CORPORATE LEGAL UPDATE

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1. Goldacre followed in Scotland

The Court of Session followed the approach of the English High Court in holding that where an administrator causes a company in administration to occupy leasehold premises for the purposes of the administration the rent payable under the lease is an administration expense.

In *Cheshire West and Chester Borough Council v. Springfield Retail Limited (in administration*) [2010] CSOH 115, the Outer House of the Court of Session followed the approach adopted by the High Court in *Goldacre (Offices) Limited v. Nortel Networks Limited (in administration)* [2010] BPIR 1003 and held that rent is payable as a mandatory obligation.

In this case the leased premises were in England but the insolvent tenant company was incorporated in Scotland and the administration subject to the jurisdiction of the Scottish courts. The situation is not an unusual one within the context of a trading retail administration. The administrators traded the business for a short while before it was sold. In breach of the terms of the lease they granted a six month licence to the purchaser of the business the terms of which required them to pay rent direct to the landlord. Inevitably, no rent was paid and the lease was never assigned.

The court held that it did not matter that the administrators had not been trading from the premises; it was sufficient that the licence to occupy had been granted for the purposes of the administration. Accordingly the administrators were ordered to pay rent for the whole period until the expiry of the licence at which point the purchaser's occupation ended and the administrators did not want to continue to occupy the premises. The rent was treated as an expense.

2. Administrators allowable charges

Administrators were entitled to claim remuneration on a time cost basis for additional work necessitated by the threats of litigation made by a majority creditor opposed to their appointment and were also allowed to charge time costs for support staff.

In the matter of Super Aguri F1 Limited [26/10/2010]

This relates to the administration of the Honda Formula 1 team, Honda being by far the largest creditor with over 85% of the debt by value.

The administrators had been appointed out of court by the directors; a step which was consistently opposed by Honda who considered the appropriate procedure was a CVL. The administrators believed that the business could be sold as a going concern and negotiated a sale of part of the business which was completed by liquidators nominated by Honda.

In the words of Registrar Jacques in allowing the administrators to recover the additional costs incurred as a result of threatened applications to remove them, he noted:

> *""[The administration] was conducted in an atmosphere akin to trench warfare, the hostile party being Honda, which did not brook any opposition to its wishes, and the object of its hostility being the applicants and the [company's directors]…..*
>
> *administrators, who are respected professional men, such as the Applicants here, when faced with an implacable opponent, such as Honda in this case, are perfectly entitled, both for the benefit of [the Company's] other creditors and for the protection of their own reputation, to deal with the steps necessary to accomplish the transition from administration to liquidation as fully and as carefully as they did, in "Rolls Royce" fashion…. Whilst the cost of the creditors'*

> *meeting may have been high, as it undoubtedly was, the root cause of such large expenditure was not the [Administrators'] profligacy, but Honda's hostility towards them."*

The administrators' firm had a policy of not including support staff time in professional charge-out rates. The administrator gave evidence that his firm considered it more appropriate not to put up professional rates, but instead to charge by reference to the cost of the people undertaking the work. The Registrar regarded this policy as "both logical and convincing" and allowed the support staff time costs in full. He rejected the suggestion that *Re Cabletel Installations Limited (in Liquidation)* [2005] *BPIR 28*, and the *Practice Statement on the Fixing and Approval of the Remuneration of Appointees* (2004) require secretarial and clerical time to be covered by the charge-out rates of professional staff, and not charged for separately other than in cases involving a disproportionate amount of such work. Paragraph 5(7)(ii) of the Practice Statement simply states that there needs to be an explanation as to why the time of support staff is charged for separately, and confirmation that it is not also covered by the hourly rates of professional staff.

It should be noted that this was a fact specific case and largely turned on the convincing nature of the evidence of the senior administrator.

3. Removal of administrators

There have been several cases over the last few years which have resulted in the removal of administrators, an extreme and tragic example being *Coyne v DRC Distribution Ltd* [2008] BPIR 1247 *w*here a creditor made an application for the removal of administrators on the basis that they had not acted in a way to safeguard the company's assets. Prior to the administration, the director (who appointed the administrators) had transferred most of the business and assets away from the company for no consideration to another company set up by him. The judge found that the administrators had not acted expeditiously or robustly enough in trying to unravel those dubious transactions before offering the company for sale. As the Court of Appeal put it, their conduct of the administration had the potential for disaster written all over it and that is what happened. They had failed to take the elementary steps which ought to have been taken in an attempt to make the administration a successful one. The application for removal fell away when the administrators successfully made an application for the compulsory winding-up of the company. The creditor sought costs, however, which the judge summarily assessed and made an order requiring the administrators personally (see IR 1986, r 7.39) and the director jointly and severally with them to pay the creditors' costs. On appeal, the Court of Appeal confirmed the order.

A less extreme, but equally high profile example, is *Clydesdale Financial Services Ltd & Ors v. Smailes (No 1)* [2010] BPIR 62 where David Richards J said in making an order for the removal of the office holders:

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

It was solely on this ground that the court ordered the removal and the judge even went so far as to say:

> *"I reject all the allegations of impropriety made against the administrators but for the reasons already given grounds do exist which would justify an exercise of the power of removal."*

A more recent case where the removal of the administrators was overturned on appeal was *Clark & Anr v Finnerty & Anr; Re St Georges Property Services (London) Ltd (in administration)* [2010] EWHC 2538 (Ch). St Georges purchased two properties in London. With the downturn in the economy and the impact upon the property market altered St George's original aim to refurbish and sell the properties. As a result, their aim changed to waiting for an improvement in the property market before seeking to sell. The properties were leased out in the interim to obtain an income pending an improvement in the market.

The purchase had been funded by means of a loan from Davenham Trust with personal guarantees being given by the directors. It had always been proposed that Davenham would be repaid out of the proceeds of sale of the completed properties. When the properties were not sold it demanded repayment of the loan and applied the default interest rate of 3% per month on the full facility balance until repaid. When repayment was not forthcoming it appointed administrators under paragraph 14 of Schedule B1 IA 86.

The Guarantors contended that the loan agreement was extortionate within the meaning of s. 244 IA 1986, and in respect of the default interest rate, a penalty. The Guarantors asked the administrators to make an application to court under s. 244 IA, 86 for a declaration that it was as an extortionate credit transaction. They further offered to pay for the application and to provide a full indemnity to the administrators in relation to any adverse costs order they might suffer on the proposed application. A transaction is extortionate if, having regard to the risk undertaken by the person supplying the credit, its terms require *"grossly exorbitant payments to be made"* or *"it otherwise grossly contravened ordinary principles of fair dealing"*.

The administrators were not optimistic about the outcome of any application and were advised by two separate firms of solicitors that it would be speculative and very much an uphill struggle given that such applications rarely succeed. They refused to bring an application and the Guarantors issued an application for their removal pursuant to paragraph 88 of Schedule B1 IA 86, which provides that the court may order the removal of an administrator from office. The Guarantors wanted the office holders to be replaced by alternative insolvency practitioners who they said were willing to issue the application.

The Registrar granted the application to remove the administrators, but did not criticise the administrators, finding that the administrators were entitled to reach the conclusion that they were not prepared to bring the proceedings. However, the Registrar considered that there were certain exceptional circumstances that persuaded her to grant the application, including:-

1. the fact that the Guarantors were the majority unsecured creditors;
2. they were continuing to pay another secured creditor and had deposited a significant sum (£950,000) with their solicitors to discharge all costs and expenses of both the action and the administration;
3. if the administrators were not replaced, there would be no challenge to the default rate to the detriment of the Guarantors; and
4. without a s. 244 application, the Company stood no chance of being rescued as a going concern.

The Registrar's decision was overturned by the Chancellor on appeal. He noted that the paragraph 88 power is unlimited on the face of it, but that it was difficult to imagine circumstances in which the court would remove an administrator otherwise than on sufficient cause shown. He pointed out that the same conclusion was reached by Warren J in *Sisu Capital Fund Ltd v Tucker* [2006] BPIR 154:

> *"The free-standing power under paragraph 88 appears to be unlimited. However, like Nourse LJ in Re Edennote Ltd when addressing section 172(2), I consider that it is not easy to think of any circumstances (that is to say, I cannot at present think of any circumstances) in which the court would remove an administrator under paragraph 88 without cause being shown."*

The jurisdiction conferred by paragraph 88 was further considered by David Richards J in *Clydesdale Financial Services Ltd v Smailes (above)* in the context of a claim by creditors to challenge a sale of a company's assets in a 'pre-pack' administration. The Registrar correctly derived the following propositions from that judgment:

> *"(1) there must be a good ground for removing an administrator but the ground need not involve misconduct, personal unfitness or imputation against his integrity (Paragraphs 14 and 30);*
>
> *(2) the Court will have regard to the wishes of the majority of creditors (Paragraphs 14 and 30);*
>
> *(3) the issue raised by the applicant need not be resolved in his favour at the time of the application. He has only to show that the evidence raises a serious issue for investigation. (Paragraph 26)."*

In concluding that there was no reason to remove the office holders the Chancellor said:

> *"It is true that an administrator may be removed without any criticism of him. But if an administrator is unbiased and entitled on the material before him to reach a relevant conclusion his decision should be respected unless and until the court concludes otherwise. That is the effect of the elaborate provisions of Schedule B1. The fact that another mind might reach a different conclusion may be a reason to challenge the administrator's decision but, in my judgment, it cannot be a good reason to remove him altogether."*

It now seems clear that in the absence of any grounds for allegations of unfair conduct or misapplication, administrators should be allowed to perform their functions without risk of removal. Administrators can only be removed under paragraph 88 Schedule B1 IA 86 for good or sufficient cause, which must be ascertained by reference to the purposes of the office and the facts of the case.

4. Miss Sixty – Guarantee Stripping

Mourant & Co Trustees Ltd and another v Sixty UK Ltd (in liquidation) and others [2010] EWHC 1890 (Ch)

The High Court's quashing of a company voluntary arrangement (CVA) used to "strip" out a parent company guarantee puts the use of such CVA's in serious doubt.

Landlords leased two premises at the Met Quarter shopping centre in Liverpool to the Company, with the Company's liabilities to the Landlords guaranteed by the Company's Parent. After experiencing trading difficulties, the Company went into administration and the administrators proposed a CVA.

The effect of the CVA was to release the Parent from all liability under the guarantees upon payment of a sum of £300,000 to the Landlords. Such figure was said to represent 100% of the Company's estimated liability to the Landlords on a surrender of the leases, and to be calculated on the basis of advice received and certain specified assumptions. Thus the Landlords were ostensibly to receive full compensation on the basis of a notional surrender of the leases, but they were to be deprived of any recourse against the Parent as guarantor during the remainder of the 10-year terms of the leases, which had been granted in 2006 and still had approximately 7½ years to run. The CVA also provided for two other stores occupied by the Company to close, and for their landlords to receive 21% of the Company's estimated liability to them under the relevant leases. All other creditors under the CVA would continue to be paid in full, subject to normal terms and conditions, with the benefit of an agreement by the Parent to defer repayment of a sum of just under £15m due to it from the Company. It was intended that the Company would continue to operate as a going concern, and with the exception of the landlords of the four closed stores no other external creditors were asked to accept any reduction in, or compromise of, their debts. The CVA was approved, with the Landlords being the only creditors present at the meeting who voted against the proposal. The Landlords applied to revoke the approval of the CVA under s 6(1) IA 86 on the grounds that the CVA

1. unfairly prejudiced the interests of the Landlords as a creditor of the Company; and;

2. there had been some material irregularity at or in relation to the creditors meeting.

The challenge centred on the alleged inadequacy of the compensation payment to them of £300,000, and the compulsory deprivation of the benefit of the Parent's guarantees.

The Landlords asserted that:

1. They had been unfairly treated in comparison with the generality of the external unsecured creditors, all of whom were to be paid in full while they were being asked to accept compensation which was much too low;

2. Far from being based on advice, as represented in the proposal, the compensation actually amounted to less than one third of the sum recommended in the only advice on the question which the Company and the Administrators had disclosed;

3. There could be no justification for requiring them to give up the valuable benefit of the guarantees in precisely the situation they were designed to meet, namely the inability of the tenant to honour its obligations under the leases, where there was no suggestion that the Parent would have been unable to meet its liabilities as guarantor; and

4. They had been unfairly treated in comparison with at least one creditor, Muji, the original tenant of one of the other closed stores, whose right of indemnity had not been curtailed, with the result that Muji would be able to prove for the amounts it was called on to pay, and under the CVA it could expect to recover those amounts in full.

Shortly before the hearing, the Company and the Administrators stated that they did not intend to attend or be represented at the trial and there was no point in continuing with a substantive hearing of the application, because the CVA was either going to be modified on terms which would remove the features which gave rise to the application, or alternatively it would fail. They proposed an order be made by consent giving directions for the summoning of a further meeting to consider the modifications to the CVA that were being prepared by the Administrators and offered to pay the Landlords' costs of the application on the standard basis, subject to detailed assessment. The Landlords rejected the offer. The Company and the Administrators appeared at the trial, only to apply for an adjournment. Upon that adjournment being refused, they took no part in the hearing.

Henderson J in a far reaching judgment held:

1. The court had no power to give directions by consent for the summoning of a further meeting to consider a revised proposal. The power in s 6(4)(b) IA 86 was only exercisable where the court was satisfied as to either of the grounds mentioned in s 6(1) IA 86. Thus a case of unfair prejudice and/or material irregularity had to be made out to the court's satisfaction before such an order could be made.

2. A voluntary arrangement made between a tenant and its creditors, including landlords with the benefit of third party guarantees, was capable of imposing upon the landlords a binding release of their rights under such guarantees, even though the guarantor was neither the company which was proposing the arrangement, nor a party to it.

3. As regards unfair prejudice, the principles could be summarised as follows:

    a. Any CVA which left a creditor in a less advantageous position than before the CVA would be prejudicial to the creditor. The real issue was generally whether the prejudice was 'unfair'.

b. There was no single and universal test for judging unfairness in that context, and the question depended on all the circumstances of the case, including in particular the alternatives available and the practical consequences of a decision to confirm or reject the arrangement.

c. In assessing the question of unfairness, a number of techniques may be used, including what might be described as 'vertical' and 'horizontal' comparisons.

d. A vertical comparison was a comparison between the position that a creditor would occupy and the benefits it would enjoy in a hypothetical liquidation, as compared with its position under the CVA. The importance of that comparison was that it generally identified the irreducible minimum below which the return in the CVA could not go.

e. A horizontal comparison was a comparison between the position of the applicant and the position of other creditors, or classes of creditors. The fact that a CVA involved differential treatment of creditors was a relevant factor which called for careful scrutiny, although it would not automatically render a CVA unfairly prejudicial. It was necessary to ask whether the imbalance in treatment was disproportionate, and also whether the differential treatment might be justified, for example by the need to secure the continuation of the company's business by paying essential suppliers or service providers

4. In this case, on a vertical comparison, the critical point was that in a liquidation the Landlords would still have had the benefit of the guarantees for the remainder of the term of the leases. They would also have had the option, following a disclaimer of the leases by a liquidator of the Company, to require the Parent to step into the Company's shoes and to take equivalent leases in its own name. Neither the Company nor the Parent could unilaterally alter any of those contractual provisions, and but for the CVA it would have been open to the Landlords to continue to enforce the guarantees against the Parent.

5. It was unreasonable and unfair in principle to require the Landlords to give up their guarantees. The ability to enforce the terms of the existing leases against the guarantor for a further 7½ years was a most valuable right, and there was no sufficient justification for requiring any of the guaranteed landlords (let alone just one of them) to accept a sum of money in lieu, as it was difficult, if not impossible, to determine what sum would fairly compensate the landlord for the loss of such rights, and in the absence of a compelling justification a landlord should not be forced to accept a sum which was based on numerous assumptions which may or may not prove to be well-founded.

6. The Landlords' challenge to the value of £300,000 assigned to their claim was unanswerable. The expert evidence, and the advice which the Company itself obtained, showed that a figure in the region of £1m was the least that could fairly be regarded as appropriate. £300,000 was not, in fact, a genuine estimate of the value of the Landlords' claim, but was instead dictated to the Administrators by the Parent.

7. The Administrators appeared to have abdicated their responsibilities as office holders and put forward a proposal for the CVA which they must have known could not be objectively justified, and which was based on a cynical calculation by the Parent of what it hoped it could get away with. The Administrators then compounded their dereliction of duty by falsely representing in the proposal that the figure of £300,000 was based on advice they had received.

8. It was not for the office holders to advocate the interests of one group of creditors as against another group, nor to engage in brinkmanship, or attempt to extract ransom payment, on their behalf by refusing to put forward what they (the office holders) regarded as a fair proposal in order to extract a better proposal for the first group. The responsibility of an office holder, in attempting to fulfil the purpose for which he was appointed, was to try to structure an arrangement that would be capable of achieving the necessary statutory majorities and would not be unfairly prejudicial to any creditor.

9. Those principles should have been well known to the Administrators, but they chose to disregard them. They allowed the Parent to dictate the offer to be made to the Landlords, secure in the knowledge that the CVA would be passed by the large majority of unsecured creditors who would be paid in full.

10. The CVA was fatally flawed, and had to be set aside. It was a CVA that should never have seen the light of day. The evident purpose of the CVA was to compel the Landlords to give up their rights for a fraction of their fair value, and to improve the group's negotiating position. It was the duty of administrators or other office holders, in such circumstances, to maintain an independent stance, to act in good faith, and only to propose a CVA if they were satisfied that it would not unfairly prejudice the interests of any creditor, member or contributory of the company. The need for a responsible and professional attitude was even more pronounced where the CVA was structured in such a way that it was bound to be passed by the votes of creditors whose position was either unaffected or improved, and where another much smaller class of creditors was to be deprived of valuable contractual rights.

11. Whilst not having heard the administrators' side of the story, there was a prima facie case of misconduct on their part which ought to be considered by the professional bodies to which they were answerable. Copies of the judgment should be sent to the appropriate bodies by which they were licensed to act as insolvency practitioners.

5. Petitioning creditor's costs

Re Capitol Films Limited [2010] EWHC 180 (Ch)

Irish Reel had initially been hired by Capitol Films to work on a film about Mary Queen of Scots, which was to be shot in Ireland. Actress Scarlett Johansson was set to star in the title role.

Irish Reel was hired to scout for locations for the film, but did not receive full payment for its work. In August 2008, a winding-up petition had been presented against Capitol Films and Irish Reel had become the petitioner. The winding-up petition was later dismissed.

In February 2010 Capitol Films was placed into administration in the High Court in London. Irish Reel appeared at the hearing of the administration petition and wanted to recover the costs it had incurred in bringing the winding-up petition.

> Capitol Films disagreed that Irish Reel were entitled to the costs of the petition. They argued that the recoverable costs were limited to those costs of appearing at the hearing of the administration petition. The judge had to interpret rule 2.12 of the Insolvency Rules which states:
>
> *"(1) At the hearing of an administration application, any of the following may appear or be represented…*
>
> *(e) any person who has presented a petition for the winding up of the company….*
>
> *(3) If the court makes an administration order, the costs of the applicant, and of any person whose costs are allowed by the court, are payable as an expense of the administration."*

Briggs J found that one of the purposes of r.2.12(1)(e) IR 1986 was to enable the petitioner for a winding up order to seek an order for costs of the petition (which will ordinarily be dismissed if an administration order is made) such that the court clearly had jurisdiction to make the direction sought having regard to the terms of r.2.12(3).

Irish Reel also argued that its costs should be paid out of Capitol Films' assets in priority to the administration expenses. However, the court was not persuaded by this argument and did not think there was a good reason to vary the priority in which costs are paid in an administration.

6. Balance sheet solvency

BNY Corporate Trustee Services Limited v. Eurosail-UK 2007-3BL [2010] EWHC 2005 (Ch)

The Chancellor considered the proper interpretation of the requirement to take into account a company's 'contingent and prospective creditors' when assessing balance sheet insolvency.

S.123 IA 86 sets out the criteria for determining whether a company is unable to pay its debts including the balance sheet test at ss (2) as follows:

> "*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."*

In this case the Chancellor had to consider the interpretation of this section within the context of complex financial security arrangements arising out of the collapse of Lehman Brothers. The court held:

1. The assets to be valued are the present assets of the company; there is no question of taking into account any contingent or prospective assets.

2. The requirement to take into account contingent and prospective liabilities cannot require such liabilities to be aggregated at their face value with debts presently due. Commercially an obligation to pay £100 today has a higher present value than an obligation to pay £100 in five years time.

3. Taking into account contingent and prospective liabilities requires a consideration of the overall context and facts applicable to the company in question. Such an exercise includes taking into account when any prospective liabilities fall due, whether such liabilities are denominated in a foreign currency, what assets are available or will become available to meet any future liabilities and if any provisions have been made for the allocation of losses.

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January 2011