Technical Bulletin

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97.1 Invalid Administration Appointments – Further High Court Decisions

- Three recent High Court decisions have considered out of court appointments of administrators by the directors of a company which were potentially invalid.
- In some of the cases, the court, exercising powers under Paragraph 13 of Schedule B1 of the Insolvency Act 1986, made an administration order with retrospective effect.
- The court was not prepared to make a retrospective order where the “threshold conditions” pertaining to solvency and statutory purpose could not be satisfied either on the date the order would have been made or the date on which it would otherwise become effective.

In ***Derfshaw Limited & 6 Others***[1] the High Court considered an application for directions in respect of seven recent administration appointments where the directors in each case failed to send notice of intention to appoint an administrator to their respective companies (as the Chancellor held would be necessary - see the decision in *Minmar* (see Technical Bulletin 96 at 96.2)).

All seven companies satisfied the criteria required for an administration order - the likelihood of achieving the statutory purpose and the solvency test (as set out in paragraph 11 of Schedule B1).

In following the decision in *Minmar*, Mr Justice Morgan accepted that where administration appointments were invalidated by the absence of the mandatory service of the prescribed notices upon a company, a practical solution was to accept that the initial appointment was invalid and to make an application for a court appointment, effectively starting again. The Judge noted that significant steps had been taken by administrators and it would be unfortunate if the result of following *Minmar* was that those steps were not validly taken. If the court had power to do so, the proper response to the difficulty would be to make the administration orders retrospectively to the moment when the purported appointments out of court were intended to take effect. The question was, did the court have power to make an administration order retrospectively?

Mr Justice Morgan referred to the decision in *G-Tech Construction Limited* where the court had made such an order. Counsel informed him that similar orders had been made in several cases since *G Tech*. He noted that it is quite a significant thing to make an administration order with retrospective effect and that ideally clearer statutory language than that used in paragraph 13 of Schedule B1 would provide for it. However, in the case before him the desirability of making retrospective orders was considerable and as there was authority for such orders, he was prepared to make them. He also held that any such orders would effectively ratify the previous actions of the administrators, and therefore acknowledged the possibility for ancillary orders in respect of associated office holder fees and expenses.

[1] [2011] EWCH 1565 (Ch)

Re Care Matters Partnership Limited[2], also concerned an invalid out of court appointment. The High Court held that the paragraph 11 of Schedule B1 *"threshold conditions"* could not be satisfied on the date that the court would otherwise be making the order (namely that the company is or is likely to become insolvent and is reasonably likely to achieve the purpose of administration) and therefore refused to make an administration order with retrospective effect.

This was further complicated by the fact that the initial office-holder (appointed out of court), had been replaced by a court appointed administrator. Any retrospective order would have had to take into account both the initial appointment and subsequent court order, which was viewed as unnecessary and ultra vires the court's powers under paragraph 13 of Schedule B1.

Norris J reasoned that whilst the statutory purposes could have been seen as achievable objectives as at the date that the initial, defective appointment was purportedly made, this could no longer be said to be the case due to actual occurrences during the administration. The level of realisations in the case had been significantly lower than expected and were far exceeded by the initial administrator's time costs. He expressed doubt as to whether the administration had actually achieved anything and was reluctant to grant a retrospective order where the only effect would be to pay part of the initial office-holder's fees.

In contrast to Hart J in *G-Tech*, Norris J opined that where an appointment was defective due to procedural irregularity (as opposed to lack of standing on the part of the appointor), the actions taken by the purported appointees might be ratified by the court under a general power conferred under paragraph 104, Sch B1. However the question of the court's jurisdiction under paragraph 104 was not argued before him and he concluded that the only proper course for him to take was to accept that the only answer in this case, if the purpose of administration could have been achieved, would have been pursuant to *G-Tech Construction*

In ***Adjei and others v Law For All***[3], Norris J handed down a judgement on 19 October 2011, in which it was deemed appropriate that a retrospective administration order should be made.

The case involved an out of court administration appointment that was invalid as a result of defects in both the drafting of the appointment documents (notice of intention to appoint) and service of the documents upon all of the prescribed recipients.

Norris J held that it would be appropriate in this case for the order being sought to take effect from the original appointment date. This was due to the fact that there had been no material difference with regard to the solvency of the company or the likelihood of achieving the statutory purpose of the administration between the original appointment date and that on which the order would be made.

[2] [2011] EWHC 2543 (Ch)
[3] [2011] All ER (D) 154 (Oct)

The court declined to make a costs order in respect of the directors' legal fees in connection to the case. The directors were viewed as being at fault for the errors in relation to the invalid appointment and the court did not see why creditor funds should be depleted to enable the directors to receive the *'first fruits of the administration by way of reimbursement of the expenses of their corrective action'.*

Comment

These recent High Court decisions highlight the difficulties that can arise when considering the correct course of action for an office-holder in the case of a defective out of court appointment. The courts appear to have adopted a cautious approach when asked to exercise their discretionary power to make a retrospective administration order.

It is apparent from comments by the High Court in each of these recent cases that there is some uncertainty as to the principles in *Minmar* and *G-Tech* (retrospective orders under para 13 Sch. B1) and that clarification from the appellate courts would be desirable. Norris J in the closing paragraph of his judgement in Care Matters stated *'Without hesitation I give permission to appeal. My respectful view is that both the issues surrounding the validity of appointments arising from Minmar and the apparent solution afforded by G-Tech Construction are in need of definitive determination in a case fully argued on both sides'*.

The full texts of the *Derfshaw* and *Re Care Matters* judgments are available on the British and Irish Legal Information Institute web site at:

http://www.bailii.org/ew/cases/EWHC/Ch/2011/1565.pdf

http://www.bailii.org/ew/cases/EWHC/Ch/2011/2543.html

97.2 Transfers of Undertakings – Automatic Transfer Mechanism Deemed to Apply in the case of Pre-pack Sales

- The Employment Appeal Tribunal ('EAT') held that following the completion of a pre-pack sale and subsequent dismissal of an employee by the transferee, the transferee and not the Secretary of State was responsible for payment of the basic unfair dismissal award and notice pay liability.
- The EAT emphasised the distinction between liabilities '*payable before the transfer*' and those incurred at a later date, to determine whether transferor or transferee was accountable. This would establish whether or not any part of the liability would be payable by the Secretary of State on behalf of the insolvent company.

The EAT in *Pressure Coolers Limited v Molloy & Others [2011] UKEAT 0272_10_0906*, considered the TUPE Regulations 2006 and the application of their provisions in the case of an administration involving a pre-pack sale of business and assets.

Maestro International Limited (‘Maestro’) got into financial difficulties and agreed to sell its business and assets to Pressure Coolers Limited (‘PCL’). It was agreed that PCL would acquire the business by way of a pre-pack sale in an administration. The sale of the business was completed on the same day as the appointment of the administrator.

Mr Molloy was one of several employees who passed over to PCL. There had been no consultation by Maestro with Mr Molloy or any of his colleagues concerning the proposed sale of the business. Although, shortly before transfer, it was proposed that the administrator would send letters to the employees which the purchaser had identified it would not require, such letters were not, in fact, sent before the sale was completed. Consequently, Mr Molly was first informed by PCL shortly after completion of the sale agreement that he was being made redundant. At some point after completion of the sale agreement, letters were sent to those employees made redundant to inform them of the fact and to assert that it had been the act of the administrator.

The Employment Tribunal held that there had been a TUPE transfer, that according to the sequence of events, Mr Molloy's employment had been transferred to PCL and that he had been unfairly dismissed. After various procedural complications, the question which came before the EAT was whether Mr Molloy’s claim should be paid by the Secretary of State or by PCL.

The argument that it should be paid by the Secretary of State was based on Regulation 8(3) of TUPE 2006, which provides that in the case an employee whose contract transfers to the transferee, the scheme under which the Secretary of State will meet the claim will apply irrespective of the fact that the qualifying condition that the employee’s employment has been terminated has not been met, and that the date of transfer shall be treated as the date of termination.

The EAT rejected this argument. It was important to bear in mind that TUPE was intended to give effect to Council Directive 2001/23/EC (‘the Acquired Rights Directive’), Article 5.2(a) of which makes it clear that relief of the kind implemented by Regulation 8(3) of TUPE applies to debts arising before the transfer. The purpose of the deeming provisions in Regulation 8(3) was to enable transferring employees to avail themselves of the Secretary of State guarantee in circumstances where, at the date of transfer, there would otherwise have been no termination of their employment.

In the present case this did not apply. Mr Molloy was dismissed after the transfer by PCL, and therefore PCL, and not the Secretary of State, was liable to pay the claim.

Legal commentary following this decision has suggested that it is inconsistent with promotion of a ‘rescue culture’, which was the rationale behind the 2006 revisions to TUPE. It is uncertain whether the drafting inadequacies of the 2006 revisions which have led to significant difficulties, tribunal and court decisions will be addressed by the anticipated employment law reforms by the coalition government.

As things currently stand, in the case of an intended transfer of a business, the timing of any potential dismissals would appear to be of paramount importance in any discussion between the insolvency practitioner and the purchaser.

The full text of the judgment is available on the EAT web site at:

http://www.employmentappeals.gov.uk/Public/Upload/10_027204790480rjfhSBRN.doc

97.3 Liquidation – Guidance on Prohibited Names

- The Scottish Court of Session held that all circumstances pertaining to the respective companies must be considered in context when determining whether a company designation is a 'prohibited name', for the purposes of sections 216 and 217 Insolvency Act 1986,

The Outer House in *Advocate General for Scotland v Reilly [2011] CSOH 141* held that the context of all the circumstances pertaining to the insolvent and new companies must be considered in determining culpability under sections 216 and 217, as opposed to a mere analysis of the words used in their respective names.

The company in liquidation was Aqua Seal IT Limited and the new entity was Aquaseal UK Limited. A noteworthy segment of Lord Bannatyne's judgment referred to the wording of section 216, '*…so similar…as to suggest an association…*' and that the court's determination should '*make the comparison in the context of all the circumstances in which they were used…*'.

Not only were the names very similar, but the two companies performed similar types of work (a particular type of roof coating services), in similar geographical areas (the same city, albeit different towns).

There are also obiter comments referring to evidence suggesting that the directors had taken deliberate steps to transfer assets to a successor entity or diminishing residual assets, and the fact that there were insufficient funds to allow a distribution to any class of creditor.

An implication that can be drawn from the judgement is that in the absence of sufficiently similar "other factors", the mere use of a similar word in the names of the insolvent and new companies alone, may not be construed as use of a prohibited name.

The full text of the judgment is available on the British and Irish Legal Information Institute web site at:

http://www.bailii.org/scot/cases/ScotCS/2011/2011CSOH141.html

97.4 Email Exchange Capable of Creating a Binding Contract

- The High Court recognised the potential for email exchanges to satisfy the formalities required to create a binding contract between the respective parties.
- Where parties inserted their respective names at the end of their email exchange, this could be sufficient to constitute a 'signed' document, even when applied to a disposition of an interest in land.

In Green (Liquidator of Stealth Construction Limited) v Ireland [2011] EWHC 1305 (Ch) the High Court considered the potential for an exchange of emails to create an enforceable right to a grant of a second charge over company property.

The case involved a loan from Mrs Ireland to Stealth Construction Limited for the purchase and development of a property, on the understanding that a second charge would be granted in her favour (the bank which was lending the majority of the purchase consideration was to have priority). The only written evidence of the agreement was an email exchange between her and her sister (who was a director of the company).

Funds changed hands and the purchase completed several months later, however, the requisite steps to formalise the grant of a change were not taken at the time and Mrs Ireland did not take steps to follow up on the matter as she was suffering from a long-term illness. When the loan and interest fell due in October 2008 and the company was unable to make the repayment due to cash-flow issues, Mrs Ireland discovered that the charge was not in place. She demanded that the position be remedied and the company obliged.

A winding-up petition was eventually issued against the company which precipitated the appointment of fixed charge receivers over the company's various properties. Following the sale of the property and repayment of the first charge-holder's secured debt, Mrs Ireland was paid a net surplus of £130,414. The liquidator of the company sought to set aside the charge as a preference to a connected party.

On the facts of the case, the court held that a binding agreement had not been created due to the fact that the email chain did not incorporate all the terms of the agreement and also referred to a further document to be prepared at a later date. The potential for a binding agreement being created by the email exchange however, was acknowledged by the court, and has been described in subsequent legal commentary as '*one more in a trend towards the judicial recognition in England of electronic contracts*'.

97.5 The Pensions Regulator and Contribution Notices – the Bonas Case

- Judicial examination of the first instance that the Pensions Regulator has used its 'moral hazard' or anti-avoidance powers.
- In the case of an insolvent company, the amount specified by a Contribution Notice must be compensatory, not punitive in nature. They should be reasonable, reflecting the amount of the section 75 debt which the employer has been prevented from paying into scheme as a result of the actions of the target entity.

The Pensions Act 2004 conferred anti-avoidance powers upon the Pensions Regulator ("the Regulator") in the form of the contribution notices ("CNs") and financial support directions ("FSDs") regimes. Under section 38, the Regulator has the power to issue a CN which effectively ordered a party or its associate to make a payment when there has been a deliberate act or omission preventing the recovery of a debt due from an employer to its pension scheme.

The Bonas Case[4], concerned a strike-out application in respect of a CN issued against a Belgium based parent company, Michel Van de Wiele NV ("MVdW") for its involvement in the sale of the business of its wholly owned subsidiary company, Bonas Machine Company Limited ("Bonas"), to another of its subsidiaries.

Facts of the case

Bonas was acquired by MVdW in 1998 and had traded at a loss from that date until 2006 when it entered into administration. It had survived by virtue of MVdW's continual financial support. MVdW had no legal obligation to provide financial support or to meet Bonas' pension liabilities.

In May 2006, Bonas' defined benefit pension scheme trustees issued a draft actuarial valuation showing deficit on an ongoing basis of £7.7m and a section 75 deficit[5] of over £23m. The payments required to repair the deficit would be in excess of £725,000 per annum over a 15 year period. Bonas could not afford to make the payments and MVdW withdrew their financial support.

Bonas entered into a "pre-pack" administration in December 2006 which included sale of its business to a newly-formed MVdW subsidiary for £40,000.

Prior to the sale, MVdW had been advised of potential risk of the Pensions Regulator using its moral hazard powers if the sale went ahead and that a negotiated settlement was likely to be in excess of £8m. Neither the scheme trustees nor the Regulator were consulted about the pre-pack sale. The sale was deemed by the Regulator to have been a calculated attempt to prevent recovery to the Bonas Group Pension Scheme and that WVdW had acted with the purpose of avoiding liabilities in relation to obtaining clearance from the Regulator to proceed with the pre-pack sale.

The scheme trustees and Pension Protection Fund had submitted a proof for the full section 75 deficit of £23m, and received a dividend of c£1.272m. The section 75 shortfall was in the region of £21m. The Regulator sought to invoke its anti-avoidance powers, by issuing its first ever CN for the £21m shortfall as they believed WVdW had taken a tactical decision by not seeking approval of the pre-pack sale so they could effectively retain the Bonas business for a small sum, whilst leaving behind the pensions liability.

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[4] *Michel Van de Wiele NV v The Pensions Regulator [2011] UKUT B3 (FS) (17 January 2011)*

[5] As defined in s75 of the Pensions Act 1995

After hearing representations from both sides, the Determinations Panel upheld the Regulator‘s case and determined to issue a CN in the amount of £5.089m. WVdW referred the Panel’s decision to the Upper Tribunal (Tax and Chancery) Chamber, asking for the Regulator‘s case to be stuck out. The Regulator sought to increase the CN amount to £21m and to add a Bonas director to proceedings for the part he played in the sale.

Tribunal Decision

Warren J considered the meaning of section 38 Pensions Act 2004 in detail and made it clear that in his view, the amount that could be demanded by the Regulator by way of CN ought to be compensatory, not punitive in nature.

He saw some merit in the submissions on behalf of the Regulator and therefore allowed the case to continue, rejecting both MVdW’s strike out application and the Regulator’s application to revive its case against the Bonas director. Warren J expressed strong reservations as to the amounts being demanded and the basis used in assessing the CN amount which had previously been determined.

He opined that a more suitable amount would be one which compensated the scheme for the ‘*undervalue*’ as a result of the pre-pack sale which was ‘*for a value at the lower end of a range of acceptable values to the disadvantage of the pension scheme creditor*’. Whilst conceding that an examination of the issues at full trial was required, he intimated that the amount demanded in the CN should be for the difference between the market value and purchase price paid for the business. The evidence before the tribunal suggested that the maximum value that the business could have been sold for was £100,000 and the consideration paid by the WVdW subsidiary was £40,000.

The parties decided to settle the issue, thus dispensing with the need for a full trial and therefore also dispensed with the opportunity to obtain judicial guidance as to the operation of the CN regime under section 38 Pensions Act 2004. The Regulator eventually issued a revised contribution notice in the amount of £60,000.

In June 2011, the Regulator issued a report regarding the Bonas case under section 89 of the Pensions Act 2004 disputing any suggestion that that the scope of a CN is limited to compensation for detriment caused to a scheme by a target’s conduct. In their opinion, there is potential for the obiter dicta comments in the Bonas case to be misunderstood. They went on to state that Warren J’s comments were not intended to restrict the Regulator in respect of existing or future cases and that going forward, they will seek to use their ‘*moral hazard powers in a reasonable manner wherever appropriate*’.

The full text of the judgment is available on the British and Irish Legal Information Institute web site at:

http://www.bailii.org/uk/cases/UKUT/TCC/2011/B3.pdf

97.6 IVA – Court of Appeal Guidance on Material Irregularity

- The Court of Appeal held that an undisputed assignee of a debt would have an entitlement to vote at an IVA creditors meeting.
- They also considered the function of the chairman at meetings and meaning of “material irregularity” for the purposes of section 262 Insolvency Act 1986. It was confirmed that a breach of duty of good faith owed by a debtor to his creditors could provide grounds for the approval of an IVA to be revoked.

In *Kapoor v National Westminster Bank Plc & Anor [2011] EWCA Civ 1083* the Court of Appeal provided clarification with regard to voting rights where a debt had been assigned and also in respect of the law governing the “prescribed procedural matters” at a creditors meeting. The debtor was appealing a High Court decision to revoke the approval of his IVA on the grounds of a material regularity in relation to the assignment of an associate’s debt (original decision reported in Technical Bulletin 95 at 95.3).

The Court of Appeal upheld the High Court decision to revoke the approval of Mr Kapoor’s IVA. They disapproved of the initial judgment in relation to the voting rights of an equitable assignee of part of a legal debt, ruling that the undisputed assignee would be entitled vote at creditors meeting. The role of the chairman at a creditors meeting was also discussed by the court which held that where there has been an objection to a party voting at the meeting, the correct procedure is to allow that person to vote for an appropriate amount whilst noting that an objection had been made. The chairman has no discretion or entitlement to ignore a vote unless a breach of the Rules or Act had occurred.

On the facts of this case however, where the assignment of a debt of an associate company was ‘…*patently and irrefutably designed to subvert the legislative policy underlying that provision*…’ (Rule 5.23(4)), the vote of the assignee should have been excluded. It was held that a debtor owed a duty of good faith and transparency to his creditors and this was breached by the assignment to circumvent the rules in relation to the requisite majority voting for the approval of an IVA. The material irregularity was the treatment of the debtor’s IVA as passed when there were insufficient non-associated votes in favour of approving the arrangement. The decision to revoke the approval of Mr Kapoor’s IVA was deemed as correct and therefore the appeal was dismissed.

97.7 Distributions of Capital Outside Formal Winding Up – Withdrawal of Treasury Solicitor’s Concession on Bona Vacantia

- The Treasury Solicitor has withdrawn the concession waiving the Crown’s right to claim funds distributed outside formal winding up as bona vacantia where the amount of the distribution is less than £4,000.

With effect from 14 October 2011, the Treasury Solicitor has withdrawn the concession that allows informal dissolution and distribution of capital up to £4,000 without a formal winding up or reduction of capital (see Technical Bulletins 78.4 and 83.4).

The reason given for the withdrawal is that the implementation of the Companies Act 2006 has made it easier to reduce a company's share capital, so the concession is now 'less relevant' (sic).

Generally speaking, a company may only make a return of capital to shareholders –

- by a reduction of share capital
- where the company redeems or purchases its own shares, or
- where there is a distribution of assets to members in a winding up.

Otherwise, distributions must be made out of profits.[6]

Under section 641 of the Companies Act 2006 a private company may effect a reduction of its share capital by special resolution supported by a solvency statement made by the directors.

In view of the withdrawal of the concession it is clearly important to ensure that any distribution of capital is made strictly in accordance with the statutory provisions.

The withdrawal has no effect on HMRC ESC C16, which will eventually be replaced by an equivalent statutory provision.

97.8 Provision of Services Regulations 2009 – Information to be Made Available by Service Providers to their Recipients Prior to Engagement

- Incorporation of the EU Services Directive into UK law places a strict requirement for information pertaining to a proposed appointee and their firm to be provided to the recipient of their services

The Provision of Services Regulations 2009[7] have imposed a mandatory minimum in respect of information that service providers must make available to the recipients of their services. If the services to be provided fall within the definition in Regulation 8(1), information pertaining to the service provider and their complaints procedures must be accessible to the intended recipient, to enable them to make an informed judgment when deciding whether or not to instruct the firm. Further obligations fall upon the service provider if additional information is requested by the recipient or where any disputes arise.

The information that must be available includes the firms full name, legal status and form, address and contact details, VAT number (where applicable), general terms and conditions, details of after-sales guarantees, pricing details and information pertaining to the firm's professional liability cover (including the name and address of PII providers). Further information must be made available if the business of the provider is regulated by a professional body or requires entry on a public register or authorisation scheme.

[6] Sections 829-830 Companies Act 2006
[7] SI 2009/2999

Although the 2009 regulations principally reinforced the conduct rules imposed upon members by their regulatory bodies, they go further, imposing specific disclosure requirements prior to engagement. Therefore any pre-appointment correspondence with prospective appointors will need to comply with the Regulations.

A copy of the Provision of Services Regulations 2009 and guidance notes form the Department of Business, Innovation and Skills can be found on the following websites:

http://www.legislation.gov.uk/uksi/2009/2999/contents/made
http://www.bis.gov.uk/files/file53100.pdf