceedings (Fees) Order 2016/692), it was much easier to argue that administration would achieve a better result than liquidation (and therefore purpose (b) could be achieved) even if there was no substantive difference between the work to be carried out by the officeholder because the ad valorem fees could be avoided in administration.

Now that is no longer the case, it seems likely that purpose (c) will be brought more sharply into focus, along with the underlying tendency in English insolvency law towards liquidation.

Re Baltic House gives rise to a further normative question: is it right that, where there is a marginal difference in terms of projected outcomes, courts should be precluded from making an administration order?

The author's view is that the better solution would be that, where there is a marginal difference between liquidation and administration (or where there is equality in terms of their result), the courts should have dual jurisdiction to make either an administration order or winding-up order, even if there is a risk of harm to unsecured creditors. The reason for this is that the matter is better dealt with as a question of discretion, rather than one option being cut off as the result of a lack of jurisdiction. It is submitted that that point is thrown into relief by the point made in the Applicant's evidence–a company can go from administration to liquidation, but it cannot go back the other way. However, being a result of the statutory scheme, if that change is to be made, it is one that will have to be made by the legislature.