ADMINISTRATION – TWELVE MONTHS OF LAW AND PRACTICE

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Entry and Exits into Administration

1. It has been a busy year for Administrators dealing with issues of entries and exits. One major issue for office-holders concerns out of court appointments and the question of whether or not there has been a proper appointment. At the date these notes were drafted there remains great uncertainty for practitioners. The Chief Registrar has petitioned the Insolvency Service in the hope that it may use its influence to provide greater clarity and the Chancery Division Judges have called for clarity from the Court of Appeal. A number of articles have been written about the subject and members of Guildhall Chambers have participated in many talks. As the position is well known it is not intended to talk about this subject at the seminar but it is touched on below by reference to a useful Insolvency Lawyers' Bulletin after dealing with Special Administration Orders and issues arising about entering administration[1].

A new way in - Special Administration Orders

2. The Investment Bank Special Administration Regulations 2011 (SI 2011/245) (the 'Regulations' or 'SAR') came into force on 8 February 2011 for certain types of financial businesses. On 30 June 2011 the Investment Bank Special Administration (England and Wales) Rules 2011 (SI 2011/1301) (the 'Rules') came into force. The introduction of the Investment Bank Special Administration Regulations 2011 followed the insolvency of Lehman Brothers where it became apparent that there were unanticipated complexities in resolving an investment bank's insolvency. Essentially, the issues stemmed from the complex ways in which client money and assets are held by broker dealers. This caused delays in allowing the administrator to identify and return assets to clients. It was recognised that there was an impact on the attractiveness of the UK as a place to conduct prime brokerage business, with potential knock-on consequences for UK competitiveness in general.

3. The Government explanatory notes to the Regulations explain:

> "The Government believes that there is a strong case for a SAR for investment firms to ensure that there is minimum disruption to financial markets as a result of their insolvency. It is important that client trust property is returned promptly on the insolvency of an investment firm in order to mitigate the possibility that clients are forced into financial difficulties themselves. The prompt return of client assets will also benefit the insolvent firm's unsecured creditors as their claims can be dealt with quicker and administration expenses will be reduced."

4. The objective of the Regulations is to provide the right conditions for an administrator to fulfil certain objectives, which are:

   4.1 to ensure the return of client money or assets as soon as is reasonably practicable;

[1] For detailed notes see the Guildhall Chambers website for a paper produced by Jeremy Bamford and Christopher Brockman earlier this year: http://www.guildhallchambers.co.uk/uploads/docs/section9/Invalid_Administrator_Appointments_ChrisBrockman_JeremyBamford_Feb2012.pdf.

4.2 to ensure timely engagement with market infrastructure bodies and the Authorities; and to either rescue the investment bank as a going concern, or wind it up in the best interest of the creditors.

5. The procedure that has to be followed to enter special administration is set out in the Regulations and requires careful study. The Regulations introduce new terminology which needs to be understood by those used to dealing with ordinary company administrations: for example 'Authorities' is a generic term used to refer to the Financial Services Authority, the Treasury and the Bank of England. An investment bank has a wide meaning: it means an investment deposit bank to which the definition in section 2 of the Regulations applies or section 91 of the Banking Act 2009. These are institutions which:

5.1. have permission under Part 4 of the Financial Services and Markets Act 2000 to carry on at least one of the following regulated activities:

5.1.1. safeguarding and administering investments;

5.1.2. dealing in investments as principal; or

5.1.3. dealing in investments as agent;

5.1.4. hold client assets (whether or not on trust); and

5.1.5. are incorporated or formed in the UK (so this would include partnerships).

6. At the same time as the Regulations came into force, The Investment Bank (Amendment of Definition) Order 2011 clarified that, for these purposes, client assets include client money. They also clarified that the Regulations do not apply to insurance intermediaries.

8. Unlike Schedule B1 administrations, it is not possible to enter the special administration regime by out of court process. An investment bank can only enter the special administration regime by court order and the order appoints an administrator. The administrators are to pursue the special administration objectives in accordance with the statement of proposals. The statement of proposals has to be approved by the meeting of creditors, clients and in certain circumstances the FSA.

9. Those eligible to make an application for a special administration order for an investment bank include the bank itself, directors of the bank, one or more creditors of the bank, a contributory, an officer for a magistrates court in exercise of the Magistrates Court Act 1980 and the secretary of state or the FSA. If an application is made other than by the FSA then the FSA has to be informed of the pending application as it has a right to be heard at the hearing of the application and any other hearing of the court in relation to the regulations.

10. Once the application has been made it cannot be withdrawn without the permission of the court. The application itself must nominate the person to be appointed administrator and that nominee has to accept the appointment.

11. The grounds for making an application are:

11.1. The investment bank is or is likely to become unable to pay its debts - re Cheyne Finance applies - Ground A;

11.2. That it would be fair to put the bank into administration - Ground B; and

11.3. That it is expedient in the public interest to put the bank into administration - Ground C.

12. The Secretary of State may only apply for an order pursuant to Ground C and may also make an application pursuant to Ground B. Any of the other persons listed above may make an application pursuant to Ground A or B. Ground C will be considered in a similar manner as public interest winding up petitions pursuant to section 124A Insolvency Act 1986.

13. The court has wide powers on an application and may make the order sought, dismiss the application, adjourn the hearing, make an interim order or make any other order it thinks appropriate. The court has an additional duty when considering an application made by a contributory. The court has to decide whether or not the applicant contributory is acting reasonably and whether or not they should be pursuing other remedies.

14. Before the court makes a special administration order it has to be satisfied that the FSA has been given notice (and such notice has been filed at court) and two weeks has elapsed or the FSA has consented to the application. Further there has to be no outstanding application for a special administration order in addition to the one before the court.

15. The special administration objectives differ from the objectives set out for administrators by Schedule B1 to the Insolvency Act 1986. But the administrators do have a duty to follow the special objectives as would an administrator of a company that falls within Schedule B1. The special objectives are as follows:

    15.1. Objective 1 is for the administrator to ensure the return of client money or assets as soon as is reasonably practicable;

    15.2. Objective 2 is for the administrator to ensure timely engagement with market infrastructure bodies and the authorities; and

    15.3. Objective 3 is for the administrator to either rescue the investment bank as a going concern or wind it up in the best interests of the creditors.

16. As with Schedule B1 the administrator has flexibility to prioritise these objectives as appropriate, so the administrator will not be required to return all client assets before addressing unsecured creditors. However the FSA does have the power, having consulted with the Treasury and the Bank of England, to direct the administrator to prioritise certain objectives over the others, if that is necessary to maintain public confidence in the stability of the UK financial markets. This may be helpful to the administrators in providing them with a defence to undertaking (or failing to undertake) certain actions which might otherwise expose them to personal liability and as a result any administrator of an investment bank should adopt an early stance of communication and cooperation with the FSA. The language of the Regulations does make it mandatory to "commence work on each objective immediately after appointment, prioritising the order of work on each objective as the administrator thinks fit in order to achieve the best results overall for clients and creditors and set out in the statement of proposals under paragraph 49 of Schedule B1 the order in which the administrator intends to pursue the objective once the statement has been approved."

17. The SAR Rules supplement the Regulations and set out some of the mechanics behind the Regulations, such as who is entitled to attend creditors meetings (all clients of the investment bank, as a separate class of creditors, as well as all creditors in the ordinary course) and how they operate, and provide, among other things, that the costs of returning client assets will be paid for out of the client assets.

18. There have been at least three special administrations since June 2011. The first was MF Global where Richard Fleming, Richard Heis and Mike Pink of KPMG LLP were appointed joint special administrators of MF Global UK Limited, a UK based broker-dealer business, and MF

Global UK Services Limited, which provides employee and pension services in relation to the UK operations, on 31 October 2011. Meetings of creditors have to be called and this in itself can cause difficulties. In this case the meeting was attended by 800 representatives of creditors and clients (the Barbican was hired). The sums were large: $100m of client money. But who pays for the calling of the meeting? Who pays for the special administrators to deal with client money?

19. These are some of the questions that faced Tim Ball of Mazars LLP who was appointed joint administrator of Pritchard Stockbrokers Limited in February 2012. The Company had over 12,000 clients and £10s of millions in client accounts.

20. The scale of the investment bank operations will mean extraordinary man power will be required to unravel complications and deal with any difficulties that are discovered. If the books and records are in good order the tasks will be easier but administrators will wish to check (like an audit) what has happened and will need to know at what point any trades have reached. The scales of the challenges are great. In *Worldwide Spreads Limited*, a UK based spread betting business Special Administrators were appointed on Sunday 18 March 2012. The company was incorporated in Dublin and had 15,000 clients.

21. At the time of writing these notes a judgment has been handed down, but not yet approved, by Hildyard J in respect of MF Global UK. It is inevitable that the Special Administration procedure is going to throw up issues in the months and years ahead and it is not hard to envisage that there will at times be a friction between the interests of creditors and the interests of clients that will challenge an office-holder.

22. Separately, the FSA is currently conducting a market consultation in relation to a proposed requirement for financial services firms to maintain Recovery and Resolution Plans ("RRPs") — "living wills". The purpose of such a "living will" would be to set out recovery options which may be mobilised quickly and effectively in the event of a firm running into financial difficulties. The FSA has set a deadline of June 2012 for the submission of Recovery and Resolution Plans by banks, building societies and the largest investment firms.

<u>Appointment issues</u>

23. *Rowellian Football Club* [2011] 3 WLR 1147 ran into serious financial difficulties. The football team played and operated within the United Counties Football League which represents level 4 in the semi professional game in the UK. Over 100 members paid a subscription of £5 per annum.

24. It had a deficiency of about £150,000. Barclays Bank Plc had the benefit of a fixed charge and therefore had the right to appoint a receiver, but chose not to do so. Part of the reason why the bank decided not to appoint a receiver could have been that the receivers could not sell the club as a going concern. A voluntary arrangement was proposed, but this was rejected by the creditors.

25. Accordingly proposed administrators agreed to act. They considered that there was a realistic prospect that the objective in paragraph 3 of Schedule B1 could be achieved. Two offers had been made for the assets of the football club and if the higher offer was accepted the deficiency would be reduced to the order of just over £100,000. In these circumstances the court considered that there was little doubt that administration would be the best route to achieve what the club and creditors wanted.

26. Schedule B1 to the Insolvency Act 1986 contains the appropriate provisions for administrations and paragraphs 1 and 2 make it clear that an administrator of a company

means a person appointed to manage the company's affairs, business and property. A person may be appointed as administrator of a company either by the court (pursuant to paragraph 10) by a holder of a floating charge (paragraph 14) or by the Company or its directors (paragraph 22). It is also clear that all the provisions relate to a 'company'.

27. A 'company' falls within the meaning of Schedule B1 (paragraph 111(1A) to the Insolvency Act 1986 (generally a company within the meaning of the Companies Act 1985 or 2006, incorporated in an EEA state or having its main centre of interests in a member state other than Denmark). There was no direct authority on the interpretation of paragraph 111(1A). It was argued that the club fell within the definition of a company as it was not incorporated in the EEA state and did its main centre of interests in a member state other than Denmark. The argument was supported by reference to *Re International Bulk Carriers* [1993] Ch 77 where the issue was whether receivers appointed under a debenture in a standard English form given by an unregistered foreign company to its bankers were administrative receivers within the meaning of section 29(2) of the Insolvency Act 1986. If they were they would have had the additional powers under sections 234 to 236 of the Act. The court held that for the purpose of section 29(2) an unregistered foreign company was a 'company' with the result that the additional powers in the Act were available to the receivers. In his view it would have frustrated the purpose of the legislation which was to reinforce the position of contractual receivers.

28. However the court was not considering the statutory scheme that applied to a club in *International Bulk Carriers* and it would strain the language of the legislation to include an unincorporated 'club'. The rules of a club have to be considered but generally a club is not 'an association' within the meaning of the legislation to allow a compulsory winding up petition under section 220 Insolvency Act 1986: *St James Club* (1852) 2 De GM at 387.

29. When considering the club rules in order to determine whether or not the club fell within the meaning of paragraph 111(1A) the court found that contrary indicators were the provision for subscriptions and expulsion and ended "it seems to me, if the Club is not susceptible to compulsory winding up it is difficult to see why Parliament should have intended it to be subject to the administration regime." There was therefore no jurisdiction to appoint an administrator.

30. On the theme of entry into administration those reading this will be aware that there has been a spate of cases resulting in little certainty with regard to validity of out of court appointments where there has been a failure to comply with a procedure. The position was neatly summed up in a helpful and recent bulletin produced by the Insolvency Lawyers Association (bulletin 386) as follows:

30.1. "Absent bad faith as distinct from an irregularity, the judges seem minded to find a pragmatic solution: *Minmar*, *London Bar Company* and *Msaada* all involved elements of deliberate omission as distinct from inadvertent omission.

30.2. Where the omission relates to failure to give notice to the company, as opposed to any other "prescribed" parties, and there is no dispute between the directors and the shareholders (as in *Bezier* and *Virtualpurple*), Norris J has identified avenues by which that omission need not be fatal.

30.3. In *Msaada*, Warren J commented on the period of notice required to be provided to "prescribed" parties under para 26(2), Sched B1 IA1876 and considered that they be given a "reasonable time". If 5 days is required for the purposes of para 26(1), then the same period is also reasonable under para 26(2). It must surely be the case that person(s) served under para 26(2) can consent to short notice, even if Sched B1 IA1986 is silent on the point.

30.4. To minimise the risk of confusion about notices to the company under paragraph 26(2), an appointment by the company under para 22(1) may be preferable.

30.5. Whether a distinction can be drawn between the categories of “prescribed persons” under para 26(2) IA1986 and r2.20(2) IR1986 remains to be seen.”

Exit issues

31. Exits have also been in the news in the last year. In June 2011, the court made an administration order on an application made by an associated company in *Stanleybet UK Investments Ltd* [2011] EWHC 2820. The proposals put to creditors were focussed on the sale of its shareholding in a Polish betting operator. Two offers were made, one of which came from Stanleybet’s major creditor - the estate of Lord Steinberg which was also a part owner in the betting operator and the other from an associated company owning shares in the company in administration. The betting operator’s continued operations depended upon services provided to it by the associated company and it was therefore exposed to risk the longer it traded in administration. The negotiations dragged on and both offers were withdrawn. Lord Steinberg’s estate disagreed with the tactics of the administrators and believed the administrators had failed to market the Polish betting operator adequately so as to identify and obtain the best outcome. The argument was backed up by a report produced by Grant Thornton to the effect that further steps could be taken to market the shares in the operator, but the administrators disagreed with the report and wanted to sell the shares in the operator to the associated company for less value but greater certainty than the offer made by the estate. The offer from the associated company was put back on the table. By October 2011 the joint administrators found themselves in a stalemate and applied to the court seeking directions and an order pursuant to paragraph 55(2) of Schedule B1 to the 1986 Act for an order that they cease to act as administrators and directing them to send a notice to place the company into voluntary liquidation.

32. Skeleton arguments were filed and the positions of the parties set out. However at the hearing each of the parties appeared to change their position including the administrators who advanced the argument, contrary to their written submissions, that they should be allowed to continue with their proposals to creditors and sell the shares to the associated company. After considerable argument the joint administrators changed again and adopted their original position asking the court to place the company into voluntary liquidation. This was supported by the estate and opposed by the associated company. A complex situation. The court had to make a decision and did so acceding to the application having regard to the following matters:

32.1. “The joint administrators approach was considered and unless the contrary was shown, was the approach of responsible administrators in a difficult and complex situation. In such situations the court should give considerable weight to their view;

32.2. Although creditors views are not absolutely binding upon administrators they should have regard to majority creditors such as the estate which held 87% of the company’s debt;

32.3. The estate had given an undertaking (under pressure from the bench) to cover additional costs involved in seeking to remarket the shares and this would cover some of the prejudice that may be suffered by the associated company.”

33. These are useful points to have in mind when making an application for directions and generally dealing with creditor wishes.

34. On the same theme of directions, the administrators of *Hellas Telecommunications (Luxembourg) II SCA* (in administration) [2011] EWHC 3126 applied for directions on how to

proceed in light of their opinion that the purpose of the administration was at an end in November 2011. In circumstances where the company had no property to permit a distribution to its creditors the administrators considered a notice should be served pursuant to paragraph 84(1) of Schedule B1 on the registrar of companies triggering the registrar's duty to register it and after three months dissolving the company. However a group of unsecured creditors (holding 5% of the unsecured debt) did not agree with this proposed course of action and wanted the company to go into compulsory liquidation as it considered there to be viable claims against the management, advisors and investors of the company. The group also opposed the application of the joint administrators to discharge them from liability pursuant to paragraph 98 of Schedule B1. Accordingly both parties agreed that the administration should come to an end but could not agree on what should happen next.

35. The same Judge who dealt with *Stanleybet UK Investments Ltd* ordered that the company should go into liquidation. The Judge commented that:

    35.1. "That application had been properly made by the administrators and it was important in these circumstances that the various arguments should be ventilated between the parties;

    35.2. A significant proportion of unsecured creditors wanted to the company to be wound up and no other creditors opposed this proposed course;

    35.3. The creditors could in any event petition for a winding up order. If they were to petition, the likely outcome would be that the court would make a winding up order;

    35.4. It was common ground that it is possible to challenge a conclusion of an administrator under paragraph 84(1) that he thinks there is no property of a company available to make a distribution on the basis that the conclusion is irrational, in the sense that no reasonable administrator in the particular circumstances could properly reach that conclusion;

    35.5. However it was conceded that there was no complaint that the conclusion reached by the administrators was based on irrationality or was flawed: the decision was perfectly sound and rational based on the investigations made;

    35.6. In the ordinary course, if creditors wish an insolvent company to go into liquidation in order for its affairs to be examined by a liquidator and there is no significant opposition from other creditors the court will accede to such an application;

    35.7. It was a reasonable position for the unsecured creditors to want the affairs of the company to be examined independently by a liquidator and a passage from Derek French *Applications to Wind Up Companies*, 2nd Ed (2008) was that read "the basic rule is that where a creditor petitioner's debt is undisputed and not satisfied and there are no exceptional circumstances, the creditor is entitled to expect the court to exercise its jurisdiction in the way of making a winding up order" was approved."

36. The court acceded to the application of discharge taking effect 28 days after they had filed their final report. It would not be fair to leave the administrators on risk generally when they no longer retained the assets of the company out of which they would be entitled to meet any liability incurred.

37. One of the shortcomings of the statutory regime for administrations of insolvent companies, as it existed before the reforms introduced by the Enterprise Act 2002, was the lack of a simple procedure for converting an administration into a voluntary liquidation. The decisions in *Re Powerstore (Trading) Ltd* [1997] 1 WLR 1280 and *Re Norditrack (UK) Ltd* [2000] 1 WLR 341 provided practical solutions to some of the problems. The introduction of schedule B1 to the

Insolvency Act 1986 setting out the new structure for administrations provided the opportunity to produce a simple process. This is contained in paragraph 83, which is headed “Moving from administration to creditors’ voluntary liquidation”.

38. In *E-Squared* [2006] EWHC 532 Richard J commented that:

> “These provisions envisage a simple, seamless procedure. First, if paragraph 83(1) applies, the administrator may send the relevant notice to the registrar of companies. As soon as reasonably practicable he must also file a copy of the notice with the court and send a copy to each creditor whose claim and address is known to him. Secondly, “on receipt” of the notice, the registrar of companies must register it. It is registration which causes the appointment of the administrator to cease to have effect and the company to be wound up as if a resolution for winding up had been passed on the day of registration. The status of the date of registration as the operative date is underlined by provisions in paragraph 83(8)(b) and (e), substituting the beginning of the date of registration for the time of passing the resolution for voluntary winding up in sections 86 and 129 of the Insolvency Act 1986.”

39. In February of this year the court was asked in a case known as *Globespan Airways Ltd* [2012] EWHC 359 to consider again the ‘seamless procedure’. The administrators had delivered the Registrar of Companies a notice with their names set out as the liquidators but failed to include their address as required in the notice. The Registrar returned the notice rejecting the application to register it. The Administrators resubmitted a completed notice. That was also rejected and the period for the administration expired. A third notice was sent and it purported to show the appointment of liquidators. The issues to be determined were (i) whether the omission of a repetition of the proposed liquidators' addresses meant that the first notice had not been duly delivered; (ii) whether the provisions of para.83 were disapplied where a notice under para.83 was received by the Registrar before the termination of the relevant administration but the administrative steps to bring about that registration only occurred after the end of the administration; (iii) the appropriate relief.

40. The court ordered that the first hand delivered notice was not invalid and should have been accepted by the Registrar of Companies. The ground of invalidity (failure of completing the addresses of the liquidators) was not relevant as their addresses were elsewhere on the notice. The court found that it was not necessary to repeat the addresses in the section where it was complained that they were not set out. The Judge said:

> “Since any person of reasonable intelligence reading the First Notice as a whole would without difficulty understand that Mr Cartwright and Mr Oakley-Smith had the addresses clearly identified in section (a), without needing to be repeated in section (e), I consider it clear that the requirements as to the content of the notice were met.”

41. The question was whether the notice had the prescribed contents, not whether it set out the relevant addresses on the precise part of a single-page document. The starting point was a purposive rather than merely literalist interpretation of para.83. Paragraph 83 was designed to provide a simple and inexpensive means whereby administrators could, in the circumstances stated in the paragraph, move the company seamlessly from administration into creditors' voluntary liquidation.

Attacks on administrators

42. The past year has seen attacks on administrators in the form of challenges to their decision making, disclosure and making them personal liable for fees and costs.

43. The first case that is worth mentioning concerns a security for costs application in relation to a company that was in administration. It is interesting as it sets out the various tests and considers contingent fee arrangements and ATE insurance in that context. The court also dealt with the usual submission by a company in administration/liquidation which is that the claim would be stifled if security for costs was awarded.

44. The case was heard in the TCC and is known as *Natas Group Limited (in administration) v Style & Wood Limited* [2011] EWHC 3464. The bare facts were that N had been retained as a sub-contractor by S in property refurbishment works. It went into administration, and commenced proceedings against S for a sum exceeding £3 million, which it claimed was the balance due to it under the contract. S disputed N's entitlement and issued a counterclaim for overpayment. N had ATE insurance and the lawyers had signed up to a contingency fee arrangement. Significant volumes of evidence served, by both parties. N's financial position was such that the threshold for the exercise of the court's discretion to make an order for security for costs had been passed: it was no longer trading, its largest alleged debtor was S, and if its claim failed it would be insolvent to the sum of £1.6 million. S estimated its gross costs at £335,000, and sought overall security of £280,000. The head of the Technology and Construction Court - Akenhead J - followed *Michael Phillips Architects Limited v Riklin & anor [2010] EWHC 834 (TCC)* and considered that "the threshold to the Court having jurisdiction where the claimant is a company is that there is reason to believe that it will be unable to pay the defendant's costs if ordered to do so. Once the threshold is established, the Court has a broad discretion as to whether to order security for costs and if so in what amount." Other factors he gleaned from *Keary Developments Limited v Tarmac Construction* [1995] 3 All ER 534 where it was held that:

44.1. "The court has a complete discretion whether to order security, and accordingly it will act in the light of all the relevant circumstances.

44.2. The possibility or probability that the plaintiff company will be deterred from pursuing its claim by an order for security is not without more a sufficient reason for not ordering security…By making the exercise of discretion under s 726 (1) [of the Companies Act] conditional on it being shown that the company is one likely to be unable to pay costs awarded against it, Parliament must have envisaged that the order might be made in respect of a plaintiff company that would find difficulty in providing security…

44.3. The court must carry out a balancing exercise. On the one hand it must weigh the injustice to the plaintiff if prevented from pursuing a proper claim by an order for security. Against that, it must weigh the injustice to the defendant if no security is ordered and at a trial the plaintiff's claim fails and the defendant finds himself unable to recover from the plaintiff the costs which had been incurred by him in his defence of the claim. The court will properly be concerned not to allow the power to order security to be used as an instrument of oppression, such as by stifling a genuine claim by an indigent company against a more prosperous company, particularly when the failure to meet that claim might in itself have been a material cause of the plaintiff's impecuniosity…but it will also be concerned not to be so reluctant to order security as it becomes a weapon whereby the impecunious company can use its inability to pay costs as a means of putting unfair pressure on the more prosperous company…

44.4. In considering all the circumstances, the court will have regard to the plaintiff company's prospects of success. But it should not go into the merits in detail unless it can clearly be demonstrated that there is a high degree of probability of success or failure…

44.5. The court in considering the amount of security that might be ordered will bear in mind that he can order any amount up to the full amount claimed by way of security, provided that it is more than simply a nominal amount; it is not bound to make an order of a substantial amount…

44.6. Before the court refuses to order security on the ground that it would unfairly stifle a valid claim, the court must be satisfied that, in all the circumstances, it is probable that the claim would be stifled. There maybe cases where this can be properly be inferred without direct evidence…

44.7. However, the court should consider not only whether the plaintiff company can provide security out of its own resources to continue the litigation, but also whether it can raise the amount needed from its directors, shareholders or other backers or interested persons. As this is likely to be peculiarly within the knowledge of the plaintiff company, it is for the plaintiff to satisfy the court that it will be prevented by an order of the security from continuing the litigation…The lateness of the application for security is a circumstance which can properly be taken into account…"

45. The court held that in all but the most unusual cases, "the burden lies on the claimant company to show that, apart from the question of whether the company's own means are sufficient to meet an order for the security, there will be no prospect."

46. It is often the case that ATE insurance will be available to insolvent companies pursing litigation where the prospects are good enough for the insurer to take the risk. ATE insurance was available to N and the court had to consider whether or not this was sufficient. In this respect it commented that:

46.1. "There is no reason in principle why an ATE insurance policy which covers the claimant's liability to pay the defendant's costs, subject to its terms, could not provide some or some element of security for the defendant's costs. It can provide sufficient protection.

46.2. It will be a rare case where the ATE insurance policy can provide as good security as a payment into court or a bank bond or guarantee. That will be, amongst other reasons, because insurance policies are voidable by the insurers and subject to cancellation for many reasons, none of which are within the control or responsibility of the defendant, and because the promise to pay under the policy will be to the claimant.

46.3. It is necessary where reliance is placed by a claimant on an ATE insurance policy to resist or limit a security for costs application for it to be demonstrated that it actually does provide some security. Put another way, there must not be terms pursuant to which or circumstances in which the insurers can readily but legitimately and contractually avoid liability to pay out for the defendant's costs.

46.4. There is no reason in principle why the amount fixed by a security for costs order could not be somewhat reduced to take into account any realistic probability that the ATE insurance would cover the costs of the defendant."

47. On the facts of the case the court found that there was insufficient evidence to support the contention that N's claim would be stifled. Although its claim was substantial, the evidence suggested that N's director, its administrators, and some of their advisors did not believe that the claim was worth anything approaching the amount sought. There was an absence of detail and corroboration from N's administrators on possible arrangements for recovery of the debt by third parties on N's behalf. Further, in view of a conditional fee agreement and the ATE insurance, N would only have to find, in the interim, payments on account for its

disbursements, which would be substantially repaid either by the ATE insurer if N's claim failed, or by S if N's claim substantially succeeded. The ATE insurance provided a degree of comfort, but not as much as N suggested. The £250,000 covered not only S's costs but also N's disbursements, which some months earlier had been estimated at £289,719, albeit that £127,000 of that related to the insurance premium, which might have been deferred. The insurance did not provide as good cover as a payment into court or a bank guarantee. The case is a useful guide to what would concern a court in respect of an insurance policy such as terminating clauses and what happens to claims when part 36 is offered and not beaten at trial.

48. Administrators faced another procedural hurdle in the matter of *Maltby Investments Limited* [2012] EWHC 4 where an applicant sought pre-action disclosure and inspection of documents held by the administrators pursuant to CPR 31.16 alternatively under its inherent jurisdiction. A lender (Citi) obtained ownership of Maltby's wholly owned subsidiary known as MAL almost immediately after the appointment of the joint administrators by way of a "pre-pack" sale. The proceeds of sale were insufficient to discharge the indebtedness to Citi; Citi had organised several valuations which had confirmed that conclusion. The holding company of Maltby (MH) anticipated that the administrators were not properly appointed and that the assets were sold at an undervalue. It therefore wanted to have sight of the valuations used and relied upon by the administrators, the appointment and contract of sale documentation. Seeking to make good the attack against the administrators counsel for the applicant submitted that:

> "[the creditors were] entitled to have that sale conducted properly by insolvency office holders owing duties to MIL's creditors. The practical effect of the pre-pack has been to enable Citi to foreclose and thereafter determine the timing and manner of the sale exclusively be reference to its own interests, leaving the estate stranded with only a contingent contractual claim to overage. That was wrong in principle."

49. The argument was largely procedural in nature and the outcome was decided on whether or not the CPR test for pre-action disclosure could be given in these circumstances. It is perhaps a matter to have in mind, but if there has been proper disclosure with SIP 16 the court, absent special reasons, is unlikely to give pre-action disclosure.

50. The court rehearsed some of the material set out in the SIP statement which included the fact that there had been intermittent discussions between Citi and TF over a couple of years but that had not resulted in a consensual restructuring. It recorded that the directors considered that open marketing of the business without a clear resolution of the group's financial issues would have been very destructive of the underlying business thereby prejudicing rather than assisting Maltby's creditors. The SIP 16 statement also referred to the three valuations so that:

50.1. "Valuation one had been obtained on the instructions of Maltby using two different methods: Market Approach and Income Approach. It assumed a sale on a going concern basis without any discount factor in respect of a sale by an administrator. The top end of the estimated enterprise value was at least £1bn less than the amount of the Citi debt of £3.3bn. It is to be inferred that the JAs had this valuation before their appointment.

50.2. A second valuation had been obtained by Citi.

50.3. A third valuation was obtained by the JAs themselves. According to the SIP 16 statement, this was done in order to provide them with an indication of the potential value of the group. It was prepared on the same basis as the first valuation but also considered an LBO approach.

50.4. According to the SIP 16 statement, all of the valuations supported the conclusion that the enterprise value of the business was substantially less than the amount owed to Citi.

50.5. The SIP 16 statement set out in section 6 the alternative courses of action, considered by the JAs and the possible financial outcomes of alternative courses of action, including why it was not appropriate to trade the business and offer it for sale as a going concern during the administration."

51. On the submission made by counsel that the pre-pack allowed Citi to determine the price and timing of the sale the Judge commented "That assumes, of course, that the JAs were in the pocket of Citi, a suggestion which finds no support in the evidence."

52. In these circumstances Warren J found that "to seek a sight of those documents in order to impugn the behaviour of Citi or the JAs would be no more than the proverbial fishing expedition". The Judge said it is necessary to ask whether disclosure is desirable to (i) dispose fairly of the anticipated proceedings (ii) assist the dispute to be resolved without proceedings or (iii) save costs. He answered all questions in the negative.

53. The ILA point out that it was a shareholder who was making the application for pre-action discovery rather than an outsider and questions whether or not there would have been a different outcome if the application had been made by an outsider.

54. As an aside (an important aside) it appears from the report that the case of *Eurosail* is to be heard by the Supreme Court.

55. Administrators also faced attack in February this year where solicitors issued a claim in respect of unpaid fees in a case known as *Wright Hassall LLP v Morris* [2012] EWHC 188. The claim related to fees due under a contingency fee agreement to W when acting on behalf of two companies in administration. After not being paid, W sued for its fees, naming M, as administrator, the defendant. M argued that the CFA was made between the solicitors and the companies in administration and not him personally. The Judge held that liability was established with damages to be assessed and W to be awarded its costs, and named M, as administrator for the companies, as the defendant in his order.

56. The matter returned to court on the issue of whether M was personally liable. W submitted that the order named M as the defendant and therefore he was personally liable; the fact that he was referred to as the administrator was irrelevant:

> "the order is made naming Mr Morris as defendant and is therefore a personal liability of his; the reference to his position as administrator being irrelevant. It has not been appealed, and it is not open to Mr Morris now to characterise the liability as that of the companies in administration so that the claimant is at risk of insufficiency of assets in the estate."

57. W argued that an analogy could be drawn with the liability of trustees who were generally personally responsible for contracts entered into in the execution of a trust. The court held that where litigation was commenced against an administrator arising out of contractual obligations said to have been entered into by him as administrator, the cause of action would generally be against the company and not him. Naming M as the administrator recognised that he was being sued as an agent rather than in a personal capacity with the effect that, far from being by default an action against him in a personal capacity, the implication was the other way and it would be necessary for W to plead specifically that personal liability was alleged.

Expenses

58. A year ago it appeared that much would be likely to happen soon in relation to administration expenses. The first instance judgment in the *Nortel/Lehmans Pensions* case[2] was due to be heard by the Court of Appeal, the Insolvency Service had indicated a willingness to consider the case for urgent legislative reform (of Rule 2.67 and/or Rule 13.12 and/or to liaise with colleagues from the Department for Work and Pensions regarding the specific issues thrown up in that case) and with a large number of retail administrations and continued disquiet in the market about the decision in *Goldacre*[3] it appeared likely that further issues concerning the payment of rent as an administration expense would also soon be brought before the courts.

59. In fact, the Court of Appeal's judgment in *Nortel* endorsed the first instance decision and brought no significant changes; the Insolvency Service informed stakeholders that it had not yet received sufficient evidence to justify an urgent legislative change; and until the week before these notes were prepared, all potential *Goldacre* issues were resolved without being brought before the courts.

60. This section will look briefly at the Court of Appeal's decision in the *Nortel/Lehmans Pensions case* focussing on the importance, when considering many administration expenses, of what does and what does not amount to a contingent liability. It will then proceed to consider the arguments before the court in *Leisure (Norwich) II Ltd v Luminar Lava Ignite Ltd*[4] when considering rent as an administration expense and conclude with a note regarding the timely resurrection of the concept of items of expenditure being ordered to be paid "as if" they were administration expenses in *Re Bickland Ltd*[5].

61. It is now well known that in the *Nortel/Lehmans Pensions* case, the Court of Appeal held that where a financial support direction is issued <u>after</u> the date of appointment of administrators and leads to a contribution notice, the liability under that contribution notice is not a provable debt. Parliament could not have intended that such liabilities should go into a "black hole" and be irrecoverable. Accordingly they should be treated as administration expenses and despite the unfairness and potential anomalies of such a conclusion, should take priority over amounts owing to floating charge holders and unsecured creditors.

62. In order for the liability to amount to a provable debt, it would have to fall within the definition of "debt" in Rule 13.12(1)(b) as a liability to which the company became subject during the course of the administration as a result of an obligation incurred before that date. Whilst "debt" for these purposes can include a contingent liability, previous CA authority has established that for a liability to amount to a contingent liability, there must be some underlying legal obligation. The mere risk of a liability arising is not enough. When a liability arises as a result of the exercise of a discretion and where that discretion has not been exercised before the

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[2] *Bloom & Ors v The Pensions Regulator* [2010] EWHC 3010 (Ch).

[3] *Goldacre (Offices) Ltd v Nortel Networks UK Ltd* [2009] EWHC 3389 (Ch).

[4] [2012] EWHC 951 (Ch).

[5] [2012] EWHC 706 (Ch).

appointment of administrators or the making of a winding-up order, it could not qualify as a provable debt.

63. Permission to appeal the *Nortel/Lehmans Pensions* case to the Supreme Court was granted by the Court of Appeal on 2 November 2011. In the meantime, R3 has conducted a second survey of members urging them to provide as much evidence as possible regarding the difficulties which arise in practice as a result of this decision. Of key concern in the market is the extent to which it appears to apply to any statutory liability arising after the date of administration which cannot be considered to be sufficiently attributable to a liability arising before the date of administration.

64. Since this decision many practitioners undertaking contingency planning have had to consider carefully what may amount to a contingent claim and what may not. The fine line was well demonstrated in a recent liquidation case. In *Re Legal & Equitable Securities plc* liquidators were held wrongfully to have rejected a proof lodged in a members' voluntary liquidation which was based upon an alleged contingent claim.

65. The claim arose under a deed of indemnity whereby plc agreed to indemnify a solicitor, B against all claims, costs and expenses of a particular syndicate of lenders. The indemnity provided that it would be "a condition of these indemnities coming into effect" that B's professional indemnity insurers had refused to meet the claim. It also provided that plc would have "no obligation to provide an indemnity to B" in circumstances where a court had found B to be liable in fraud in respect of the claim.

66. All the usual contingent claim cases were presented to the court (*Glenister v Rowe*, *Re Sutherland* and the Court of Appeal's decision in the *Nortel/Lehmans Pensions case*) and the court accepted that for a contingent claim to arise, there must be a pre-existing legal obligation.

67. Counsel defending plc's liquidators argued that the clause requiring rejection by indemnity insurers operated as a condition precedent and thus prevented the indemnity becoming an obligation or a liability, contingent or otherwise, until the condition had been satisfied. At the time plc entered liquidation, the insurers had merely reserved their rights in respect of the claim (though they later rejected it). However Bernard Livesey QC sitting as a Judge of the Chancery Division held that the exchange of promises on the execution of the deed of indemnity created an obligation on plc to indemnify B if a number of future events occurred, one of which was fulfilment of the condition precedent. In his view, that was sufficient to amount to a contingent claim. It would be for the liquidator to put a value on the contingent claim, taking into account factors such as the likelihood of claims being made and that the relevant limitation period for such claims was shortly due to expire.

68. Those reviewing Rule 13.12, whereby a debt is defined to include a liability to which the company may become subject after the date of administration or liquidation by reason of an obligation incurred before that date, may remember the words of Lord Hoffmann in *Re Toshoku Finance* where he provided, as an example of such a liability, sums falling due under a lease:

> "Thus debts arising out of pre−liquidation contracts such as leases, whether they accrue before or after the liquidation, can and prima facie should be proved in the liquidation. In this respect they are crucially different from normal liquidation expenses, which are incurred after the liquidation date and cannot be proved for."

69. He went on to explain that by virtue of the principle in *Lundy Granite,* as subsequently explained in *re Oaks Pitts Colliery Co* (1882) 21 Ch D 322, contrary to the normal pari pass

rule, a landlord which has a claim for future rent capable of proof at the date of liquidation may nevertheless be given priority over other creditors if the liquidator retains the property for the purpose of advantageously disposing of it, or when he continues to use it. In such circumstances, the rent ought to be regarded as a debt contracted for the purpose of the winding up and paid in full like any other debt or expense properly incurred by the liquidator:

> "My Lords, it is important to notice Lindley LJ 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."

70. In *Toshoku* Lord Hoffmann only referred to rent, a provable debt, being paid *as if* it were an administration expense, in order to contrast it with rates which, being a liability that arose purely after the date of liquidation, should automatically be paid as an expense. He explained the distinction further by reference to *Atlantic Computer Systems plc* [1992] Ch 505, where rentals due under pre-administration computer leases could be ordered to be paid *as if* they were expenses of the administration. As noted in *Atlantic Computer Systems* the court retains a discretion whether to order that such debts be paid *as if* expenses or not. In *Toshoku* he noted that notwithstanding the Court of Appeal judgment in *Atlantic Computer Systems* the court has no such discretion in relation to post insolvency items of expenditure which properly fall to be paid as expenses.

71. Unfortunately the distinction between (i) liabilities arising after the date of administration which are automatically payable as an expense of administration and in respect of which the court has no discretion; and (ii) liabilities incurred before the date of administration which may be payable *as if* administration expenses and where the court retains a discretion, was ignored in what has become the leading case concerning the treatment of rent in an administration, albeit only a first instance decision, in *Goldacre (Offices) Ltd v Nortel Networks UK Limited* [2009] EWHC 3389 (Ch). As is well known, in *Goldacre* the court held that when an instalment of rent, payable quarterly in advance, fell to be paid during the period when a company in administration occupied only part of the property for the benefit of the administration, and where the administrators vacated the property mid-quarter, the court had no discretion and the full quarter's rent for the entire premises should be paid as an administration expense.

72. *Goldacre* was subsequently followed in Scotland and most recently, on 28th March 2012 in *Leisure (Norwich) II Ltd v Luminar Lava Ignite Ltd* [2012] EWHC 951 (Ch). In that case, the question before the court related to leases of four different properties, each occupied as nightclubs by a company in administration. The administrators were appointed mid-quarter and continued to trade the business from each of the properties. Among the questions before the court, was one which had not fallen to be considered in *Goldacre*: should the quarter's rent which had fallen to be paid before the administrators' appointment be a provable debt, or payable in full as an administration expense? The administrators argued that the only rent that can become payable as an expense of the administration is rent falling due after (a) the administration has commenced and (b) the administrators have elected to retain the relevant property for the purposes of the administration or liquidation. They accepted that the Apportionment Act 1870 would have no application to sums payable in advance.

73. It is not clear from the judgment in *Luminar* whether the distinction between expenses which should be paid automatically as expenses and those payable *as if* expenses (and in respect of which the court retains a discretion) was argued. From the comments of Judge Pelling QC it

appears that it was not and that it was accepted that once the *Lundy Granite* principle applies, there remains no degree of discretion for the court to exercise:

> "The most recent and authoritative statement of the *Lundy Granite* principle is that made by Lord Hoffman in *Re Toshoku Finance UK plc* [2002] 1 WLR 671. That case was concerned with a liquidator rather than an administrator. However, in *Goldacre (Offices) Ltd v Nortel Networks UK Ltd* [2009] EWHC 3389 (Ch) [2010] Ch. 455, HHJ Purle QC sitting as a judge of this court held that the principle I am now concerned with applied in exactly the same way in administration as it does in liquidation - see paragraph 27 of his judgment. It is common ground that this conclusion is correct. It would be wrong for me to arrive at a conclusion of law that is different from that of a judge of coordinate jurisdiction unless I am satisfied it was plainly wrong. With respect I am satisfied that Judge Purle's conclusion was plainly right."

74. On this basis he concluded:

72.1 "where rent is payable in advance and falls due for payment prior to the commencement of the liquidation or administration, it is provable but not payable as a liquidation or administration expense even though the liquidator or administrator retains the property for the purposes of the liquidation or administration for the whole or part of the period for which the payment in advance was payable; and

72.2 where rent payable in advance becomes due during a period when the liquidator or administrator is retaining the property for the purposes of the liquidation or administration, then the whole sum is payable as a liquidation or administration expense even though the liquidator or administrator gives permission to forfeit or vacates before expiry of the period for which the payment in advance is due."

75. Thus the important distinction between provable debts which can be paid *as if* they are administration or liquidation expenses (and in respect of which, [one of] the authors submits should preserve a degree of discretion on the part of the court) and those which automatically fall to be paid because they are administration expenses (where no discretion should lie), appears almost to have disappeared completely.

76. However on 22 March 2012 Mr Justice Mann's judgment in *Re Bickland Ltd* [2012] EWHC 706 (Ch) hinged upon the importance of the court retaining a discretion to order that sums may be payable *as if* expenses. A shareholder and creditor of the company which operated a Japanese restaurant had presented an application to court for the appointment of an administrator. By the time it fell to be heard, his fellow shareholder appeared to have paid the debt due to a bank holding a qualifying floating charge over the company's assets and taken an assignment of its security. Again, before the hearing, she had exercised her right as a QFCH to appoint an administrator out of court. The question before the court was whether paragraph 13(1)(f) of Schedule B1 provided the court with discretion to award the original applicant his costs and whether they could be ordered to be paid as an administration expense.

77. Paragraph 13(1) provides that on hearing the application for an administration order the court may (a) make the order sought, (b) dismiss the application ... (f) make any other order which the court thinks appropriate.

78. It was argued before Mann J that Rule 2.67 provides a complete code for what amounts to an administration expense and that as Rule 2.67(1)(c) requires an administration order to be made in order for the applicant's costs to be paid as an administration expense, there was no

scope for the court to make such an order where an appointment was, in fact, made out of court.

79. However Mann J noted that *Toshoku* did not exclude the application of the "liquidation expenses" rule, that a similar principle had been applied to administrations in *Atlantic Computer Systems* and that the availability of the principle seemed to have been confirmed by the Court of Appeal in the *Nortel/Lehamns Pensions* case. On these authorities he found that the court was entitled to exercise its discretion to determine whether costs which do not automatically fall within 2.67(1)(c) should nevertheless be ordered to be paid *as if* they did. On the facts of the case before him, he exercised his discretion in favour of the applicant and ordered that the costs of the administration application should be treated *as if* they were an expense of the administration.

80. What now remains to be seen is whether an adventurous administrator is prepared to challenge the principles underlying the judgment in *Goldacre* to return the court's attention to the distinction between expenses and sums which would otherwise be provable debts but which, on the *Lundy Granite* or "liquidation expenses" principle, can be the subject of the court's discretion and ordered to be paid *as if* expenses.

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