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Business Support & Insolvency

Summer 2021 Newsletter

What have we been up to?

Aside from our collective (but not wholly unexpected) disappointment that the lifting of the remaining Covid restrictions has been pushed back to 19 July, the team continue to advise on a wide range of insolvency related matters, amongst the recent highlights being:

- advising a recruitment consultancy specialising in the leisure and hospitality sector (and thereby significantly impacted by the pandemic) on the restructure of its business.
- assisting a number of our IP clients with complex section 236 applications against former directors and their associates, for an account of their dealings and production of company books and records.
- investigating the assignment by a debtor pre-bankruptcy of his interest in a proposed residential development site to an associated company.

In the news

Needless to say, the insolvency news headlines have remained very active over recent weeks, the most up to date major announcements being:

- the Government's **extension of business support measures** meaning that restrictions on statutory demands and winding up petitions will remain for a further three months until 30 September 2021; and
- the **letter from the Business Secretary, Kwasi Kwarteng, to the IoD and R3** stating that HMRC will take a "cautious approach to enforcement of debt owed to government" which has been accrued during the pandemic, including from the number of loans and support schemes given, but also that "a return to normal insolvency processes…will be vital to a return to a healthy and functioning economy".

In other news...

Unpacking the new pre-pack regulations

The Government has introduced new regulations, **The Administration (Restrictions on Disposal etc. to Connected Persons) Regulations 2021** which came into force on 30 April 2021, aimed at addressing criticisms levelled at the pre-pack process, including a perceived lack of transparency and accountability and the risk of disadvantaging creditors.

A brief summary of the new regulatory framework:

- The Regulations apply to all companies regardless of size.
- They apply where there is a proposed disposal of all or a substantial part of a company's business or assets.
- The administrator will be unable to complete a sale to a connected person within the first eight weeks of the administration without either:
  - the approval of creditors; or
  - an independent 'qualifying' report by an 'Evaluator'
- The primary focus of a pre-pack is an accelerated transaction designed to maximise asset values and business continuity. Under the new Regulations an administrator who wishes to seek the approval of creditors will need to refer to the intended sale within their proposals, sent within 8 weeks of their appointment.
- Given the timing constraints, administrators will only be able to seek creditor approval in this way if the circumstances allow for them to circulate their proposals promptly whilst they trade the business pending creditor approval, which adds the risks associated with trading a business with the possibility that creditors could reject the proposals.
- This means that in most cases, the proposed buyer will need to obtain a qualifying report from an Evaluator, who must have relevant knowledge, independence and professional indemnity insurance in place before acting. The written report must contain either a statement that 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 or that the Evaluator is not satisfied. The report must also set out the Evaluator's principal reasons and summarise the evidence they relied upon.
- It's the responsibility of the connected person to obtain the qualifying report, and they may obtain more than one report.
- An administrator must consider a report from an Evaluator.
- Where the administrator receives a negative report, they can still proceed with the disposal but will be required to provide a statement setting out the reasons for doing so.
- An administrator is required to send a copy of the report (or reports if more than one is obtained) to creditors and to Companies House at the same time as sending a copy of the statement of proposals.

Insolvency Service publishes monthly statistics for May 2021

The Insolvency Service has published its monthly insolvency statistics for May 2021. Total company insolvencies increased by 7% in May 2021 when compared to May 2020. There were a total of 1,011 company insolvencies in England and Wales, comprised of:

- 930 creditors' voluntary liquidations
- 31 compulsory liquidations
- 43 administrations; and
- 6 company voluntary arrangements
- 1 receivership

For personal insolvencies there was a 3% decrease in bankruptcies when compared with May 2020, with debt relief orders remaining at similar levels. Using a three-month rolling average, IVAs in May 2021 were 6% lower when compared to the average number of registered IVAs during each of the three months ending May 2020. The total numbers for May 2021 were:

- 718 bankruptcies (647 debtor applications and 71 creditor petitions)
- 1,525 DROs
- 7,393 IVAs (using a 3 month rolling average)

Insolvency in a Post-Brexit World

Prior to 1 January 2021, recognition and enforcement of restructuring and insolvency procedures and judgments between the UK and EU Member States was subject to common EU regulations which had direct effect and broadly offered automatic recognition. As from 1 January 2021 the reciprocal, automatic recognition frameworks are no more, which will likely result in delay, higher costs and parallel proceedings in multiple jurisdictions.

Following Brexit, the UK applied to accede to the Lugano Convention as an independent member, since it had left the EU. The success of the UK's application is dependent on the agreement of all signatories, and while European Free Trade Association (EFTA) member states have all supported the UK's application, the European Commission has indicated that it is opposed to the UK's ascension. However this is not final - any decision to invite the UK to join the Lugano Convention would need to be taken by a qualified majority of the European Council. It now appears that discussions have stalled and the UK will remain excluded from the Lugano Convention until a formal decision is made. Pressure is currently being brought to bear on EU member states and the European Parliament to prompt the European Commission to make a formal proposal which will be voted on by the European Council.

Whilst the UNCITRAL Model Law on Cross-Border Insolvency, the Hague Convention, the Rome convention and certain bilateral treaties will offer help in some instances, the legal position is for now, and possibly the foreseeable future, undoubtedly more complex.

In an attempt to 'pour oil on troubled waters' the Insolvency Service published on 24 March 2021 a guide entitled "Cross-Border Insolvencies: Recognition and Enforcement in EU Member States".

The purpose of the guide is to assist insolvency practitioners by providing a high level summary of the relevant domestic recognition regimes applicable in each of the EU27 jurisdictions and also describes how a UK insolvency officeholder might seek recognition and deal with assets in each jurisdiction.

A copy of the guide is available **here**

New powers to tackle unfit directors of dissolved companies

The Insolvency Service will be given powers to investigate directors of companies that have been dissolved, closing a legal loophole and acting as a strong deterrent against the misuse of the dissolution process. The Insolvency Service currently only has powers to investigate live companies or those entering a form of insolvency.

In addition, like in the case of live companies or those entering a form of insolvency, directors of dissolved companies may be disqualified from acting as a company director for up to 15 years. These powers will be exercised by the Insolvency Service on behalf of the Business Secretary.

Dissolving companies has been a method used by unscrupulous directors to fraudulently avoid repayment of Government backed loans given to businesses to support them during the Coronavirus pandemic.

The measures included in the Directors Disqualification (Dissolved Companies) Bill are to be applied retrospectively which will enable the Insolvency Service to tackle directors who have inappropriately dissolved their companies while at the same time benefitting from bounce back Government Loans.

The legislation will cover England, Scotland, Wales and Northern Ireland.

Cases that have caught our eye

Landlords fail in their bid to force the return of nominee's fees, and to establish a meaningful precedent in their ongoing fight against CVAs

Re Regis UK Ltd; Carraway Guildford (Nominee A) Ltd and others v Regis UK Ltd and others [2021] EWHC 1294 (Ch)

The court revoked the CVA for Regis on the basis that the arrangement's treatment of one creditor was unfairly prejudicial to the landlords.

For the same reasons as *Lazari Properties 2 Limited and others v New look Retailers Limited, Butters and another [2021] EWHC 1209 (Ch),* every ground of challenge was rejected by the High Court, save for the argument raised around the treatment of one creditor as critical.

Applying a long-established test of fairness, the court considered whether the treatment of two creditors as critical creditors whilst others were impaired was justified. In the first case, it considered that the treatment was justified and in the second that it was not, speculating that the parent company would be supported by its ultimate shareholder who stood to gain from the CVA. As such the CVA was deemed unfairly prejudicial to landlords by treating one creditor as critical.

No orders were made against the former nominee/supervisors in relation to the claim for repayment of fees despite a finding of breach of duty on one ground as the Court held that it was not appropriate, in the absence of bad faith or fraud which were not suggested in the case.

Foreign insolvency proceedings and the enforceability of European judgments under Brussels I

Windhorst v Levy [2021] EWHC 1168 (QB)

The appellant, Mr Windhorst, was a German businessman. In 2003, a German court entered judgment against him. Between 2005 and 2007, Mr Windhorst was subject to an insolvency plan (an individual insolvency process approved by the court) in Germany. The judgment creditor, Mr Levy, accepted at the time that he was bound by the insolvency plan. Under German procedural law, an insolvency plan did not automatically render a prior judgment unenforceable. A judgment debtor needed to apply for a declaration of unenforceability.

In April 2019, Mr Windhorst made such an application in respect of the 2003 Judgment. Mr Levy resisted this on the basis that the waiver under the insolvency plan had been rescinded by Mr Windhorst's subsequent acknowledgments of the debt and part payments.

The judge concluded that it was not necessary for her to resolve this issue concerning enforceability under Brussels I as it was common ground between the parties that the judgment remained formally enforceable under German procedural law in the absence of a successful application by the judgment debtor. This was a complete answer to the question because the test was one of formal enforceability in the country in which judgment was given.

The judge did not consider that the insolvency plan had any relevant impact on the position. There was nothing in Brussels I or the Insolvency Regulation that would require a stay of enforcement.

Costs following unsuccessful challenge to administrators' conduct

Hyde and another (as joint liquidators of One Blackfriars Ltd) v Nygate and another [2021] EWHC 1150 (Ch)

The issues before the court included (i) what costs order to make in relation to an application for security for costs (resolved by consent on the morning of the pre-trial review) (ii) whether to order costs on the indemnity basis and (iii) the quantum of the interim payment prior to detailed assessment.

The court decided on issue (i) that the former administrators had been justified in making their security application, even though the dispute turned on one clause in the ATE policy. On point (ii) it was held to be appropriate to make a limited order for costs to be assessed on the indemnity basis, in so far as it related to the evidence and conduct of the liquidators' expert (which was 'so unreasonable to a sufficiently serious degree to justify an indemnity costs order') and the former administrators' costs of dealing with part of the sales and marketing allegations, which flowed from an amendment to the liquidators' case. As for point (iii) payment on account of costs was ordered at £6.5m (72% of the total sought).

The judgment is of practical importance, as it includes a useful summary of the principles that apply to the imposition of indemnity costs, especially in circumstances where the result of the case hinges on the cross-examination of an expert witness and the consequences that flow from that.

Cross-Border Insolvency Regulations 2006 - recognition of Ukrainian bank liquidation

Re PJSC Bank Finance and Credit (in liquidation) Groshova (in her capacity as authorised officer of the Deposit Guarantee Fund of Ukraine in respect of the liquidation of PJSC Bank Finance and Credit) v Deposit Guarantee Fund of Ukraine [2021] EWHC 1100 (Ch)

In reaching its decision the court carried out a meticulous and methodical review of the requirements for recognition as set out in the Cross-Border Insolvency Regulations 2006.

One of the key considerations for the court was to consider whether the bank's liquidation was a judicial or administrative proceeding subject to the control of a foreign court. It was held that there was no requirement that foreign proceedings actually needed to be managed or controlled by a foreign court but they did at least need to be managed by a non-judicial administrative body that was capable of administering the proceedings.

After careful consideration of the facts the court granted the recognition sought.

Meaning of 'associate' - interpretation of a 'person connected with the company' in a preference claim

Darty Holdings SAS (as successor to Kesa International Ltd) v Carton-Kelly (as liquidator of CGL Realisations Ltd (in liquidation) [2021] EWHC 1018 (Ch)

The court held that there was nothing in the wording section 435 IA 1986 which required the court to interpret the meaning of 'associate' differently in cases where the alleged preferential payment was part of a wider transaction to sell the entire shareholding and sever the connection between the associated parties.

CGL Realisations Ltd (formerly Comet Group Ltd) ('Comet') went into administration in 2012 and a year later it was placed into liquidation. Comet was connected to Darty Holdings SAS (as successor to Kesa International Ltd) ('KIL') and operated a revolving credit plan granted to it by KIL. Kesa Holdings Limited ('KHL') owned the entire shareholding in Comet and entered into a detailed share purchase agreement ('SPA') to sell its shares in Comet. In addition to the SPA there was a Completion Agreement ('CA') in respect of which Comet was a party. On completion of the sale Comet repaid the monies owing under the KIL revolving credit facility. It was agreed by the parties that KIL was associated to KHL through the intermediate companies and that KIL would therefore be associated to Comet pursuant to section 435, in the event that KHL was associated to Comet at the relevant time.

The preference claim made by the Liquidator against KIL arose from what the liquidator asserted was a preference given to KIL as a connected party, by reason of the repayment by Comet of the KIL revolving credit facility, which arose out of the sale process entered into by KHL.

The court stated that the *"liquidator submits, first, that by the CA the parties agreed that payment of the three Tranches defined in the SPA was to occur at the Pre-Completion Time, and, secondly, that under the terms of the SPA, confirmed by the minutes of the meeting of the Company held on 3 February 2012, registration of the transfer of the shares in the Company occurred no earlier than Completion" and that "KIL does not take issue with the second of these contentions but submits that the payments…could not have occurred before Completion."*

Concluding its judgment, the court held that *"as a matter of interpretation of the CA, there is no reason for supposing that the payments and other steps set out in clauses 4 to 7 could not take place at the Pre-Completion Time. As I have said there is no evidence other than the transactional documents about the timing of events on 3 February 2021…and see no reason for thinking that, having just entered into the CA, the parties would have departed from the sequence set out in the CA. It follows that the impugned payments were made before Completion."*

The case is a reminder to practitioners that you cannot assume that the fact that the alleged preference is part of a process to sever the connection will lead the court to apply a different approach in construing the relevant contractual terms. When a party is receiving a payment from another party as part of a wider transaction, the key concern for the court will be the actual relationship between those two parties, rather than the wider transaction and even when a connection is about to be severed, the court will focus on the connection between the relevant parties at the time any payment is made.

And Finally...

We've had some changes in the team since our last newsletter.

Becky Nicholson has moved on to pastures new, however **Darryn Harris** joined us in March 2021, having spent a year in our Dispute Resolution team assisting on property disputes, and having cut his teeth in the insolvency world whilst working for the Insolvency Service in London.

We are also delighted that **Ollie Fitzpatrick** became a partner of the firm as of 1 April 2021 - even more so since the pubs re-opened as he can get the drinks in!!

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