HUNTING OUT CONTINGENT DEBTS IN THE POST NORTEL WORLD – A CASE STUDY

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The Case Study

Background

Anniversary Celebrations Limited ("**the Company**") is a company registered in England and Wales. It offers a holistic events organisation service for private individuals and limited companies, catering for all manner of special events and celebrations. The Company is part of a group of companies, all held by a holdco. Other group companies include a property owning company, which owns the premises which the Company occupies ("**the Property Company**"). Another group company is a service company, which employs and is responsible for all the staff that work for the Company ("**the Service Company**").

The Company is a market leader in its sector, and always achieves strong peer reviews in Office and Associates and in Events 500. It has been in business for a substantial period of time, and has built up a lot of goodwill around its name. Unfortunately, however, the legacy of the credit crunch means, that the Company is currently going through some problems. On the advice of its accountant and its lawyers, it turns to the insolvency profession for help. You meet with the Company's director and chief executive, Mr Saltwater ("**the Director**").

Aggressive creditor pressure / risk of compulsory liquidation

The Director explains to you that, on the whole, the Company's creditors are understanding of its current predicament. The majority of them are prepared to grant the Company more time to settle outstanding accounts. A few, however, are adopting a more aggressive stance.

One in particular, Costumes for Comedy Limited ("**CFC**") has threatened winding-up proceedings and asserted an imminent intention to serve a statutory demand in respect of several unpaid invoices for the supply of fancy dress costumes. Although the invoices are large (they were pretty high-end fancy dress costumes), the Director is confident that, given a short period of time, the Company can raise the cash to pay off the debt.

CFC have a second string to their bow, however. In advance of a very large event which the Company organised in Dublin, Ireland, CFC supplied a large number of very valuable vintage historical costumes under a contract with the Company. The costumes have not been returned. Unfortunately, the Company forgot to put in place any insurance for the costumes. CFC are suing the Company in the Bristol Mercantile Court and have sought an interim injunction. CFC are so confident that they act on a CFA. CFC's over-zealous lawyers have filed a precedent H which envisages a total spend on legal costs of £500,000. CFC also intend to petition in respect of the Company's liability in respect of those matters. The Director is adamant that all the costumes will be returned in due course, and that this part of CFC's claim is entirely spurious. Surely it can just be ignored, can't it?

A CVA

Having managed to get rid of CFC, attention can now turn to the Director's key and non-negotiable objective, which is to save the business and to retain it within its current corporate structure. You conclude that, whatever solution is deployed for the Company, it cannot continue trading, at least without some form of insolvency protection. You mention a CVA. The Director confirms that the Company has a very good order book. It has a viable business, and were it not for the temporary cash flow problems that it is facing, it would be successful and profitable. It has informally sounded out several of its major creditors and it believes that they would support a CVA.

There is one small problem. Yesterday, the Property Company received a phonecall from the Environment Agency ("**EA**") which mentioned something about the Environmental Damage (Prevention and Remediation) Regulations 2009, SI 2009/153 and Part 2A of the Environmental Protection Act 1990 and a remediation notice. The Director doesn't really understand what it is all about, but in response to questions from you, he confirms that he thinks that, a while ago, there may have been an accidental spillage of some toxic substances which may have seeped into the groundwater. But as he points out to you, the Company doesn't own the buildings, and anyway, the letter is addressed to the Property Company, so surely this can just be quietly ignored?

In administration

In the end, and after some frantic negotiations with creditors, the CVA plan had to be mothballed. As a result, the Company went into administration under Schedule B1 of the Insolvency Act 1986 and the business was sold shortly after your appointment as administrator had taken place. You are currently holding the proceeds of sale of that realisation. After the sale took place, you are informed by a third party that the Company is the guarantor of a liability of the third party's principal, that the principal has now defaulted, and that as a result the third party is calling on the guarantee. Upon reviewing the same, you note that the guarantee does not contain a principal obligor clause as regards the Company. In other words, the Company's liability is secondary. Should the liability be treated as a provable debt, an expense, or neither?

Appendix I (extracts from the Insolvency Act 1986 and the Insolvency Rules 1986)

s.3(3) of the Insolvency Act 1986

"The persons to be summoned to a creditors' meeting under this section are every creditor of the company of whose claim and address the person summoning the meeting is aware."

s.123 of the Insolvency Act 1986

(1) A company is deemed unable to pay its debts ...

> (e) if it is proved to the satisfaction of the court that the company is unable to pay its debts as they fall due.

(2) A company is also deemed unable to pay its debts if it is proved to the satisfaction of the court that the value of the company's assets is less than the amount of its liabilities, taking into account its contingent and prospective liabilities.

rule 1.3(2) of the Insolvency Rules 1986

The following matters shall be stated, or otherwise dealt with, in the directors' proposal – ... (c) the nature and amount of the company's liabilities (so far as within the directors' immediate knowledge), the manner in which they are proposed to be met, modified, postponed or otherwise dealt with by means of the arrangement..."

rule 1.5(2) of the Insolvency Rules 1986

The statement shall comprise the following particulars (supplementing or amplifying, so far as is necessary for clarifying the state of the company's affairs, those already given in the directors' proposal) ... (d) the names and addresses of the company's unsecured creditors, with the amounts of their respective claims..."

rule 12.3 of the Insolvency Rules 1986

Provable debts

(1) Subject as follows, in administration, winding up and bankruptcy, all claims by creditors are provable as debts against the company or, as the case may be, the bankrupt, whether they are present or future, certain or contingent, ascertained or sounding only in damages...

rule 13.12 of the Insolvency Rules 1986

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

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

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

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

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

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

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

Appendix II – Eurosail in two paragraphs and Nortel in one paragraph

BNY Corporate Trustee Services Limited and Ors v Neuberger Berman Europe Ltd (on behalf of Sealink Funding Ltd) and Ors [2013] UKSC 28 (Per Lord Walker)

> "37. Despite the difference of form, the provisions of section 123(1) and (2) should in my view be seen, as the Government spokesman in the House of Lords indicated, as making little significant change in the law. The changes in form served, in my view, to underline that the "cash-flow" test is concerned, not simply with the petitioner's own presently-due debt, nor only with other presently-due debt owed by the company, but also with debts falling due from time to time in the reasonably near future. What is the reasonably near future, for this purpose, will depend on all the circumstances, but especially on the nature of the company's business. That is consistent with Bond Jewellers, Byblos Bank and Cheyne Finance. The express reference to assets and liabilities is in my view a practical recognition that once the court has to move beyond the reasonably near future (the length of which depends, again, on all the circumstances) any attempt to apply a cash-flow test will become completely speculative, and a comparison of present assets with present and future liabilities (discounted for contingencies and deferment) becomes the only sensible test. But it is still very far from an exact test, and the burden of proof must be on the party which asserts balance-sheet insolvency.

The omission from Condition 9(a)(iii) of the reference to proof "to the satisfaction of the court" cannot alter that.

38. Whether or not the test of balance-sheet insolvency is satisfied must depend on the available evidence as to the circumstances of the particular case. The circumstances of Eurosail's business, so far as it can be said to have a business at all, are quite unlike those of a company engaged in normal trading activities. There are no decisions to be made about choice of suppliers, stock levels, pricing policy, the raising of new capital, or other matters such as would constantly engage the attention of a trading company's board of directors. Instead Eurosail is (in Mr Moss's phrase) in a "closed system" with some resemblance to a life office which is no longer accepting new business. The only important management decision that could possibly be made would be to attempt to arrange new hedging cover in place of that which was lost when Lehman Brothers collapsed. To that extent Eurosail's present assets should be a better guide to its ability to meet its long-term liabilities than would be the case with a company actively engaged in trading. But against that, the three imponderable factors identified in para 9 above – currency movements, interest rates and the United Kingdom economy and housing market – are and always have been outside its control. Over the period of more than 30 years until the final redemption date in 2045, they are a matter of speculation rather than calculation and prediction on any scientific basis."

Nortel Networks (UK) Limited [2013] UKSC 52 (Per Lord Neuberger)

"85... by the date they went into administration, the group concerned included either a service company with a pension scheme, or an insufficiently resourced company with a pension scheme, and that had been the position for more than two years. Accordingly, the Target companies were precisely the type of entities who were intended to be rendered liable under the FSD regime. Given that the group in each case was in very serious financial difficulties at the time the Target companies went into administration, this point is particularly telling. In other words, the Target companies were not in the sunlight, free of the FSD regime, but were well inside the penumbra of the regime, even though they were not in the full shadow of the receipt of a FSD, let alone in the darkness of the receipt of a CN."

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