ADMINISTRATIONS UPDATE – NOVEMBER 2020

A year in Administrations, looking at latest case law, regulatory and practice developments, including consideration of the latest draft reforms to pre-pack sales in administration.

INTRODUCTION

1. This paper, drafted by Govinder Chambay of Guildhall Chambers, will consider a number of recent cases and proposed legislative measures concerning the administration regime under the Insolvency Act 1986 ("**IA 1986**"). It is intended to be a companion piece to a webinar delivered by Hugh Sims QC of Guildhall Chambers and Joanne Rumley of Foot Anstey LLP on 26 November 2020 forming part of the Insolvency Team's Autumn Webinar Series.

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Re Tokenhouse VB Ltd (formerly Vat Bridge 7 Ltd) [2020] EWHC 3171 (Ch) (ICC Judge Jones) **pp 12-16**	Does a failure to comply with the notice requirements in Paragraph 26 of Sch B1 invalidate the appointment of an administrator?
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Re Moss Groundworks Ltd [2019] EWHC 3079 (Snowden J) & HHJ Eyre QC **pp22-27**	The importance of SIP 16 Compliance.
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IS A FINE A PROVABLE DEBT IN A WINDING UP OR ADMINISTRATION?

Re Paperback Collection & Recycling Ltd [2020] EWHC 1601 (Ch) (HHJ Hodge QC)

The Facts

2. Paperback Collection & Recycling Limited ("**PCR**") carried on a recycling business from premises in Anglesey and Deeside. On 05.06.2018, the Natural Resources For Wales (a government sponsored body) ("**NRW**") issued PCR with a statutory notice under s.59 of the Environmental Protection Act 1990 ("**EPA**") requiring the removal of waste stored unlawfully at its Anglesey site. On 25.06.2018, PCR entered into creditors voluntary liquidation. The joint liquidators of PCR, after their appointment, disclaimed the leases at Anglesey and Deeside, and the relevant waste pursuant to s.178 IA 1986, which had the effect of releasing PCR from any liability for the waste, save as to s.178(6)[1] IA 1986.

3. Criminal proceedings were issued against PCR and its directors on 01.08.2019, for a series of offences under the EPA[2] and the Environmental Permitting (England and Wales) Regulations 2016. On 24.04.2020, PCR pleaded guilty to the charges brought against it. It was possible, that when sentenced, PCR would receive a fine. The liquidators issued an application under s.112 IA 1986, seeking a direction that the funds in the liquidation be distributed to floating charge holders. *Inter alia,* the liquidators argued that even if the Crown Court imposed a financial penalty upon PCR, that it would not impact on PCR's insolvent estate.

The Decision

4. The decision explored three possible outcomes (restraint orders, confiscation orders and fines) from the criminal proceedings and what their impact would be on the insolvent estate.

[1] S.178(6) IA 1986 provides: Any person sustaining loss or damage in consequence of the operation of a disclaimer under this section is deemed a creditor of the company to the extent of the loss or damage and accordingly may prove for the loss or damage in the winding up.
[2] S.33(1)(b) and (6) of the EPA 1990 & Regulation 38(1)(a) and (2) of the EPR.

Taking the conclusions out of the order in which the judge dealt with them, it was held that: even though a fine was not a provable debt in bankruptcy, it was a provable debt in a winding up or administration of a company, when the fine was triggered by criminal offences committed prior to the company's entry into liquidation or administration. This would be the case even if the fine was imposed after the onset of administration or liquidation. Where, accordingly, the fine would be a contingent or future debt or liability. **[23]**

5. HHJ Hodge QC held that this conclusion was supported by and was the clear effect of *Re Pascoe* [1944] Ch. 310 (Morton J, Cohen J) He held that the *ratio* of *Pascoe* was that where a bankrupt had been convicted of bribery and ordered to pay a fine, it was a provable debt in the bankruptcy. Further, the judge drew on *obiter* observations by Cohen J in *Pascoe* which suggested that if a fine was not a bankruptcy debt, it was a liability. **[22]**

6. There was a deficiency in PCR's assets as regards floating charge creditors. And so whilst the judge confirmed that the fine was provable as an unsecured debt, nothing turned on this in practical terms, as this deficiency meant that there would be no impact on the insolvent estate. **[24]**

7. As regards restraint and confiscation orders under the Proceeds of Crime Act 2002 ("**POCA**") the court disregarded the impact of a restraint order. This was because no such order had been made against PCR prior to its entry into voluntary liquidation. If such an order had been made in those circumstances, it would have prevented the liquidators from taking any action against the property which was subject to the restraint order. A confiscation order under POCA was also disregarded. The NRW had no intention of asking the Crown Court to impose one. In any event, r. 14.2(2)(a)(iv) Insolvency (England and Wales) Rules 2016 ("**IR**") indicates that a confiscation order is not a provable debt in a liquidation or administration. **[13-17]**

Analysis & Commentary

8. Prior to the decision in *Re Paperback,* the IA and the IR was silent on the issue of whether a fine was a provable debt in the winding up or administration of a company. This decision providing useful clarity, therefore. It also demonstrates that courts are continuing to take an expansive view of what amounts to a provable debt.

9. The following passage from *Sealy & Milman*: *Annotated Guide to the Insolvency Legislation* 23rd Ed (2020) (which the court was referred to by counsel for the joint liquidators[3]) indicates that *Re Pascoe* was effectively reversed by r.14.2(2)(c)(i) IR:

> *"*Note that under r.14.2(2)(c)(i) fines are now regarded as not provable in a a bankruptcy (reversing the former position as declared in Re Pascoe [1944]

[3] In fact, the court was referred to an earlier edition of *Sealy & Millman* the 22nd Edition, but the only difference appears to be that the 23rd edition cited above refers to r.14.2(2)(c)(i).

Ch. 310). The Cork Committee (Cmnd.8558, para.1330) recommended that the law should be changed for all insolvency proceedings, but the legislators have done so only for bankruptcies."

10. Accordingly, it is implicit in the judge's conclusion that: **(i)** *Re Pascoe* has only been reversed to the extent that it is inapplicable in bankruptcy proceedings and; **(ii)** *Re Pascoe* can and does apply in corporate insolvency proceedings. Had the recommendations of the Cork Committee mentioned above been adopted, then presumably the judge would have concluded that a fine was not a debt provable.

11. This judgment might also provide some comfort to insolvency practitioners.[4] Before *Re Paperback*, it was suggested in a Scottish authority (so not technically binding but persuasive) *Joint Liquidators of Doonin Plant Ltd, Noters* [2018] CSOH 89; [2019] B.C.C. 217 (Lord Doherty) that a company's liability following a notice under s.59 EPA (to remove waste unlawfully stored by a company prior to the commencement of a liquidation) was an outlay "properly chargeable or incurred by the liquidator in carrying out his functions in the liquidation" within the meaning of r.4.67(1)(a) of the Insolvency (Scotland) Rules. In a case involving the administration of an English company, it has been suggested by the editors of *Sealy & Millman*, that the equivalent rule under the IR would be r.3.51(2)(a) 1986. In other words, it would rank ahead of the officeholder's remuneration. However, for the time being, *Re Paperback* must be treated as binding English authority that a fine is a provable debt in a winding up or administration and ranks as an unsecured debt.

FAILURE TO OBTAIN FCA CONSENT – NULLITY OR CURABLE DEFECT?

Re A.R.G (Mansfield) Ltd [2020] EWHC 1133 (HHJ Davis-White QC)

The Facts

12. The directors of A.R.G (Mansfield) Ltd ("**A.R.G**") served a notice of intention to appoint administrators on A.R.G's qualifying floating charge holder, who consented. The directors then filed a notice of appointment with the court, which sought to appoint the administrators. Consent of the Financial Conduct Authority ("**FCA**") pursuant to s.362A Financial Services and Markets Act 2000 ("**FSMA 2000**") was neither sought or filed along with the notice of appointment, despite A.R.G being regulated under the FCA. This was because A.R.G was showing as registered on the FCA register as A R G (Mansfield) Limited" i.e, without the full-stops after each of the capital letters "A", "R" and "G". When the FCA register was searched originally, and prior to the appointment, it was made using the correct name i.e, A.R.G (including the full stops) which revealed no results. The directors sought an order that the administrators be appointed with retrospective effect (to

[4] ILA Technical Bulletin No: 907 Paperback Collection – a fine is a provable debt in a winding up or administration 22 September 2020

the date of their original purported appointment) or alternatively, for relief under r.12.64 IR.

The Decision

13. Dealing with the central question which the HHJ Davis White QC was asked to determine. The Judge endorsed what he referred to as the *Soneji* approach. That is, when determining the effect of a breach of statute or rules, the court should consider, in light of the consequences of non-compliance, whether as a matter of statutory construction, it was intended by Parliament that an appointment made in breach of the relevant provision would be a nullity, [53]. Moreover, of the many distinctions referred to in the case, there are two which are of particular importance. Firstly, there is a difference between a procedural defect, and a defect which is of a more fundamental nature. A fundamental defect will result in the relevant action being a nullity, as opposed to an irregularity. **[48]**

14. Secondly, the Judge approved the distinction referred to in *Re Euromaster Limited* [2012] EWHC 2356 (Ch); [2012] BCC 754 (Norris J) between provisions which define the scope of circumstances in which a power to appoint arises and those which prescribe procedural requirements which must be fulfilled before an appointment is properly made. Failure to comply with the former will amount to a nullity, whereas non-compliance with the latter would result in the appointment being irregular, but valid, **[75]**. In practical terms, this would mean that r.104 of Schedule B1 to the IA and/or r.12.64 IR could potentially regularise the position.

15. The Judge preferred the approach in *Re M.T.B. Motors Limited* [2010] EWHC 3751 (Ch), [2012] B.C.C. 601 (HHJ Hodge QC) to *Re Ceart Risk Services Limited* [2012] EWHC 1178 (Ch) (Arnold J) The former case being authority for the proposition that a failure to obtain and file consent of the relevant regulator when a notice of appointment was filed with the court rendered the appointment void, and incapable of remedy under r.12.64 and/or paragraph 104 of Schedule B1. Whereas the latter case is authority for the proposition that a failure to obtain the regulator's consent was not fundamental so as to invalidate the appointment, (though it was held that the appoint only took effect from when the consent was filed) and the period between the original purported appointment and the date of filing of the consent could be validated by paragraph 104 Schedule B1.

16. The judge followed the approach of Mann J, in *Petit v Bradford Bulls (Northern) Limited* [2016] EWHC 3557 (Ch); [2017] BCC 50 by making an administration order with retrospective effect to the date of the original purported appointment and, if, and to the extent that their original purported appointment was only irregular and not a nullity, removing them as administrators under such appointment. This was on the basis that it was at least arguable that there was no power to appoint administrators without the FCA's consent so the purported appointment was a nullity which was incapable of being cured under r.12.64 IR. The only way in which the position could be regularised was by way of a retrospective appointment. **[1] [89]**

17. The judge later went on to state, (albeit obiter) and consistent with the observations made at paragraph 16 of this paper that, the requirement for regulator consents defines the circumstances in which the power to appoint arises, as opposed to being a procedural requirement that must be fulfilled. **[116]**

18. Moreover, the court provided (again *obiter*) that the conclusion reached by the judge at **[89]** was in fact the position in law, and set out a list of questions to be determined (which may be of use to practitioners considering the consequences of a potential defective appointment):

    1. What are the statutory requirements regarding the appointment?

    2. If the statutory requirements have been breached, is the consequence, as a matter of construction of the provisions, that there is only a procedural defect or is the appointment a nullity?

    3. If the appointment is subject to a procedural defect, is substantial injustice caused by what would otherwise be validation under r12.64?

    4. If there is such substantial injustice, can this be remedied by Court order?

    5. If the appointment is a nullity, can and should the defect be cured by a retrospective order? **[91]**

Commentary & Analysis

19. Cases concerning the defective appointment of administrators are legion and some of them conflict with one another, take *Re Ceart* and *M.T.B Motors*, for instance. This judgment, however, contains an impressive review of nearly all the relevant authorities, which, it is hoped, will reduce any future conflicts of opinion. Moreover, it is necessarily the starting point for those advising on such issues or who are seeking to catch up with this area of law.[5]

20. More substantively, whilst the judge's observations that a lack of regulator consent renders the purported appointment a nullity was *obiter*, practitioners would be well advised to proceed on the basis that an application for retrospective appointment will need to be made in circumstances where the consent of the regulator has not been obtained. At least, as has been suggested elsewhere, as an alternative to seeking relief under paragraph 104 of Sch B1 and/or r.12.64 IR.[6] Moving forward then, for companies which are regulated by the FCA, their consent should be obtained and filed with the court:

    (i) where no notice of intention to appoint is required – with the notice of appointment.

[5] ILA Bulletin No. 896: A.R.G. (Mansfield) Ltd – defective administration appointment 23 June 2020.
[6] https://www.exchangechambers.co.uk/appointment-of-administrators-is-the-lack-of-fca-consent-prior-to-appointment-a-curable-defect/ accessed 17.10.2020

(ii) where notice of intention to appoint is required – with the notice of intention to appoint, but see the observations below which suggest that even if not complied with, it will still be sufficient if the consent is filed by the time that the notice of appointment is filed.

21. Notably, *Re Harlequin Management Services Ltd* [2013] EWHC 1926 (Arnold J) was not referred to in the judgment. But on the basis of what the judge said in the present case, (albeit obiter) *Harlequin* should still be treated as good law, though not necessarily for the reasons given in *Harlequin.* In *Harlequin*, the FCA initially indicated that its consent was not required and then changed its mind, albeit after the notice of intention to appoint had been filed, but before the notice of appointment had been filed. The consent of the FCA was filed before the notice of appointment. Arnold J in *Harlequin* held at **[9]** that there was no defect on the basis of what he had said earlier in *Re Ceart*: at **[19]**

> *"*Although subsections (3)(b) and (4)(b) provide that the consent 'must be filed…along with the notice of intention to appoint' or 'must accompany the notice of appointment', that wording does not compel the conclusion that the consent must be filed at the same time as the notice of intention to appoint or notice of appointment, as the case may be. A consent filed the following day could still be said to have been filed' along with' a notice of intention to appoint or to ' accompany' the notice of appointment."

22. However, in the present case, the judge held that: where no notice of intention to appoint is required, the written consent must be filed with the notice of appointment, and that consent obtained later is not appropriate thus contradicting what was said in *Re Harlequin.* However, the judge went on to say that where consent is required to be filed 'along with' a notice of intention to appoint, that requirement may be complied with if it is filed at a different time, provided at the very least it was filed by the time that the notice of appointment was filed, **[99]**. As stated, in *Harlequin,* the consent was filed before the notice of appointment, and as has been suggested by other commentators,[7] would survive scrutiny.

DEFECTIVE ADMIN APPOINTMENTS - PRAGMATISM OVER PRINCIPLE?

Re Nationwide Accident Repair Services Ltd [2020] EWHC 2420 (Ch) Fancourt J

The Facts

23. This case concerned a group of 9 companies ("**the Companies**") over which an administration order was sought by the Companies sole director ("**the Director**"). Nationwide Accident Repair Services Limited ("**NARS**") included amongst the 9, was the non-trading holding company of the group. The Articles of Association of each of the Companies other than Howard Basford Ltd ("**HBL**") arguably required a quorum of at least two directors before a resolution could be passed. It was possible, therefore, that the Director did not have authority to resolve on behalf of the Companies to seek the appointment of an administrator. The Companies ultimate parent which controlled the

[7] ILA Bulletin No. 896: A.R.G. (Mansfield) Ltd – defective administration appointment 23 June 2020.

Companies declined to appoint another director or to amend the Articles and indicated that it would not sign a shareholder's resolution to appoint an administrator or consent to NARS' director making such an appointment.

The Law

24. Before explaining the judge's decision, it is important to briefly discuss three cases in which similar issues have arisen. Directors are able to make decisions to appoint administrators informally, but in such circumstances, this decision should be unanimous.[8] In *Minmar (929) Limited v Khalatschi* [2011] EWHC 1159 (Ch), Morritt C held that a decision taken by the majority of directors to appoint administrators will only be valid if the decision complies with the company's internal governance rues, that is, and *inter alia*, the decision was taken at a duly convened board meeting which was quorate. Paragraph 105 of Sch B1 does not apply in such circumstances to override the company's internal management procedure. Any purported appointment arising out of such a "decision" will be a nullity. Whilst *Minmar* dealt with an out of court appointment, it was implicit in the judgment, it is submitted, that the same principle would equally apply to paragraph 12 of Sch B1.[9]

25. *Minmar* was followed in *Baker v London Bar Co Ltd* [2011] EWHC 3398 (Ch) (Henderson J) and *Re BW Estates Ltd* [2017] EWCA Civ 1201; [2017] B.C.C. 406 (Sir Geoffrey Vos C, Underhill LJ, Henderson LJ) In the latter case especially, the central plank of the court of appeal's decision rested on the importance of ensuring the company's rules of internal governance had been complied with, at **[78]** per Sir Geoffrey Vos C:

> "I respectfully find myself in agreement with the reasoning of Sir Andrew Morritt C in *Minmar supra* at paragraphs 49-52 to the effect that there is no notion of informality in the provision allowing the directors of a company to appoint an administrator. This approach seems to me to be consistent with the decision of Millett J in *Equiticorp supra*, and also with the general requirement of company law that the provisions of the articles of association cannot be ignored."

26. *Re Brickvest Limited* [2019] EWHC 3084 (Ch) (Smith J) concerned an application made under paragraph 12(1)(b) of Schedule B1. The judge, Smith J, recognised (though he did not determine the issue finally) that the resolution to seek the appointment of an administrator was made at possibly an inquorate meeting. The judge referred to *BW Estates*, but narrowed the scope of its application to the appointment of administrators out of court. He further rationalised this on the basis of ensuring that the court retains some degree of control where the court is not involved in making the appointment, see **[10]:**

> "It is clear law that in the case of the appointment of administrators out of court , such an appointment is only regular if the internal rules regarding the company's internal

[8] Sealy & Milman: *Annotated Guide to the Insolvency Legislation* 23rd Ed. – 2020 Volume 1 (Notes to Paragraph 12 Sch B1)

[9] [43], [44]. See also the notes to Paragraph 12 Sch B1 where *Minmar* is considered as being relevant to that paragraph.

management are properly followed. That, one might think, is self-evidently the case: there must be some form of binary control where the court is not involved in the making of an appointment. Either the resolution appointing the administrator is valid or it is not. If it is valid, then the appointment can take effect. If it is not, then there is an irregularity that must be cured. The authority that stands for this proposition is *Re BW Estate Limited (No.2), [2017] EWCA Civ 1201*."

27. The judge then considered that as the administration orders were made under urgent circumstances, it would be 'inapt' to consider in detail the company's articles of association or to delay an order that ought to be made whilst the irregular position was being rectified. The judge acknowledged that there was a real benefit in making an administration order and that any delay might cause a company to be at risk of trading insolvently; and thus thwarting the purpose of an administration order. **[18]**

28. Penultimately, in *Brickvest,* the judge established an approach which should be followed in cases where a serious question arises over a directors standing to make an application for an administration order: essentially, the court should treat the matter as a discretionary one, "taking full account of the question as to standing, but not allowing the point to be automatically determinative against the application". Lastly, the judge held that one possible way of dealing with such irregularities is by way of r.12.64 IR. **[21-22]**

The Decision

29. Fancourt J went on to make the administration order. He did not consider that he was prevented from doing so by the absence of any quorum (if more than one was required) and accordingly, the possibility that the Director did not have authority to make the decision. The following reasons were given.

30. The judge held that, on the basis of *Brickvest,* and as a matter of principle, there was no impediment to a single director making an application under paragraph 12(1)(b) of Sch B1 where he is the sole director, nor would that prevent the court making an administration order where it is otherwise appropriate to do so. The judge held that by virtue of s.6 of the Interpretation Act 1978, the plural form of 'directors' in paragraph 12 of Sch B1 would include the singular. Accordingly, so the judge held, a director has standing to apply to the court for an administration order by virtue of para 12(1)(b) of Schedule B1, even if under the company's internal rules of management, i.e., the articles, he could not pass a resolution of the company to make such an application by himself. **[15]**

31. Secondly, the judge rationalised this on the basis of directors' duties and ensuring that creditors receive the best outcome:

"Each director of a company, including a single director, has a duty owed to the company and its creditors to cause a company to cease trading where it is clearly insolvent and to instigate an appropriate insolvency process. Where a better result for a

company's creditors will be achieved by an administration, a director must be entitled – if not bound – to apply to the court for that relief, if an administrator cannot be appointed out of court or for some other reason it is necessary or appropriate to apply to the court."**[15-16]**

32. Thirdly, and consistent with *Brickvest*, the judge appears to have considered that whether or not the company could have resolved to appoint an administrator is a matter that is to be taken account of and considered in the court's exercise of its discretion to make an administration order. This discretionary exercise, the judge held will take account of all the relevant circumstances, "*which may include the reasons why there is a sole director and the effect of the company's articles as to the relevant powers of its board*". Though the judge also stated that this particular issue is likely to be outweighed by other relevant considerations, such as where an administration order would result in a better return for creditors and there is no other realistic alternative to a winding up. **[15]**

33. In line with this analysis, the judge took into account the following factors in deciding to grant the administration order:

    (i) the Director was not at fault for the absence of a quorum of directors (if more than one is required) and owed a duty to the creditors of the Companies to take urgent steps to protect their interests;

    (ii) the Companies were both balance-sheet and cash-flow insolvent;

    (iii) there was no realistic alternative to selling the business other than winding up which would produce a significant shortfall to creditors;

    (iv) by appointing administrators, numerous jobs could be saved, which was considered important at a time of '*looming economic crisis and financial hardship to anyone made redundant*'. **[17]**

Commentary & Analysis

34. There appears to be a tension between *Brickvest* and *Nationwide* on one hand, and *BW Estates and Minmar.* Because the latter cases emphasise the importance of complying with the articles and indicate that an appointment made in breach of the company's internal governance rules will be invalid. Those cases do not treat the importance of complying with the articles as a matter that can be considered as part of the court's discretion. If *BW Estates* (which is a court of appeal decision) had been applied to the letter in *Brickvest* or *Nationwide*, then the outcome would be that the appointment was invalid.

35. That is not to say, however, that in the circumstances, *Brickvest* or *Nationwide* reached a bad conclusion. There is merit in taking a more pragmatic stance by looking at the bigger picture and not allowing a technical defect to stand in the way of an administration order that would otherwise be made. Unfortunately, neither *Brickvest* or *Nationwide* dealt head on or expressly with the issue concerning the importance of ensuring the articles are

complied with. The most that can be said, in an attempt to reconcile the decisions is that *Brickvest* and *Nationwide* acknowledge the importance of non-compliance with a company's articles of association, but treat this as a factor which can be outweighed in circumstances where there is real urgency behind obtaining an administration order, and where the same would produce a better outcome for creditors as opposed to a winding up.

36. Arguably, *Nationwide* goes one step further by using the Interpretation Act 1978 to provide a more strict legal basis that apparently justifies and enables directors to have standing to seek an administration order where the articles of association have not been complied with. A similar line of argument was employed in *Minmar,* where reliance was placed on paragraph 105 of Sch B1[10], however this argument was rejected on numerous bases, one of which included, at **[50]**:

> "Second, the terms of paragraph 105 give to an act of the majority the same validity as would be accorded to an act of the directors as a whole but if the act in question must still be an act of the majority of such directors, I see no reason why the reduction in the requisite number of directors should also dispense with the usual rules of internal management. To do so appears to me to be giving greater effect to a provision of general application than is to be derived from either the words used or the context in Schedule B1 in which they are used or in the previous case law to which I have referred."

37. Arguably, the same could be said about paragraph 12(1)(b) and the judge's interpretation that the reference to directors also includes the singular. Namely, that it does not, in and of itself, dispense with the usual rules of internal management. The judge's analysis might be correct in circumstances where there is only one director and the articles provide that only one-person need be present for the meeting to be quorate. One could justifiably construe paragraph 12(1)(b) as referring also to the singular.

38. Lastly, whilst not referred to in *Nationwide*, dicta in *Brickvest* which suggests r.12.64 is available where there have been defects in a decision reached by directors to appoint (or seek the appointment of) administrators is respectfully doubted. Following on from *A.R.G* and *Re Euromaster* referred to above, it appears that ensuring the internal rules of management have been complied with by holding a duly convened and quorate meeting defines the circumstances in which the power to appoint actually arises, as opposed to a procedural requirement which needs to be fulfilled. Because if the meeting is inquorate, then by the articles alone, the relevant director did not have authority to pass any resolution on behalf of the company which concerned appointing (or seeking the appointment of) an administrator and so the power had not yet arisen. The significance being that such an appointment is a nullity and incapable of being rescued under r.12.64 IR.

[10] "A reference in this Schedule to something done by the directors of the company includes a reference to the same thing done by a majority of the directors of a company."

39. Moving forward then, it would appear that courts are taking a more pragmatic approach in their treatment of issues such as those in *Nationwide,* which call into question the validity of an administrator's appointment. That is to be welcomed by legal practitioners and insolvency practitioners. However, it remains possible that a court will hand down a ruling which refers to all of the decisions above in a bid to resolve the tension referred to in paragraph 35 of this paper. Advisers and IP's should therefore be familiar with the decisions referred to above and be prepared to respond to what they say if they are raised by either an opponent or the court.

FAILURE TO OBTAIN CHARGEHOLDER CONSENT – NULLITY OR DEFECT?

Re Tokenhouse VB Ltd (formerly Vat Bridge 7 Ltd) [2020] EWHC 3171 (Ch) (ICC Judge Jones)

The Facts

40. Strategic Advantage SPC ("**the Applicant**") was a charge holder of Tokenhouse VB Ltd ("**the Company**"). The directors of the Company appointed administrators over the Company. Notice of intention to appoint was not given to the Applicant in breach of paragraph 26(1) of Schedule B1.

The Issues

41. ICC Judge Jones sought to decide the following issues: **(i)** whether the failure to give notice to the Applicant meant that the appointment by the directors of the Company was void; **(ii)** if the appointment was not void, whether the breach of paragraph 26 of Schedule B1 should be remedied by the appointment of those whom the Applicant wished to appoint or otherwise.

The Decision

42. ICC Judge Jones began by deciding which authorities bound him. The following conclusions were reached **[40]**.

    (i) This was not a case where the purported appointment was void because there was no power to appoint or the appointment was not made. Rather tellingly, therefore, it appears that the Judge did not consider that the power to appoint only arose once the requisite notice had been given under paragraph 26 of Schedule B1. A point which is explored in further detail below.

    (ii) Where there is an issue of compliance with the requirements of paragraphs 26-30 of Schedule B1, the court should follow the approach in *Re Ceart Risk Services Ltd* [2012] EWHC 1178 (Ch) to the extent that Arnold J held that the answer to the question of whether non-compliance results in invalidity depends upon whether Parliament intended that outcome. Which is determined by first identifying the purpose of the breached requirement and by identifying the consequences of non-compliance.

(iii) If there is no automatic invalidity and the breach is an irregularity, paragraph 31 of Schedule B1 is given effect to. Paragraph 104 of Schedule B1 will apply, as will r.12.64 of the Insolvency Rules 2016, and CPR r.3.10 to the extent necessary.

(iv) Accordingly, *Re G-Tech Construction Ltd* [2007] BPIR 1275[11] is not to be followed.

(v) Mr Justice Marcus Smith, in *Re Skeggs Beef Ltd* [2019] EWHC 2607 (Ch) identified three categories when deciding the consequences of a breach of the requirements for an out-of-court appointment: **(i)** where the breach is fundamental; **(ii)** not fundamental but has caused no injustice, and; **(iii)** not fundamental but has caused substantial injustice.

(vi) When answering the question of Parliamentary intention and for the purposes of categorising the breach, the provisions concerning the appointment of administrators out of court are to be interpreted in light of the statutory scheme for administrations as a whole.

(vii) Following *Re Euromaster Ltd* [2012] EWHC 2356 (Ch) (Norris J) , paragraphs 26-32 of Schedule B1 prescribe procedural requirements, which means that a breach will "*naturally fall to be treated as irregular".*

43. ICC Judge Jones highlighted that the first issue was to be decided in accordance with the principles set out at **(ii)** above. He held that a breach of paragraph 26(1) of Schedule B1 would not invalidate the appointment. Rather, the matter fell within the second category identified by Smith J in *Re Skeggs Beef*: not fundamental, but has caused no injustice. This was for the following reasons. **[41]**

44. The judge highlighted that a breach of paragraph 26(1) of Schedule B1 means the charge holder will have lost the ability to appoint its own administrator or to signal its consent to the appointee before the appointment was made. If the appointment process is to start again, the time between the expiry of the 5 days and discovery of the breach will have been lost, which might be detrimental as the purposes of the administration might no longer be likely to be achieved, or the charge holder's recovery on distribution might be reduced. **[43]**

45. Whilst not expressly stated as such, it appears, therefore, that this is the purpose of paragraph 26(1) of Schedule B1 – to ensure that a charge holder has the ability to appoint its own administrator and/or so that it can agree the appointee before the appointment under paragraph 22 of Schedule B1.

46. Again, whilst not expressly stated as such, the judge gave further consideration to the consequences of non-compliance. Invalidity and starting the process again would give rise to a myriad of potential problems; for instance, in a pre-pack sale, the intended purchaser

[11] In Re G-Tech, the relevant breach was of paragraph 29 of Schedule B1, where there was a failure to file the correct prescribed form.

may withdraw and seek more favourable terms, and of course the consequences of what had occurred before discovery of the breach may need to be unravelled. **[44]**

47. Loss of the right to appoint or agree the appointment of administrators during the 5-day period, was not considered to be a consequence of great significance. Administrators are required to be licenced insolvency practitioners, they will be officers of the court who are required to act in the interest of the creditors as a whole; they will need to prepare a proposal to which the first two purposes of paragraph 3(1) of Schedule B1 will have priority over the third. Moreover, the charge holder can seek directions from the court to cure the breach, and no such application would be required if the charge holder was content. **[46-47]**

48. Furthermore, it was held that the limited prejudice that was capable of being caused should be contrasted with the potential danger that the main purposes of the administration many no longer be achievable if the breach means that the appointment is automatically void. The consequence of automatic invalidity would be inconsistent with the need for there to be an administration and the intention of the charge holder to appoint an administrator, either through agreement or through making their own appointment. **[48]**

49. Accordingly, the judge held that the idea that non-compliance with paragraph 26(1) of Schedule B1 is a fundamental breach, mis-ranks the importance of receiving notice above the importance of there being an administration. The consequences of non-compliance with paragraph 26(1) of Schedule B1 lead to the conclusion of irregularity; which is consistent with their being a procedural requirement. **[46]**

50. The judge also highlighted that s.232 of the IA, paragraph 104 of Schedule B1, r.12.64 IR and CPR r.3.10 show that the general intention of Parliament is for defects in appointment not to affect the validity of actions taken. **[50]**

51. As to the second issue, the judge went on to cure the breach of paragraph 26(1) of Schedule B1 by having both the Applicant's nominees as the court appointed administrators.

Commentary & Analysis

52. It appears, along with the other authorities referred to in this paper which are concerned with the defective appointment of administrators, that courts are making every effort to uphold the validity of appointments where they can. Rather than being dogmatic, courts are giving real consideration to whether any prejudice is really caused by a breach or not, part of which involves looking at the bigger picture. This is an approach which must surely be welcomed by insolvency and legal practitioners.

53. Whilst in the present case, the judge was not concerned with paragraph 15 of Schedule B1, the interesting question which arises is whether the same outcome in respect of a breach of paragraph 26(1) of Schedule B1 would necessarily apply to a breach of paragraph 15 of Schedule B1. Paragraph 15 provides: (so far as relevant)

> "*(1) A person may not appoint an administrator under paragraph 14 unless—*

(a) he has given at least two business days' written notice to the holder of any prior floating charge which satisfies paragraph 14(2), or

(b) the holder of any prior floating charge which satisfies paragraph 14(2) has consented in writing to the making of the appointment.

54. So, similar to paragraph 26 of Schedule B1, there is a general overall requirement to ensure that notice is given to charge holders. There are cases which indicate(d) that a breach of paragraph 15 was a fundamental flaw which: **(i)** is not an irregularity or formal defect and; **(ii)** renders the appointment of the administrator a nullity. For instance, in *Re Eco Link Resources Ltd* [2012] B.C.C 731, (HH Judge David Cooke) it was held that a failure on behalf of a junior charge holder to give notice to a senior charge holder rendered the administrators appointment invalid and incapable of being cured. Another case which supported this view was *Adjei v Law for All* [2011] EWHC 2672 (Ch) (Norris J) However, this might be something of a moot point now, because in the present case, ICC Judge Jones considered that *Re Euromaster* superseded *Eco Link.*

55. But, in *Wright & Ors v HMV Ecommerce Ltd & Anor* [2019] EWHC 903 (Ch) Barling J said:

"*17. In addition, consideration should be given to the distinction between a provision which restricts the power to appoint and a requirement of this kind, which is obviously procedural in nature. Breach of the latter would, at worst, have the effect of rendering an appointment irregular rather than a nullity..*"

56. Whilst a very literal approach, paragraph 15 of Schedule B1 is entitled "Restrictions on power to appoint" and so, arguably, it is caught by what was said in *HMV Ecommerce*. One might think, in the context of paragraph 15, that giving notice to or obtaining the consent of a senior charge holder defines the scope of circumstances in which a power to appoint arises, as without notice, or consent, "a person may not appoint an administrator" – and so on one interpretation, the power to appoint does not exist in its complete form until paragraph 15 of Schedule B1 is complied with.

57. Moreover, in *A.R.G Mansfield,* it was held, albeit obiter, that obtaining the consent of the FCA defines the circumstances in which the power to appoint arises, and any failure to do so, therefore, renders the appointment of an administrator a nullity. In this respect, s.362A(2) of the Financial Services And Markets Act provides:

(2) An administrator of the company or partnership may not be appointed under a provision specified in subsection (2A) without the consent of the appropriate regulator.

58. The general effect of s.362A(2) of FSMA is broadly similar to paragraph 15 of Schedule B1 such that one might argue that the same conclusion must follow.

59. So, in sum, it is at least arguable that different outcomes could be reached when considering a breach of paragraph 15 compared to a breach of paragraph 26(1) of Schedule B1. Perhaps one way of reconciling any difference between paragraph 15 and 26, is that the words "a person may not appoint an administrator" in paragraph 15 does not feature in paragraph 26, and so the latter provision does not necessarily speak to the question of whether the power to appoint arises or not.

WHAT IS THE TEST TO ENGAGE THE RULE IN EX PARTE JAMES?

Lehman Brothers Australia Ltd v MacNamara & Ors [2020] EWCA Civ 321 (Patten LJ, David Richards LJ, Newey LJ)

The Facts

60. Lehman Brothers Australia Limited, ("**LBA**") was in liquidation. Lehman Brothers International (Europe) ("**LBIE**") was in administration. LBA was an unsecured net creditor of LBIE. Due to intercompany dealings, LBIE and LBA were creditors in one another's liquidation/administration.

61. The LBIE administrators and the LBA liquidators sought to agree claims between their respective estates. LBA's claim was quantified in the sum of £28,881,600. LBIE unsecured claims were quantified in the sum of £5,526,092. LBA, therefore, had a net unsecured provable claim against LBIE for £23,355,508.

62. The parties entered into a settlement agreement known as a Claims Determination Deed ("**CDD**") in respect of the net balance of LBA's unsecured claim against LBIE on 12 March 2014. The CDD recorded the Agreed Claim Amount as £23,355,508 and contained a mutual release of all claims between LBA and LBIE, save for the agreed claim. The effect of the release prevented LBA from claiming anything other than the agreed claim, in the agreed amount of £23,355,508. That sum was duly paid by way of distribution to LBA.

63. In August 2016, it became apparent following discovery by a prospective purchaser of LBA's residual claims against LBIE, that the sum of £23,355,508 had been undervalued in the claim valuation process. The value of a bond which formed part of the agreed claim amount had been converted into an incorrect currency, Australian dollars, as opposed to Euros which left a shortfall of £1,672,583.44.

64. The Liquidators of LBA sought to vary the amount of its provable claim in accordance with (what was then) r.2.79 of the Insolvency Rules 1986/1925.[12] It was accepted by LBIE that there was an error, but they declined to vary the claim, citing the wide release clause of the CDD. LBA sought a direction from the court that the administrators of LBIE increase the

[12] The equivalent rule in the Insolvency Rules 2016 is rule 14.10 (2)

agreed proof of debt by £1.67 million, under either the principle in *Ex parte James* or under paragraph 74 of Sch B1 IA.

The Principle in Ex Parte James

65. The principle in *Ex Parte James*[13] permits the court to control the conduct of an officeholder, where his conduct, either actual or proposed, and although lawful and in accordance with enforceable rights, does not accord with the standards that society expects of the court and its officers.[14]

66. Numerous terms, '*none of which are very definite*[15]' have been used in order to identify and describe the relevant standard for the principle to apply and thus engage the courts intervention. Indeed, it has been said that where it would be **unfair** for an office-holder to take advantage of his legal rights, a court will order him not to do so, *Re Nortel GmbH* [2013] UKSC 52 at [122]. Terms in this context, such as 'dishonourable', 'contrary to natural justice' and 'obviously unjust' have often been cited. Irrespective of the applicable standard, the principle does not affect the scope or nature of an officeholder's powers, but rather the manner in which those powers are exercised, *Re Lune Metal Products Ltd* [2006] EWCA Civ 1720 (Neuberger LJ (as he then was) Carnwarth LJ (as he then was) Tuckey LJ) at **[35]**.

Paragraph 74 of Schedule B1

67. Paragraph 74 empowers the court to grant relief where:

> "(a) the administrator is acting or has acted so as to unfairly harm the interests of the applicant (whether alone or in common with some or all other members or creditors), or
>
> (b) the administrator proposes to act in a way which would unfairly harm the interests of the applicant (whether alone or in common with some or all other members or creditors)."

68. There are two requirements that must be shown in order for Paragraph 74 to be applicable: **(i)** the conduct complained of has or will cause(d) harm to the interests of the applicant and; **(ii)** the conduct complained of has or will cause(d) harm to the applicants interests and that such harm is unfair.

The High Court Decision

69. At first instance, Hildyard J rejected unfairness as being the applicable test, after considering *In re TH Knitwear (Wholesale) Ltd* [1988] Ch 275 (Slade L.J. , Glidewell L.J. and Caulfield J.) and *In re Wigzell, Ex p Hart* [1921] 2 KB 835, (Lord Sterndale M.R. ,

[13] *In Re Condon, Ex Parte James (1874) LR 9 Ch App 609, [1874-80] All ER 388*
[14] Lehman Brothers Australia Ltd v MacNamara & Ors [2020] EWCA Civ 321 [35]
[15] Re Wigzell [1921] 2 KB 835 [838]

Scrutton L.J. and Younger L.J, Horridge J. and Salter J.) which he considered was authority for a stricter test of unconscionability as opposed to unfairness. **[61] [70]**

70. Secondly, it was held that neither the rule in *Ex Parte James* nor Paragraph 74 was capable of being invoked to prevent an officeholder from relying on contractual rights in respect of an agreement freely entered into, save where the contract is capable of being '*reformed or rectified or otherwise invalidated*'. **[84]**

71. The judge did not consider on the facts of the case that he would exercise the jurisdiction under *Ex Parte James* or Paragraph 74, even if it was capable of interfering with contractual rights (or imposing equitable constraints thereto) on the basis of unfairness. This was because it would undermine the finality that was intended by entering into the CDD.**[85]**

72. As for Paragraph 74, Hildyard J restricted unfair harm to cases where the administrators act **(i)** causes or would cause disadvantage to that creditor; **(ii)** cannot be justified by reference to the interests of the creditors as a whole or to achieving the objective of the relevant insolvency process; and/or which **(ii)** is discriminatory in such effect. Paragraph 74 did not in the judge's view provide a basis that justified the courts intervention either. **[78] [80]**

The Decision on Appeal

73. David Richards LJ in giving the leading judgment, reviewed a number of authorities[16] concerning application of the principle of in *Ex Parte James.* Unfairness was a phrase that featured in all of them. Whilst Lord Neuberger's adoption of fairness as the test in *Re Nortel GmbH* did not form part of the ratio, that did not mean, as Hildyard J found, that it could be dismissed. It was a point which concerned the applicability of *Ex Parte James* and was therefore worthy of consideration. **[63]**

74. The judge approved the test of unfairness which had been applied in two decisions, *Re Nortel GmbH* and *Re Clark (A Bankrupt)* [1975] 1 WLR 559 (Walton J) In the latter case, the principle was stated as, at **[563]**

> 'Stating the matter in very broad terms indeed for the moment, and deliberately using for the purpose "unemotive language", the rule provides that where it would be unfair for a trustee to take full advantage of his legal rights as such, the court will order him not to do so.'

75. The test of unconscionability was rejected. As the court accepted, the term unconscionable connotes oppression and the wrongful exploitation of property, which did not reflect the circumstances in which the principle has been considered. **[65]**

[16] *Re Hall* [1907] 1 KB 875; *Re Tyler* [1907] 1 KB 865; *Re Thelluson* [1919] 2 KB 735

76. The court stated that the principle and the test in *Ex Parte James* is that the court would not permit its officers to act in a way which would be clearly wrong for the court itself to act. Where a right-thinking person representing the current view of society would think it unfair for an officer to enforce their strict legal rights the court will order him not to do so. **[68]** When applying that principle to the facts of the case, the court said:

> 'For these reasons, therefore, in my judgment no right-thinking person would think it fair for the administrators to stand on their strict contractual rights….'. **[103]**

The Proper Approach to Paragraph 74

77. In respect of Paragraph 74, the court approved the decision in *Fraser Turner Ltd v PricewaterhouseCoopers LLP* [2019] EWCA Civ 1290, Sir Geoffrey Vos C, Males LJ and Snowden J), to the effect that where an administrators is acting in accordance with his obligations, under Sch B1 to the IA any potential or actual harm caused to a creditor cannot amount to unfair harm for the purposes of Paragraph 74. In *Fraser Turner*, at **[76]** it was said by Sir Geoffrey Vos C that:

> "In Four Private Investment Funds supra at paragraph 39, Blackburne J made it clear that there could be no unfairness sufficient to engage paragraph 74 without a suggestion that the administrators were acting otherwise than in accordance with their obligations under Schedule B1 of the Insolvency Act 1986 or an order of the court. There, as here, the Administrators were, as it seems to me, seeking in good faith to carry out their functions in the interests of the creditors as a whole. Accordingly, the judge was right here too to hold that any harm that might have been caused to FT by selling the mine without procuring Timis Mining to pay the Royalty could not have been caused "unfairly" within the meaning of paragraph 74."

78. However, the court drew a distinction between where an administrator is acting in accordance with his obligations, and where he is acting in accordance with his discretion. In the former, as the court put it, '*there can be no question that he is causing unfair harm'*. In the latter, and where the exercise of discretion causes unfair harm to a creditor, '*there is no reason in the terms of Paragraph 74 or in its evident purpose why the court should not in an appropriate case grant relief*'. **[82]**

79. The relevance of this distinction is that the court held that whilst it is an important factor to be taken into account that the administrator is carrying out statutory functions and is doing so in the interests of the creditors as a whole, that may still involve the infliction of unfair harm upon a particular creditor. **[84]**

80. Furthermore, the court held that Paragraph 74 is not confined to cases of discrimination. The approach taken by the court was that Paragraph 74 was not to be made subject to mandatory qualifications that are not present within the statute. It appears therefore, that

the Court of Appeal have given a very wide interpretation of Paragraph 74, which in turn, broadens the scope of an administrator's potential liability. **[83]**

Can Ex Parte James be applied to prevent enforcement of contractual terms?

81. The court held there were no grounds for excluding contractual rights from the scope of Paragraph 74 or the principle in *Ex Parte James.* Though whether an officeholder would be prevented from enforcing his strict contractual right was a matter which would depend on the facts of the particular case. **[87]**

Analysis & Commentary

82. By adopting a standard of unconscionability, the High Court was thought to have limited the circumstances in which the court would control the conduct of an officeholder.[17] It follows, logically, that by lowering the bar to 'unfairness', a creditor has more opportunity to challenge the conduct of an officeholder under *Ex Parte James.* This has had a practical effect already. Officeholders may wish to consider whether exercising a right to bring a preference claim, say, would be treated as 'unfair'. In *Re Fowlds (a bankrupt)* [2020] EWHC 1200 (Ch) (ICC Judge Jones) *McNamara* was referred to and it was held, albeit obiter, at **[107]** that:

> "In my judgment notwithstanding the purpose of section 340 of the Act and the importance of the statutory scheme and policy of equal distribution of assets which are or should otherwise be part of bankruptcy estate, the right-thinking person representing the current view of society would not consider it right to exercise legal rights resulting from a preference in this case. Not when the result will be to achieve the sale of the family home of a mother without any other significant assets when she received the Payment as a commercial debt payment without knowledge and the Prerequisite is met"

83. Though it should also be remembered that this issue is necessarily fact-sensitive given that the test is governed by abstract concepts such as 'unfairness' and 'the current view of society'.

84. Furthermore, by rejecting any mandatory qualifications to Paragraph 74, creditors have more opportunity to challenge the conduct of an administrator, save for where the conduct concerned arises out of the administrator acting in accordance with his statutory obligations. In circumstances where an administrator is acting pursuant to his discretion, it will not always be an answer to say that the administrator is carrying out statutory functions in the interests of the creditors, because the court has recognised that in such circumstances unfair harm may still be caused.

AN ADMINISTRATOR'S FUNCTIONS & THE RESCUE OBJECTIVE

[17] https://www.erskinechambers.com/interpretation-of-the-principle-in-re-condon-ex-parte-james/ - date accessed 25 November 2020

Re Lehman Brothers (International) Europe (In Administration) [2020] EWHC 1932 (Ch) Sir Geoffrey Vos, C

The Facts

85. As discussed earlier, LBIE was in administration. The administrators sought directions from the court pursuant to paragraph 63 of Schedule B1 that they be able to consent to a request from the directors of LBIE under paragraph 64 of Schedule B1 that they make a distribution of surplus funds to LBIE's shareholder, LB Holdings Intermediate 2 Limited ("**LBHI2**") which was also in administration. The original purpose of LBIE's administration was the objective under paragraph 3(1)(b) of Schedule B1, i.e, achieving a better result for creditors as a whole than would be likely if the company were wound up (without first being in administration).

86. The essential legal issue to be decided was whether, in consenting to the request, the administrators would be performing their functions with the objectives in paragraph 3 of Schedule B1.

The Decision

87. Sir Geoffrey Vos C accepted that the functions of an administrator were very broad and consenting to the request would fall within either paragraph: 14, 59 or 64 of Schedule B1. **[24]** The judge acknowledged, however, that if, by consenting to the request the administrators would not be performing their functions with one of the statutory objectives in paragraph 3, the court could not sanction the administrators proposed course of action. **[25]**

88. The judge held that the only objective of LBIE's continuing administration was to rescue LBIE as a going concern. **[27]** The judge referred to three authorities: *Denny v. Yeldon* [1995] Pens LR 37; *Re Polly Peck International plc* [1999] Pens LR 37 *Re Allanfield Property*, [2015] EWHC 3721 (Ch). In *Yeldon* at **[17]** the court sanctioned a course of action whilst purposefully not referring to the objectives of the administrators and explained the relationship as between the objectives of the administration and an administrator's powers:

> "It will be noted that my view deliberately ignores which of the statutory grounds were the basis for the administration order. Those grounds go only to what the administrators, as officers of the court, should be trying to achieve. They do not limit the powers of the administrators once they are appointed."

89. In *Re LBEL No. (9)* [2017] EWHC 2031 (Ch) however, Hildyard J at **[64]** however, adopted a strict interpretation of paragraph 3 of Schedule B1, holding that "any performance of an administrator's function must be performed for, and only for, the administration's purpose".

90. The judge acknowledged that the administration regime places 'multifarious' demands upon an administrator. But *Yeldon* and the cases referred to above showed that an element of pragmatism must be shown. As the judge held, it may well be impossible or stretching it somewhat to tie each step which administrators take pursuant to a lawful exercise of their powers directly and causatively to the relevant objective in paragraph 3 of Schedule B1. However, the judge reasoned, paragraph 3 of Schedule B1 does not explicitly state that every exercise of every function must be with the objective in paragraph 3. In this respect, Hildyard J in *Re LBEL* was not referred to the trio of cases outline above. Nor did he consider what the outcome would be in more detail if every function was to be exercised with the objective of achieving the statutory objective. **[39-40]**

91. Accordingly, the judge held that there does not to be a causative analysis at all. That is, not every exercise of "an administrators' powers must be capable of being shown to specifically advance the statutory objective in a definable way" as this requirement would be unworkable.

92. As such, the judge went on to find that whilst complying with the directors request would not of itself cause or promote LBIE's rescue, it would not change the fact that the administrators were performing all their functions with the overall objective in paragraph 3(1)(a). Complying with the request was commercially appropriate and the administrators were directed to be at liberty to give the consent requested under paragraph 64. **[46]**

Commentary and Analysis

93. This judgment exemplifies a growing trend of courts adopting a pragmatic approach in circumstances where the IA appears or has been interpreted strictly. The judgment acknowledges at **[44]** that administrators need to exercise function which are necessary but not specifically directed at any of the statutory objectives because they are ancillary. By recognising this, administrators can be confident that they will not need to show that every exercise of their functions was to specifically advance the rescue objective. Whilst of course they should not do anything which is geared towards achieving an outcome that is inconsistent with paragraph 3 of Schedule B1, it will be enough to show that the relevant act is within the administrators powers and that they are pursuing the statutory objective overall.

94. Moving forward and in practical terms, this may reduce slightly the scope of circumstances in which an administrator will need to seek directions on such matters and of course from an exercise of his/her functions from being challenged in such a way.

THE IMPORTANCE OF SIP 16 COMPLIANCE

Re Moss Groundworks Ltd, [2019] EWHC 3079 (Ch) (Snowden J)

The Facts

95. The directors of Moss Groundworks Limited ("**the Company**") applied for an administration order. The application sought the appointment of two members of Leonard Curtis as joint administrators.

96. Historically, the Company had traded profitably. From 31 July 2018 to the end of June 2019, however, the Company recorded a loss of approximately £96,000. The directors sought the advice of Leonard Curtis on 14 August 2019. From that advice, the directors concluded the Company was insolvent. The management accounts of the Company showed that it had tangible assets with a book value of £816,000, and a ledger of book debts with a book value of £1.49 million. However, the Company also had creditors due within one year and after one year in excess of £2 million.

97. The court was satisfied that the Company was or was likely to become insolvent, so that the first requirement for making an administration order in paragraph 11(a) of Sch B1 was satisfied.

98. The remaining issue was whether paragraph 11(b) of Sch B1 was satisfied, namely whether, the administration order was reasonably likely to achieve the purpose of the administration. The purposes which were considered likely to be achieved were: (i) achieving a better result for creditors as a whole than would be likely if the company were wound up; or (ii) realising property in order to make a distribution to one or more secured or preferential creditors.

99. A compulsory liquidation was considered disadvantageous by the proposed administrators. This was because if the business closed and contracts were terminated, it would impact the realisations from the Company's book debt ledger. The ledger was contractual in nature and would give rise to disputes for non-payment and counterclaims.

100. Instead, it was proposed that a pre-pack sale of the assets and business of the Company would take place. The administrators report contained a detailed plan for how the business would be marketed. However, what actually occurred was this:

Paragraph 9.25 of the report:
"On 2 September 2019, due to the circumstances detailed above and time constraints relating to this application, Leonard Curtis placed two advertisements on the following websites: (1) www.leonardcurtis.co.uk, the website of the [proposed joint administrators themselves]; and (2) www.charlestaylor.co.uk, the website of Cerberus Asset Management."

101. What the report did not go on to explain, however, was that the website advertisement was in terms which required all interested parties to sign a non-disclosure agreement and to provide offers and proof of funding by 5 p.m. on 4 September 2019, i.e, two days later. This did not correspond with the approach envisioned earlier on in the report which provided more time and steps to be followed.

102. No offers were received by unconnected parties. An offer was received for the business and assets of the Company by a new company which was connected with the directors of the existing Company. That offer was £130,000, £25,000 of which was payable on exchange of contracts, and the remainder a month later, on or before 07 October 2019.

The Decision

103. The history and concerns raised over pre-packaged administrations ("**Pre-Packs**") is explored in further detail below. Suffice it to say that concerns raised about Pre-Packs were sought to be addressed in 2009 when the Insolvency Service issued a Statement of Insolvency Practice – SIP 16, the purpose of which was to set out basic principles, procedures and standards that were required to be met by officeholders in relation to Pre-Packs. SIP 16 is now in its third iteration following the Graham Review.[18]

104. Whilst Pre-Packs are indeed legitimate[19], courts have reiterated the requisite standards required by administrators in cases involving Pre-Packs. In the present case, the judge referred to *Re Kayley Vending Ltd* [2009] EWHC 904 (Ch) which was a case concerning the courts discretion to make an administration order in a case involving a Pre-Pack. That case is authority for the following propositions:

(i) When the court is exercising its discretion in a Pre-Pack case, the court must be alert to see that the procedure is not being abused to the disadvantage of creditors. If it is, or it might be, the court may conclude it is inappropriate to give the Pre-Pack the apparent approval by making the administration order;

(ii) The court will be assisted by the provision of information in relation to the Pre-Pack transaction and its background which falls within r.3.6(3)(g) of the Insolvency Rules 2016. In most cases, the information required by SIP 16 falls within the above requirement and ought to be included in the application;

(iii) It is unsatisfactory to wait until an application is actually opposed to then rely on the courts ability to give directions for the filing of further evidence on the hearing of the opposed application.

105. The judge did not grant an administration order. The marketing of the Company's business and assets was very truncated. In terms of compliance with SIP 16, the administrators simply issued a statement in their report, without any further elaboration:

[18] Palmer's Company Law Volume 4, Part 14 - Company Administrations, Receivership and Voluntary Arrangements Chapter 14.0 [14.039.et seq]

[19] *DKLL Solicitors v Revenue and Customs* [2007] EWHC 2067 (Ch); [2007] B.C.C. 908, *Transbus International Ltd* [2004] EWHC 932 (Ch) *Innovate Logistics Ltd v Sunberry Properties Ltd* [2008] EWCA Civ 1321; [2009] B.C.C. 164; *Re Kayley Vending Ltd* [2009] EWHC 904 (Ch); [2009] B.C.C. 578; *Re Hellas Telecommunications* (Luxembourg) II SCA [2009] EWHC 3199 (Ch); [2010] B.C.C. 295; *Re Halliwells LLP* [2010] EWHC 2036 (Ch); [2011] B.C.C. 57.

"*We confirm that the marketing undertaking has conformed to the marketing essentials as set out in the appendix to Statement of Insolvency Practice 16."*

106. The court held that the information provided by the administrators was wholly inadequate to explain how the marketing essentials in SIP 16 had been complied with. Furthermore, there was no adequate explanation of why the business of the Company and assets with a book value in excess of £1 million, was to be acquired by a company owned by the directors for £25,000 in cash and a promise to pay a further £105,000 in a month's time. The court was not, in sum, able to satisfy itself that the case was not one which amounted to an abuse of the administration process.

107. However, whilst the judge did not make an administration order, he did allow an adjournment to give the Company and the proposed administrators the opportunity to reconsider the evidence, the process of marketing which had taken place and their compliance with SIP 16 so that the court might be satisfied that it was appropriate to make an administration order.

The Second Hearing

108. Following the adjournment, the application came before HH Judge Eyre QC. To address the concerns identified above, substantial material was presented to the court:

(i) One of the proposed administrators provided a detailed witness statement with a SIP 16 compliant report attached to it;

(ii) a report was provided which gave considerably more detail about why the value ascribed to the book debts and the work in progress was appropriate.

109. Furthermore, to address the issue that the marketing was truncated, the explanation put forward was that the marketing had been delayed because a substantial payment to the Company was imminent. There was concern that marketing the business would cause the debtor to take fright and delay payment. Further, an out of court appointment was intended and for a longer marketing period under the protection of the statutory moratorium, however, the presentation of a winding up petition prevented this course of action, as a result of paragraph 25 of Sch B1.

110. The further material provided a detailed explanation of the value ascribed to the work in progress and the book debts in the context of a liquidation or other insolvency process. Arguments were put forward based on the nature of the work in progress and the practicalities of the construction industry. Unfortunately, these arguments were not set out more fully in the judgment which would explain the rationale behind the valuation of the book debts and work in progress.

111. In addition, a director of the Company offered to undertake to forego, in the event of an administration, the sums owed to him by way of director's loan account, which was £80,000. The court considered that the significance of this offer was not simply that it gave rise to a modest increase for other creditors, but that it signified recognition by the director of the interests of other creditors. Which in turn, assisted the court in addressing the concern that the sale was an abuse of the Pre-Pack administration procedure.

112. The court held that paragraph 11(a) and (b) of Sch B1 were satisfied. Further, it affirmed the basic proposition that when those criteria are established, the court has a discretion and has to consider whether it is appropriate to make an administration order. At that stage, the court has to have regard to the potential for abuse when there is a proposed Pre-Pack sale and particularly where the intention is that the Pre-Pack sale is to existing management or those connected with the vendor company. In this respect the following points of principle were raised:

(i) where there is a significant risk of abuse, the court cannot approve an administration with a view to simply leaving matters to the administrator's judgment.

(ii) Where it is clear that the pre-pack system is being abused, or the application may be an abuse, the court should decline to make an order. The court must consider the degree of such a risk. If there is real concern such that there is a significant degree of risk of abuse, the court should not exercise its discretion in favour of an administration.

(iii) There will be some degree of risk in almost every case and there will be cases in which it is appropriate for the court to regard the risk as not being significant. And the position of the administrator as an independent IP, along with the rights of creditors' to challenge matters/hold accountable the administrator can be seen as sufficient protection against the risk of abuse.

(iv) Evidence of SIP 16 compliance is likely to be sufficient in most cases to assuage the courts concerns. Conversely, a party who fails to demonstrate compliance and that the administration order is appropriate will need to explain clearly why the risk of abuse is insignificant.

113. The court held that the material at the first hearing of the application was 'sketchy'. However, the provision of further material including explanation and an indication by the director that he would not pursue his loan account reduced the risk that the application was an abuse of the pre-pack administration procedure. The risk was less apparent, and the role of the administrator and the rights of the creditors were sufficient protection against any risk of abuse. Accordingly, the administration order was granted.

114. The court declined however, that the costs of the previous hearing should be treated as an expense of the administration. This was in recognition of the deficiencies in the material put forward in the first hearing.

Commentary & Analysis

115. This case makes it clear that SIP 16 must be complied with and the court must be furnished with evidence of this. Whilst the hearing was adjourned, that should not be treated as an incitement to laxity; it is entirely possible that a court would refuse to grant an administration order under which a Pre-Pack sale is contemplated, if non-compliance with SIP 16 prevents the court from being satisfied that the application is an abuse of the administration procedure. Even if the court were to adjourn the hearing, by preventing the costs of the first hearing from being payable as an expense of the administration, that should be treated as a good incentive to ensure the court has all the appropriate information, and as a warning for the consequences that will arise if there is any failure to do so.

IMPROPER MOTIVE – PARAGRAPH 81 OF SCH B1

Re C A & T Developments Ltd [2019] EWHC 3455 (Ch) (HHJ Haliwell)

The Facts

116. Mr Koon, ('**the Applicant'**) advanced the sum of £309,976.24 to C A & T Developments Limited, ('**the Company**') as part of a joint venture entered into with the directors of the Company, Mr Parker, and Mr Stone. The joint venture involved the purchase and sale of development property in England. It was agreed that if the monies were used to buy and develop property, the Applicant would receive 60% of the net profits when the property was resold.

117. On 1 June 2016, the Company purchased development land at Lunsford Lane, Larkfield, Aylesford, Kent, ('**the Property'**) for £275,000. The planning permission for the Property lapsed on 31 March 2019. Mr Parker arranged for the Company to grant him (Mr Parker) a debenture, ('**the Debenture**') in respect of sums advanced by him to the Company under the terms of a facility agreement in the sum of £11,400. It was held that the Debenture charged the Company's assets not only in respect of the sums due under the facility agreement, but any sums advanced prior to the same.

118. On 29 July 2019, the certificate of registration of the Debenture was issued, following which the Applicant instructed solicitors who demanded immediate repayment of the sums the Applicant had advanced. Those instructed on behalf of the Applicant threatened to wind up the company and challenged the enforceability of the Debenture. They warned that the Applicant would seek to ensure a liquidator investigated the conduct of the directors and bring claims under s.213 and s.423 of the IA. Indeed, they warned that if the Debenture was validly entered into, a liquidator would be expected to take action to set it aside.

119. On 5 August 2019, the Applicant presented a winding up petition in respect of the Company. Mr Parker instructed solicitors, who on 6 August 2019, contacted Mr Bowes, the First Respondent advising that Mr Parker was seeking the appointment of an

administrator under the Debenture. Mr Bowes made inquiries about the value of the Property and advised that consent to act would be subject to confirmation that the Debenture was valid and enforceable. Mr Bowes was provided with 'comfort' that this was the case, and on 15 August 2019, Mr Bowes and Mr Rosler were formally appointed as joint administrators under the Debenture. The winding up petition was suspended pursuant to Paragraph 40(1)(b) of Sch B1 to the IA.

120. On 3rd September 2019, the Applicant commenced proceedings seeking relief under Paragraph 81 of Sch B1 to the IA. On 20 September 2019 the administrators sent to the creditors, their proposals for achieving the purpose of administration. The background and events leading to the administration were described, the statutory purpose of the administration was confirmed, and their management proposals explained. In preparing proposals and the outcome statement, the Joint Administrators were found to have relied heavily on information provided by Mr Parker. The statutory objective the Joint Administrators chose to pursue, pursuant to Paragraph 3(1) (b) of Sch B1 to the IA was to achieve a better result for the creditors as a whole than would be likely to be achieved if the company were wound up (without first being in administration).

Paragraph 81 Sch B1

121. By Paragraph 81:

"81(1) On the application of a creditor of a company the court may provide for the appointment of an administrator of the company to cease to have effect at a specified time.

81(2) An application under this paragraph must allege an improper motive-

(a) in the case of an administrator appointed by administration order, on the part of the applicant for the order, or

(b) in any other case, on the part of the person who appointed the administrator.

81(3) On an application under this paragraph the court may-

(a) adjourn the hearing conditionally or unconditionally;

(b) dismiss the application;

(c) make an interim order;

(d) make any order it thinks appropriate (whether in addition to, in consequence of or instead of the order applied for)."

The Decision

122. The judge confirmed that the improper motive allegation is a gateway which engages the courts jurisdiction. Relief under Paragraph 81 is not conditional upon or in any way related to a determination of the improper motive allegation.

123. The "improper motive" must be attributed to the person who made the appointment, (or on the applicant seeking an administration order) and, logically, it must pertain to his "motive" for making the appointment, or seeking the order, as the case may be. The judge provided some examples of what an improper motive might entail:

'*In this respect, impropriety in his motive might comprehend fraud, dishonesty, bad faith or an intention to achieve a collateral purpose to the disadvantage of other creditors. It might also involve knowingly taking advantage of conduct that was actuated by such a motive.*'

124. There is little authority on Paragraph 81. The judge referred to *Jackson v Thackrar* [2007] EWHC 2173 (TCC*), Curistan v Keenan* [2011] NICh 23 and *Thomas v Frogmore Real Estate GP1 Ltd* [2017] EWHC 25. The last two cases are important because they set out the following principles:

(i) In order for the statutory jurisdiction to be invoked, it is sufficient if there is a motive that is in disharmony with the statutory purpose of administration and was causative of the decision to appoint. If there is no disharmony it is difficult to see why the motive then must be treated as improper or as a material matter militating towards termination of the administration.

(ii) However, even if a motive is improper and causative of the decision to appoint, if the statutory purpose of the administration is likely to be achieved, then this is the main 'touchstone' for the court. Where the purpose of the administration is capable of being achieved, the existence of an improper motive may become of 'relative insignificance'. True to this principle, which was laid down in in *Thomas*, the judge in that case went on to hold:

'…*even if I had concluded that there was any improper motive in this instance that would not have led to an order under paragraph 81 terminating the administration in the absence of satisfactory evidence that the statutory purposes of administration were not likely to be achieved. On the evidence before the court I am far from satisfied that this is the case*…'.

125. In terms of significance, the judge stated, presumably in comparison to the present case - "*however in these cases* [those cited above] *there was no suggestion that the appointment might have a material bearing on the administration itself*'. **[54]**

126. The judge provided further guidance by highlighting that nowhere in Paragraph 81 is the requirement that the allegation must be substantiated in court. It follows, therefore, that an application which gives proper particulars of the improper motive will be sufficient. Moreover, the judge highlighted that it is implicit that the allegation be advanced honestly,

and on reasonable grounds, and that the court would be unlikely to be persuaded to exercise its statutory discretion to grant relief under Paragraph 81, where this is not so. **[54]**

127. The judge went on to highlight, that in the absence of a good reason, the court will not exercise its discretion to make an order. Subject to the caveat that it would not be for the court to provide circumstances which would constitute a good reason, the following would be capable: **(i)** where the appointment amounts to a serious abuse of the administration procedure; **(ii)** where there is something in the circumstances of the appointment which is likely to undermine the administration or interfere with the administrator in the proper performance of his duties. It appears that the judge effectively widened the scope of matters which fall for consideration by including factors such as the above. **[55]**

128. The judge made an order under Paragraph 81(1) of Sch B1 providing for the Administrators' appointment to cease to have effect.

129. The court found that the Applicant honestly believed that in appointing the administrators, Mr Parker was actuated by an improper motive. As the court found, there were reasonable grounds for that belief. The court held that Mr Parker was indeed actuated by an improper motive had an improper motive. Mr Parker caused the Company to enter into the debenture and appointed the Administrators whilst knowing that (i) the Company was insolvent without the support of the Applicant, and (ii) the Applicant, as the majority creditor, had the majority in value of the creditors' voting rights. Accordingly, the judge held that Mr Parker entered into the debenture in order to enable him to appoint his own administrators and improve his prospects of influencing the insolvency process, which included the management and disposal of the Property and the handling of any complains concerning the conduct of the directors. As such, Mr Parker sought to obtain a collateral advantage over the Applicant. **[60]**

130. As to whether the purpose of the administration was likely to be achieved, the judge held:

> *'It is not self-evident that administration will achieve a better result for the creditors than liquidation if the Property is simply to be disposed of at a proper price taking into consideration all professional advice in connection with issues of marketing and the sale price.'* **[62]**

131. It will be recalled that the judge considered that an example of a good reason for making an order under Paragraph 81 was *'where there is something in the circumstances of the appointment which is likely to undermine the administration or interfere with the administrator in the proper performance of his duties',* **[55]**. This was clearly satisfied in this case. The very debenture under which the Joint Administrators had been appointed was susceptible to challenge under s.238 and s.239 of the IA. As such, there was a potential conflict of interest and duty. Furthermore, the Applicant was the majority creditor and there

was little prospect that the Joint Administrators proposals would be approved. Accordingly the Joint Administrators would need to make an application seeking relief under Paragraph 55 of Sch B1. However, in light of the stance taken by the Applicant, the administration was at an impasse. **[41] [64] [66]**

Commentary & Analysis

132. The value of this judgment to practitioners is that it provides useful guidance as to the approach taken by the courts in relation to an application under Paragraph 81. For instance, it explains (non-exhaustively) the type of factors the court will consider when deciding to grant an order under Paragraph 81. There is little authority on Paragraph 81, and so therefore any further guidance or clarification provided by the court is welcome.

PRE-PACK REFORMS – FURTHER SCRUTINY?

A Brief History

133. Pre-Packs have been upheld as legitimate in several cases.[20] They have attracted criticism, however, in circumstances where the sale back is to existing management and other connected parties, because of the 'apparent lack of transparency in the transaction'[21]. Those concerns were sought to be addressed in 2009 when the Insolvency Service issued a Statement of Insolvency Practice – SIP 16, the purpose of which was to set out basic principles, procedures and standards that were required to be met by officeholders in relation to pre-packs.

134. In 2014, the "Graham Review into Pre-pack Administration" (" **the Graham Review**") concluded *inter alia* that pre-packs are cheaper, preserve jobs and provide some benefit to the UK economy. However, in response to concerns regarding *inter alia* transparency and the consideration given to whether the new company was viable, the Graham Review set out six recommendations which were designed to increase transparency, increase returns to creditors and reduce the failure rate of pre-packed new companies, as well as improving the perception of pre-packs more generally.[22] Those recommendations were:

(1) **Pre-pack Pool**. On a voluntary basis, connected parties approach a 'pre-pack pool' before the sale and disclose details of the deal, for the pool member to opine on.
(2) **Viability Review**. On a voluntary basis, the connected party complete a 'viability review' on the new company.
(3) **SIP 16:** that the Joint Insolvency Committee considers, at the earliest opportunity, the redrafted SIP16 in Annex A.

[20] N19
[21] N18
[22] N18

(4) **Marketing:** that all marketing of businesses that pre-pack comply with six principles of good marketing and that any deviation from these principles be brought to creditors' attention.
(5) **Valuation**s: SIP16 be amended to the effect that valuations must be carried out by a valuer who holds professional indemnity insurance.
(6) **SIP 16**: that the Insolvency Service withdraws from monitoring SIP16 statements and that monitoring be picked up by the Recognised Professional Bodies.

135. The Graham Review also recommended introducing a reserve legislative power should the concerns raised about pre-packs continue. The recommendations above were adopted by the coalition government in the late stages of 2015. Moreover, s.129 of the Small Business and Enterprise Act inserted paragraph 60A into Schedule B1 which gave the Secretary of State power to impose restrictions, control, and conditions in relation to sales of company property to connected persons. Paragraph 60A(10) of Schedule B1 however provided that that power was to be exercised within 5 years of its creation and expired at the end of May 2020.

Review of Previous Reforms

136. On 8 October 2020, the Government published its report ("**the Report**") on the findings and recommendations following its review of the measures introduced in November 2015 by the Graham Review. The Report acknowledged that pre-packs are 'a valuable part of the insolvency landscape' by being a useful tool to rescue businesses, preserve jobs and value. All the more so during the Covid-19 pandemic.

137. However, whilst there has been some improvement (discussed below) concerns still abate about the transparency of pre-pack sales, and whether they are always in the best interests of creditors, particularly when the sale is to a connected person, which represents around half of all pre-pack sales. More topical concerns were raised also; during the parliamentary debates on the passage of the Corporate Insolvency and Governance Act 2020 ("**CIGA**") it was highlighted that there might be a significant increase in pre-packs during the pandemic to the detriment of creditors and that the ease of pre-packs may well undermine the rescue measures imposed by CIGA.

138. The Report concluded, *inter alia*, that:

(1) Over a third of the cases reviewed were sold for less than market valuation, which lent weight to the perception that pre-packs were not in the best interests of creditors, despite how the sale might have been the best offer on the table; **[7.1]**

(2) the 'comply or explain' approach in relation to marketing has shown that explanations sometimes lack detail; **[7.2]**

(3) the viability report which is required to be attached to the SIP16 statement has been unsuccessful. Only 28 % of 163 connected party pre-packs provided a statement. This was of concern given that in 72% of the connected party pre-packs there was an element of deferred consideration; **[7.2]**

(4) Of the cases reviewed, at least 1 in 5 of SIP 16 statement is non-compliant.

139. Overall, whilst the evidence indicated that there had been some positive impact as a result of the voluntary measures, the Report did not find convincing evidence that pre-pack reforms have changed behaviours sufficiently in line with expectations. Accordingly, the Report concluded that further regulation and use of the power in paragraph 60A of Schedule B1 was justified to ensure that pre-pack sales are subject to a measure of independent scrutiny.

140. The legal basis for doing so arises out of how s.8 of CIGA revived the power to impose legislative measures in paragraph 60A of Schedule B1 and replaced sub-paragraph 10 of the same with June 2021 as the date of expiry.

An Overview of the Proposed Legislative Reforms

141. The Report published draft regulations ("the Draft Regulation") which are intended to be laid before Parliament. The aims and objectives of the Draft Regulation is to:

(1) provide stakeholders with more assurance that a pre-pack sale is appropriate;

(2) improve transparency and creditor confidence in the pre-pack process;

(3) promote viable business rescue whilst balancing the rights of those affected by failure and will supposedly contribute to leading the country's economic recovery from Covid-19.

142. In summary, the Draft Regulations only apply to sales which take place within 8 weeks of a company entering administration. The Draft Regulations are not limited to pre-packs – they concern any substantial disposal of the company's assets within the 8 week period which begins when the company enters administration. The Draft Regulations will apply where there is a disposal in administration of all or a substantial part of a company's assets. An administrator will be unable to dispose of property of a company to a person connected with the company within the first 8 weeks of the administration without either **(i)** the approval of creditors or **(ii)** an independent written report. The connected party purchaser will be required to obtain the written report and the provider of it must be independent of the connected party purchaser, the company and the administrator and must meet certain eligibility requirements.

The Proposed Legislative Reforms – In Detail

Definitions

143. Draft Regulation 4 indicates that the Draft Regulations apply to a 'substantial disposal' by an administrator. Regulation 4 goes on to provide a definition of 'Substantial Disposal':

> "4.—(1) These Regulations apply to a substantial disposal by an administrator.
>
> (2) "Substantial disposal" means a disposal, hiring out or sale to one or more connected persons(a), during the period of 8 weeks beginning with the day on which the company enters administration, of what is, in the administrator's opinion, all or a substantial part of the company's business or assets.
>
> (3) A substantial disposal includes one which is effected by a series of transactions."

144. At Regulation 3 some key definitions are provided:

> "3. In these Regulations –
> "the Act" means the Insolvency Act 1986,
>
> "case made opinion" has the meaning given to it in regulation 8(3)(f)(i),
>
> "case not made opinion" has the meaning given to it in regulation 8(3)(f)(ii),
>
> "connected", for the purposes of regulation 7(b)(iii) and regulation 10(1)
>
> (otherwise than in the expression "connected person"), has the meaning given to it in section 249 of the Act,
>
> "evaluator" means the individual who makes the report,
>
> "relevant property" means the property being disposed of, hired out or sold by the substantial disposal,
>
> "report" means the report described in regulation 7,
>
> "Schedule B1" means Schedule B1 to the Act, and
>
> "substantial disposal" has the meaning given to it in regulation 4."

Making a Substantial Disposal with Creditor Approval – How?

145. Regulation 5 provides the conditions by which the administrator may make a substantial disposal, which as aforementioned, is either by obtaining creditor approval or where an independent report has been obtained.

146. By Regulation 6, creditor approval will be satisfied where: **(i)** the administrator seeks a decision from the company's creditors under paragraph 51(1) or paragraph 52(2) of Schedule B1 and; **(ii)** the creditors approve the administrators proposals without modification or with modifications which the administrator consents to.

Making a Substantial Disposal after obtaining an Independent Report

147. In terms of obtaining a report, by Regulation 7(b), the evaluator, i.e the person who provides the report, cannot be **(i)** the administrator; **(ii)** an associate of the administrator or **(iii)** connected with a company with which the administrator is connected.

148. Regulation 7 provides that an administrator will be able to make a substantial disposal if the connected person obtains a report which meets the requirements set out in Regulation 8.

149. By Regulation 8(1)(a)(b)(c) the report must meet the requirements as to qualification set out in Regulation 9, independence set out in Regulation 10 and must not be excluded from providing the report by Regulation 11. Taking each in turn. Regulation 9 provides that an individual meets the requirements as to qualification if the individual believes they have the requisite knowledge and experience to provide the report.

150. Regulation 10 provides, in respect of independence that:

> "10.—(1) An individual meets the requirements as to independence unless the individual—
>
> (a) is connected with the company,
>
> (b) is an associate of the connected person or connected with the connected person,
>
> (c) knows or has reason to believe that the individual has a conflict of interest with respect to the substantial disposal, or
>
> (d) has, within the 12 months before the date of the report, provided advice to, and in respect of, the company or a company connected with the company—
>
> (i) in connection with or in anticipation of the commencement of an insolvency procedure under Parts I to V of the Act, or
>
> (ii) in relation to corporate rescue or restructuring.
>
> (2) In this regulation "conflict of interest" means a financial or other interest which is likely to affect prejudicially the independence of the evaluator in providing the report.

(3) Nothing in this regulation is intended to limit the scope of an individual's obligation to comply with any professional or regulatory requirements to which that individual is subject."

151. In terms of being excluded from providing the report, Regulation 11 provides a long list of exclusions (which should be consulted in full) but provides that an individual will be excluded if:

(1) he has at any time been convicted of an offence involving dishonesty or deception in the UK or elsewhere and the conviction is not spent;

(2) the individual has at any time made a composition or arrangement with, or granted a trust deed for, the individual's creditors unless the individual has been discharged in respect of it;

(3) the individual has at any time been made bankrupt, and has not been discharged or has been made the subject of a bankruptcy restrictions order, unless that order has ceased to have effect or has been annulled;

(4) a moratorium period under a debt relief order applies in relation to the individual;

(5) a debt relief restrictions order is in force;

(6) the individual is subject to a disqualification order under section 1 of the Company Directors Disqualification Act 1986 or an undertaking thereto;

(7) the individual has at any time been— (i) removed from the office of charity trustee or trustee for a charity by an order made by the Charity Commission for England and Wales or the High Court on the grounds of any misconduct or mismanagement in the administration of the charity for which the individual was responsible or to which the individual was privy, or which the individual by the individual's conduct contributed to or facilitated, or (ii) removed under section 34 of the Charities and Trustee Investment (Scotland) Act 2005(c) (powers of the Court of Session) from being concerned in the management or control of any charity or body;

(8) (h) the individual is a patient within the meaning of section 329(1) of the Mental Health (Care and Treatment) (Scotland) Act 2003(d) or has had a guardian appointed under the Adults with Incapacity (Scotland) Act 2000(e), (i) the individual lacks capacity, within the meaning of the Mental Capacity Act 2005(f), to provide the report;

(9) or the individual has at any time been subject to any measures in another jurisdiction equivalent to those set out in sub-paragraphs (c) to (h) of the Draft Regulation.

What form should the report be in and what should it include?

152. The report must, by virtue of Regulation 8(2): be in writing (which includes electronic form) dated and authenticated by the evaluator. Moreover, the report must include a statement that the evaluator meets the requirements set out in paragraph 9, 10 and 11. Regulation 8(3)(b)-(h) provides:

> "8. […….]
>
> (b) state what knowledge and experience the evaluator has to provide the report,
>
> (c) identify the relevant property,
>
> (d) state the consideration to be provided for the relevant property,
>
> (e) identify the connected person and their connection to the company,
>
> (f) include a statement that either—
>
> (i) the evaluator is satisfied that the consideration to be provided for the relevant property and the grounds for the substantial disposal are reasonable in the circumstances (a "case made opinion"), or
>
> (ii) the evaluator is not satisfied that the consideration to be provided for the relevant property and the grounds for the substantial disposal are reasonable in the circumstances (a "case not made opinion"),
>
> (g) include the evaluator's principal reasons for making the statement in sub-paragraph (f)(i) or (f)(ii) above and a summary of the evidence relied upon, and
>
> (h) include a statement that there is sufficient evidence for the evaluator to provide the statement described in sub-paragraph (f)(i) or (f)(ii) above."

The administrator's obligations in relation to the report & notification requirements

153. Assuming the above is satisfied, the connected person, by virtue of Regulation 7(c) should provide the report to the administrator. Moreover, Regulation 7(d)-(g) establishes further requirements which an administrator should be satisfied of in relation to the report:

> 7. This regulation is satisfied if-
>
> […..]

(d) in the administrator's opinion, there have been no material changes since the date of the report to—

(i) the relevant property,
(ii) the terms of the substantial disposal, or
(iii) any circumstances relating to the substantial disposal,

(e) the administrator has considered the contents of the report,
(f) the administrator has no reason to believe that, on the date of the report, the evaluator did not meet the criteria in regulation 8(1), and
(g) the administrator has no reason to believe that, on the date of the report, the evaluator did not have the requisite knowledge and experience to provide the report.

154. Regulation 12 provides important notification requirements. Where an administrator has made a substantial disposal, he/she must send to every creditor of the company (apart from opted out creditors) of whose claim and address the administrator is aware: a copy of the report, excluding any information which in the administrators opinion is confidential or commercially sensitive, and must send to the registrar of companies a copy of the report, with the same exclusion referred to above, Regulation 12(2)(3).

155. Regulation 12 (2)(b) provides, curiously, that if the report contains a case not made opinion, i.e, the evaluator is not satisfied that the consideration to be provided are reasonable, then the administrator must set out his reasons in a statement for proceeding with the substantial disposal which must also be sent to the creditors and the registrar of companies.

156. The documents referred to above which are contained in Regulation 12(2) and (3) must be sent with and at the same time as the copy of the statement of proposals required to be sent to the registrar of companies and to creditors under paragraph 49(4) of Schedule B1.

Analysis & Commentary

157. By deciding to impose legislative restrictions on pre-packs, the government has clearly taken concerns in relation to pre-packs seriously. The proposed Draft Regulations clearly add an unprecedented layer of scrutiny. The positives are as follows:

(1) If utilised, the creditor approval route should address concerns regarding the transparency of pre-packs and the perception that creditors are kept in the dark until the sale has concluded. The Draft Regulations provide a clear mechanism, therefore, for creditors to become engaged in the process.[23]

[23] https://www.stewartslaw.com/news/does-new-pre-pack-administrations-rules-spells-good-news-for-creditors/ - date accessed 17 October 2020

(2) Even if the creditor approval route is not used, it may be of comfort to creditors, administrators, and company directors that an independent report has been obtained. For creditors, this is because it will add an element of objective and independent legitimacy to the process, which might reduce the perception that the deal was not in their interests. For administrators, this is because it might reduce the extent to which the administrator can be challenged or otherwise criticised from allowing the sale to go through. Similar reasons might apply to company directors. [24]

(3) If the independent report route is used, then the obvious place to go in terms of obtaining that report would be the pre-pack pool. This might address the issue of how the pre-pack pool is currently under- utilised.[25]

158. The negatives, however, are as follows:

(1) Directors may be less willing to obtain creditor approval and simply adopt the independent report route. Indeed, a director might not want to risk a creditor disagreeing with the proposed sale and so might just short circuit the process.[26] A director might also consider that in lieu of the time pressure involved, it would be quicker to obtain an independent report shortly in advance. This cuts against the prospect of creditors being engaged in the process.[27]

(2) Whilst it might be said that creditors will nonetheless take some comfort from the independent report, there are outstanding issues. The evaluator will (presumably) take his instruction from the connected party which raises obvious concerns as to the accuracy of whatever information the evaluator is provided with.[28]

(3) What is the requisite knowledge and experience? Without any clear guideline, there is a risk that the evaluator may not even be able to provide the best or the most informed view. In turn, reducing creditor and market confidence in the independent report route. Though the fact that the administrator must have no reason to believe that the evaluator did not have the requisite knowledge and experience to provide the report might provide a safeguard here.

(4) Others[29] have highlighted the challenge in finding a truly independent evaluator who is willing and able to provide a report quickly, which of course might pose a risk to whether the pre-pack can be completed on time. To that, the author would add, 'and expensive'. Which gives rise to other issues explored below.

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[24] N23
[25] https://www.kirkland.com/publications/kirkland-alert/2020/10/uk-reforms-of-prepackaged-administration-sales - date accessed 17 October 2020
[26] https://gateleyplc.com/insight/quick-reads/proposed-reform-to-pre-pack-sales-in-administration/ - date accessed 25 November 2020
[27] N23
[28] N23
[29] N23

(5) The costs of obtaining the report may add an extra layer of expense to the administration process.[30] If an administrator has to spend some time (and thus cost) in dealing with the report this will no doubt be felt by creditors.

(6) If an administrator can still sanction a substantial disposal in circumstances where the report contains a case not made opinion, then are we not likely to run into the same position as before, best stated by the Report?

> "However, our review has found that some connected party pre-packs are still a cause for concern for those affected by them and there is still the perception that they are not always in the best interests of creditors. The fact that evidence available indicates that over a third of the cases reviewed were sold for less than the market valuation lends weight to this perception, notwithstanding that in some cases the sale may have been the best offer on the table." (Emphasis added)"

(7) The counterpoint to (6) above is that an administrator may be less likely to proceed with the substantial disposal where the report contains a case not made opinion. Because, in such circumstances the administrator has to justify why that is in a statement. An administrator may feel that doing so leaves him/her open to challenge in the future and may simply find that the requirements to make a substantial disposal are not satisfied.

Non-legislative matters

159. The Report states that the government will work with the industry and the recognised professional bodies to prepare guidance to accompany the Draft Regulations and to ensure SIP16 is compatible with the legislation. The government will work with the regulators to ensure:

(1) there is greater adherence to the principles of marketing;
(2) where no marketing has been undertaken that this is fully explained by the administrator and any explanation probed by the regulator where necessary;
(3) there is a continued increase in compliance with the reporting requirements under SIP16; and
(4) it is understood why viability reports are not being completed and how this could be improved.

160. It should also be noted that should the above matters not be successful, the Report indicates it will consider whether supplementary legislation will be necessary.

[30] N23

Govinder Chambay
Guildhall Chambers
25 November 2020

Please Note

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