Ten cases every Insolvency Practitioner should know

Webinar Case Summaries – Follow up Materials

1. **Eurosail**[1] (*Test for balance sheet insolvency*)

The Facts

Eurosail acquired a portfolio of sub-prime mortgage loans funded by the issue of loan notes in various classes and currencies. Most of the notes were finally repayable until 2045. As the income from the underlying mortgages were payable in Sterling but the notes were payable in US dollars and Euro as well as Sterling, Eurosail entered into various currency swaps with an entity in the Lehman Brothers Group to protect against the fluctuation in exchange rates. The notes provided that on the happening of an event of default, the notes would all become due and payable. An event of default included the inability of Eurosail to pay its debts within the meaning of section 123(2).

Following the collapse of the Lehman Brothers Group, Eurosail lost the protection of the currency swaps leaving it only with a claim in the Lehman's insolvency. That, together with adverse moves in both interest and currency rates and the poor performance of the domestic mortgage market, Eurosail's audited accounts showed liabilities substantially higher than its assets. However, Eurosail was able to continue to pay interest on the notes and to repay principal to the extent that funds were available.

A group of subordinated noteholders commenced proceedings to determine if there was a basis on which to declare an event of default. They argued that if Eurosail was allowed to pay interest on all the notes and principal on the higher ranking notes, they would face a shortfall, whereas, if an event of default was declared, their position would be improved because they then ranked pari pasu with the noteholders.

The Law

Section 123(2) states:

"*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.*"

The Decision

In the long awaited conclusion to this case, the Supreme Court upheld the decision of the Court of Appeal, however, it expressed its concern as to the usage of the concept of "the point of no return" as referred to by the Court of Appeal.

The Supreme Court held that:

- the statutory test for a company unable to pay its debts is materially different from the position under the Companies Act 2006;
- the balance sheet test requires a court to be satisfied that, on the balance of probabilities, the company has insufficient assets to meet all its liabilities, including prospective and contingent liabilities;
- the more distant liabilities, the harder this will be to establish; and

[1] BNY Corporate Trustee Services Ltd and others v Eurosail-UK 2007-3BL PLC and others [2013] UKSC 28 (9 May 2013)

- there is no need to have recourse to the concept of "the point of no return" as alluded to in the Court of Appeal judgment, and the expression should not pass into common usage as a paraphrase of section 123(2).

Comment

A much more detailed consideration of the particular circumstances of the company whose insolvency is being assessed will need to be carried out in determining whether or not a company is balance sheet insolvent for the purposes of section 123(2). Anyone assessing a company's solvency should err on the side of caution before concluding that a company is balance sheet insolvent where a company's liabilities may not be triggered for a long period into the future and where it continues to pay its debts as they fall due.

2. **Nortel**[2] (*Provable debts and administration expenses*)

The Facts

The Nortel and Lehman companies were the subject of the statutory "moral hazard" provisions set out in the Pensions Act 2004, by virtue of being part of a group of companies that operated a pension scheme.

The underfunding of each group's pension scheme meant that there was a real prospect of each of the companies becoming the subject of a financial support direction and subsequently a contribution notice.

The Law

The Pensions Act 2004 allows the Pensions Regulator to impose liability for a pension scheme debt on a company with a defined benefit scheme or, more importantly, those connected and associated to the employer, for example, group companies. The Pensions Regulator may require group companies to make a payment to the scheme under a contribution notice (**CN**) or to provide support to the scheme under a financial support direction (**FSD**). Unless the Pensions Regulator uses its power under the act, companies other than the employer itself would ordinarily have no direct liability to the scheme.

A creditor may prove in the administration or liquidation of a company if the creditor is owed a debt. A "debt" in this context includes:

- a liability to which the company is subject when it goes into administration or liquidation (rule 13.12(1)(a) Insolvency Rules 1986)

- a liability that arises from an obligation to which the company was subject when it entered administration or liquidation (rule 13.12(1)(b))

The Decision

The Supreme Court unanimously held that the financial support direction liabilities were a provable debts in the administrations of the companies under rule 13.12(1)(b) of the Insolvency Rules 1986.

The companies were under an obligation by virtue of the statutory scheme set out in the Pensions Act which created a legal relationship between them and the Pensions Regulator that carried a real prospect of a payment liability arising in the future

The court held that the companies were under an obligation to make a payment to the Pensions Regulator pursuant to the statutory scheme even though they were not subject to an FSD when they entered administration. Accordingly the FSD liabilities were liabilities arising under an obligation to which the companies were subject when they went into administration.

Comment

Prior to this decision there had already been a controversial extension of the categories of liability that may be considered to be expenses in the case of *Goldacre* where rent falling due in the period of an administration was deemed to be an administration expense. This has inevitably led to questions being raised as to where this progression towards giving certain categories of liability preferential status may end.

This decision is good news for insolvency practitioners, lenders and other creditors and is bound to be seen as promoting the rescue culture. Substantial expense claims hinder the ability of an administrator or liquidator to achieve an advantageous result for creditors. The decision also avoids the risk of debt finance drying up more generally.

[2] Re Nortel Companies and others [2013] UKSC 52 (24 July 2013)

3. **McDonagh[3] and Pengelly[4]** (*Insolvency single event*)

The Facts

In each case, the employees' employment ended when their employer went into liquidation and they claimed against the National Insurance fund for arrears of pay and unpaid holiday pay. Their claim was rejected on the basis that they had no entitlement because, unbeknown to the employees, the company was already insolvent having entered into a CVA. The employees' claims were upheld by two Employment Tribunals. However, the Secretary of State appealed against these decisions and the EAT allowed the appeal.

The Law

Section 182 of the Employment Rights Act 1996 provides that the Secretary of State shall make payment out of the National Insurance fund if:

- the employee's employer has become insolvent;
- the employee's employment has been terminated; and
- on the appropriate date the employee was entitled to be paid the whole of part of any debt to which this part applies.

Under section 183, insolvency is defined as including company voluntary arrangements, and section 185 defines "appropriate date" which for arrears of pay and holiday pay is the date on which the employer became insolvent.

The Decision

The Employment Appeals Tribunal (**EAT**) held that employees who were employed by companies which had entered into company voluntary arrangements were not entitled to payments out of the National Insurance Fund when the company subsequently went into liquidation.

Liquidation would be a separate insolvency event if there was no CVA but when it is preceded by a CVA, it is the earliest of those processes that are relevant; the legislation only provides for one insolvency event. The appropriate date is a single date, being the date on which the company became insolvent, which in this case would be the date on which the CVA was approved by the court.

Comment

Apart from being manifestly unfair on the employees concerned, which was a point that was acknowledged by the court, this case also raises the questions as to whether in the future employees may seek to vote against a proposed voluntary arrangement because they are concerned by the consequences of a failure.

[3] Secretary of State for Business Enterprise and Skills v McDonagh & Ors UKEAT/0287/12/LA
[4] Secretary of State for Business Enterprise and Skills v Pengelly & Ors UKEAT/0312/12/LA

4. **I Lab Facilities**[5] (*Affected employees and TUPE*)

The Facts

An employer facing insolvency had contemplated transferring both parts of his undertaking to a single transferee, but eventually the liquidator transferred only one part, the other part being closed down.

The claimants who were employed in the part which was closed down were dismissed and brought proceedings for, amongst other things, breach of the information and consultation obligations under regulation 13 of the TUPE regulations.

The claim was brought against the transferee as well as the employer by reason of the joint liability provisions of regulation 15(9). The Employment Tribunal upheld the claim on the basis that the employees were "affected employees" by reason of having been excluded from the eventual transfer notwithstanding the original intention that they would be included. The transferee appealed.

The Law

The obligation to inform and consult is in relation to any "affected" employees, who are defined as "*any employees of the transferor or the transferee (whether or not assigned to the organised grouping of resources or employees that is the subject of a relevant transfer) who may be affected by the transfer or may be affected by measures taken in connection with it*" (Regulation 13(1), TUPE).

The Decision

The EAT held that the sale of one part of the business will not render those employed in another part of the business that did not transfer "affected employees" for the purposes of TUPE. The indirect impact that the transfer of only the part of the business in which the claimants were not employed may have had on the part in which they were employed did not make them "affected employees".

Additionally, the EAT made it clear that no claim for breach of the TUPE information and consultation obligations unless a relevant transfer actually takes place.

Comment

This constitutes further good news for the rescue culture in that a potential purchaser of part of an ailing business is less likely to be put off by the possibility of facing claims for a failure to consult and to provide information about a transfer from those who would not be affected.

[5] I Lab Facilities Ltd v Metcalf & Ors UKEAT/0224/12/RN

5. **AEI Cables**[6] (*Protective awards*)

The Facts

A company suffering from financial difficulties sought professional advice from a firm of accountants. The company was advised that unless it reduced costs or secured additional finance there was a risk that the company could be said to be trading whilst insolvent and accordingly that the directors may be a risk of facing personal liability for wrongful trading. When the company's bank withdrew support, the directors immediately took the decision to close one of the company's plants and took steps to notify a union official of the proposed closure. The following day 124 employees were made redundant with immediate effect.

The dismissed employees brought a claim before the employment tribunal which held that there had been a complete failure to consult and made the maximum protective award possible. The company appealed. There was no dispute as to the fact that the company had failed to consult and that the tribunal had been right to make a protective award. There was also no attempt to argue that the insolvency of the company was a special circumstance. The question at issue was the amount of the award.

The Law

Under section 188 of the Trade Union and Labour Relations (Consolidation) Act 1992 (**TULRCA**), where an employer is proposing to dismiss as redundant 20 or more employees at one establishment it must collectively consult with representatives of the affected employees. Where there are 100 or more proposed redundancies the collective consultation must begin at least 45 days before the first dismissal. An employment tribunal may make a protective award against a company for failing to comply with these obligations. The maximum protective award is up to 90 day's pay for each dismissed employee.

If special circumstances exist which makes it not reasonably practicable for the employer to comply, he must take all steps towards compliance as are reasonably practicable in the circumstances. However, the courts have consistently held that the insolvency is not in itself a "special circumstances" for these purposes.

The Decision

The EAT held that it was unreasonable to expect an employer to trade while insolvent to enable it to provide information and to consult in accordance with its obligations. In making the maximum protective award the employment tribunal had failed to take account of the fact that the employer was insolvent and could not lawfully carry on trading to enable it to consult for a period of more than 10 days or so. The employer's actions were not one of an employer deliberately flouting its obligations but those of an honest employer doing its best to keep the union informed. In the circumstances the EAT reduced the protective award from 90 to 60 days.

It was stressed that the purpose of making an award is penal, not compensatory in nature and was intended to encourage employers to comply with their obligations. The starting point was the maximum award however that should be reduced if there are mitigating circumstances justifying a reduction to an extent which the tribunal consider appropriate. The employment tribunal in this case failed to have sufficient regard to the insolvency and the consequences of continuing to trade to enable a consultation period to take place. A 90 day consultation period was simply not possible and therefore the award for 90 days could not stand.

Comment

Although it has long been established that insolvency is not in itself a special circumstance, this case makes it clear that employment tribunals should take into account the impact of an employer's insolvency in considering its ability to consult for the prescribed minimum period. That said, it does not

[6] AEI Cables Ltd v GMB & Ors UKEAT/0375/12/LA

overrule the need for employees to do all that they possibly can to carry out some form of collective consultation.

6. **Ethel Austin**[7] (*"Establishment" and collective redundancies*)

The Facts

This case concerned the administration and then liquidation of two retailers: Ethel Austin and Woolworths. After being made redundant with no or inadequate consultation, employees at stores with 20 or more employees received a protective award from the employment tribunal. However, employees at stores with fewer than 20 employees (which amounted to 1,210 employees at Ethel Austin and 3,233 employees at Woolworths) were not consulted and received no protective award, as each store was held to be a different "establishment". USDAW appealed on behalf of its members to the EAT.

The Law

Under section 188 of the TULRCA "*where an employer is proposing to dismiss as redundant 20 or more employees at one establishment within a period of 90 days or less*", the employer is obliged to consult with appropriate representatives of the employees who may be affected by the proposal. Where an employer fails to comply with these obligations, the employment tribunal may make a protective award.

The Decision

Relying on a number of domestic and ECJ cases that set out the proper approach to be taken in interpreting legislation, the EAT concluded that there was authority for courts to add words to legislation or to take words away to comply with the policies of the legislation. The EAT took the view that was possible to interpret the words "at one establishment" broadly to mean the whole of the relevant retail business rather than each of the individual stores. However, the EAT went further and accepted the argument that the words "at one establishment" should be deleted from section 188 as a matter of construction.

In the alternative, the EAT also stated that where an employer has an establishment at which there are 20 dismissals it would be possible to say that all other employees in other establishments should be consulted as they would fall within the definition of affected employees. This reasoning would have allowed the EAT to uphold the appeals but, as it recognised, would not have provided a permanent solution to the interpretation of section 188.

Comment

It has long been acknowledged that the words "at one establishment" in the TULRCA are inconsistent with the underlying EC directive but until now the courts have not adopted a purposive interpretation which would have rewritten the provisions of section 188. As far as Ethel Austin and Woolworths are concerned the EAT's judgment means that all employees from the smaller stores are entitled to collective consultation and became entitled to a protective award.

[7] USDAW v Ethel Austin Ltd (in administration) and another case UKEAT/0547/12; 0548/12

7. **Data Power Systems Limited**[8] (*Statutory purpose and administration orders*)

The Facts

Data Power Systems Limited was set up to operate a data centre, however, the project to install the centre failed shortly after its instigation. The company had relatively limited assets and had significant liabilities to a number of trade and other creditors. It had no employees and had not granted any security over its assets.

A group of creditors applied to court for an administration order. In support of the application, the proposed administrator filed evidence that contained the assertion that the administration of the company was reasonably likely to lead to a better return for creditors than would be in the case of a liquidation. A counter application was issued by another creditor which sought the appointment of a different insolvency practitioner as administrator but which also contained a statement similarly asserting that the statutory purposes of administration were reasonably capable of achievement.

The Law

An administrator may be appointed to an insolvent company by the court pursuant to paragraph 11 of Schedule B1 to the Insolvency Act 1986. To make an administration order, the court must be satisfied that the company is insolvent and that one or more of the statutory purposes of administration are reasonable likely to be achieved if administrators are appointed. The statutory purposes under paragraph 3(1) are:

- The rescue of the company as a going concern.
- Achieving a better return to creditors of the company than would be the case in the liquidation of the company.
- Achieving a better return to preferential creditors or one or more of the secured creditors of the company.

The Decision

The High Court refused the administration application, instead appointing a provisional liquidator to the company. Whilst the court accepted that the company was insolvent, it concluded that the evidence before it did not demonstrate that any of the statutory purposes of administration were reasonably capable of achievement. The principal evidence was simply the assertion by the proposed administrator in his supporting witness statement that one of the statutory purposes could be achieved. The evidence contained very little, if any, support for the assertion made.

Although the company was clearly insolvent and it was appropriate for it to become subject to some sort of insolvency process, the court could not make an administration order. The court exercised its discretion to treat the administration application as a winding up petition and reviewed its powers under section 125 of the Insolvency Act 1986. The court held that, despite the absence of any application for the appointment of a provisional liquidator, the power to make any order that the court thought fit was wide enough for the court to appoint a provisional liquidator.

Comment

The case provides a reminder that, notwithstanding that an out of court appointment merely requires an assertion by the proposed administrator that one of the statutory purposes of administration is achievable, that is not sufficient for the purposes of a court appointment; a higher evidential burden is required in a court application.

The case is also notable because of the court's decision to appoint a provisional liquidator to the company, despite there being no application before the court for such an appointment. The court treated its administration application as a winding up petition and appointed a provisional liquidator using its powers to make any such order as it thinks fit under section 125 of the Insolvency Act 1986.

[8] Data Power Systems Ltd and others v Safehosts (London) Ltd and another [2013] EWHC 2479 (Ch) (17 May 2013)

8. **Bramston v Haut**[9] (Suspension of discharge – proper and improper use)

The Facts

The bankrupt made an IVA proposal which he claimed would be supported by the majority of his creditors shortly before his automatic discharge was due, however, the trustee opposed the application on that basis that he believed the bankrupt had mislead creditors, that he had hidden assets, and that the proposed IVA was an attempt to prevent a thorough investigation of his affairs.

On the application of the bankrupt, the High Court ordered the suspension of discharge believing that it would be in the best interests of the creditors to do so and held that the trustee had exercised his powers improperly by objecting to the bankrupt's request for an order suspending his automatic discharge, ordering the trustee to personally pay the bankrupt's costs in relation to the application. The trustee applied to overturn the decision.

The Law

Under section 279(1) of the Insolvency Act 1986 (IA 1986), a bankrupt is automatically discharged from bankruptcy after one year has passed from the making of the bankruptcy order against him. However, if the bankrupt fails to comply with his obligations to his trustee or the Official Receiver may apply to court for an order suspending the bankrupt's discharge from bankruptcy (sections 279(3) and (4) of the Insolvency Act 1986). The bankrupt cannot apply himself for an order suspending his discharge from bankruptcy.

The Decision

The Court of Appeal held that the power conferred under section 279 was to ensure a debtor's compliance with his obligations under the Insolvency Act 1986. The extension of the period during which the bankrupt suffered disabilities by virtue of his bankruptcy was a penal measure to be used where the bankrupt's assistance was not forthcoming.

In this case, the suspension was not related to the bankrupt's non-compliance with his obligations but was instead intended to give him time to put an IVA proposal to his creditors and secure an annulment of his bankruptcy. The use of the section 279 power in this manner was unsuitable and beyond the scope of the section. Save in exceptional circumstances, only a trustee in bankruptcy or the official receiver should be able to apply.

Lord Justice Kitchin expressed the view that a more appropriate application could have been made under sections 252 – 256 where a stay of proceedings was potentially available and further indicated that the trial judge had erred in concluding that the trustees actions had been unreasonable as the trustee does not have a duty to respond positively to a bankrupt's request that he cooperate in the promotion of a proposal for an IVA. Accordingly the trustee's appeal was allowed and the costs order was not allowed to stand.

Comment

The case confirms that unless the court directs otherwise, only the trustee or official receiver may apply for a bankrupt's suspension of discharge; unless the circumstances are exceptional, the provisions should not be a mechanism for a recalcitrant bankrupt to force his own agenda on his trustee.

Insolvency practitioners will also welcome the Court of Appeal's confirmation that courts are unlikely to interfere with the administration of a bankruptcy estate unless a trustee has acted in bad faith, perversely or unreasonably.

[9] Bramston v Haut [2012] EWCA Civ 1637

9. **Davis v Price**[10] (*Binding creditors and suspension of IVA*)

The Facts

Mr and Mrs Price were creditors of Mr and Mrs Davis for an un-liquidated amount. The Davis' proposed interlocking IVAs and the Price's submitted their claim in the creditors meeting called to consider the Davis' IVA proposals. The chairman at the meeting valued the Price's claim, for voting purposes, a £1 and the IVAs were approved.

The Prices applied to Court to challenge the IVAs approval on the ground that the valuation of their claim at £1 was a material irregularity. The Court made an order suspending the approval of the IVAs and directing the Davis' to consider calling a further meeting of creditors to reconsider the original proposal or to consider making revised proposals to their creditors. The Court directed that, if there was a further meeting, the Price's claim should bear its full amount for voting purposes. The Court also ordered that the Davis' pay the Price's costs.

The Davis' called a further meeting, to consider revised interlocking IVA proposals. The Prices submitted a claim for the full amount of their original claim but did not make any claim for the costs liability. The IVAs were approved. Following the approval of the IVA, the Prices served a statutory demand on the Davis' for the costs liability. The Davis' successfully applied to set this statutory demand aside arguing that it was a liability caught by the terms of the revised IVA. The Prices appealed the decision to set aside the statutory demand.

The Prices argued that the costs liability was not caught by the IVAs because the IVAs could only bind creditors to whom the Davis' owed liabilities at the date of the first meeting. The critical factor, argued Price, was that the Court suspended the approval of the IVAs, instead of revoking it. Accordingly the effect of the creditors approval for the IVAs at the second meeting was to end the suspension of the approval so that the IVAs took effect as if they were approved one and for all at the first meeting. The fact that the Court, in the order suspending the approval of the IVAs, referred explicitly to the value of the original claim in relation to voting, showed the intention of the order was to create the effect that the Prices argued for.

The High Court dismissed the appeal.

The Decision

it was held that a creditor of an individual whose claim against that individual increases between the first creditors meeting called to consider proposals for an individual voluntary arrangement and a second meeting called to consider revised proposals, is bound by the IVA for the full amount of his claim, not just the amount due at the date of the original meeting. The court confirmed that that is the case not only where a court revokes the original approval of the IVA but also where the court suspends that approval.

Consequently all creditors of the Davis' were bound by the IVA in respect of the Davis' liability to them at the date of the second meeting. In the Prices' case that included the costs liability. Consequently the statutory demand was improperly served and the original decision to set it aside was correct.

Comment

Although this case deals with a relatively rare occurrence in practice, the decision is notable because it is the first time the Court has considered the particular point.

Practitioners should also note that the Court rejected the argument, raised on behalf of the debtor, that the effects of suspending an IVA's approval was to limit the scope of the final IVA to the particular creditors bound by the original IVA, even if their claims had increased in the intervening period. The Court could see no reason why following the logic of its reasoning a new creditor should not be bound by the subsequently approval IVA in the same way as an existing creditor with a new claim.

[10] Davis v Price [2013] EWHC 323 (Ch) (21 February 2013)

muckle LLP

10. **Appleyard v Wewelwala**[11] (*Trustee's expenses*)

The Facts

On 20 April 2011 a bankruptcy order was made against a debtor on the petition of a creditor, Davenham Trust Limited following non-payment of a statutory demand based upon a judgement debt.

The debtor sought permission to appeal the order, initially be written application, on the basis that Davenham had refused her offer to settle the debt by way of instalments. Permission to appeal was refused and Mr Appleyard was subsequently appointed as the debtor's trustee in bankruptcy by the Official Receiver with effect from 20 July 2011.

The debtor then pursued an oral application for permission to appeal the bankruptcy order and notified the trustee through his solicitors of the hearing date. Justice Floyd adjourned the hearing to a later date at which Davenham was directed to attend. The order did not direct the debtor to notify the trustee or indicate that an appeal would be heard immediately if permission to appeal was granted.

At the adjourned hearing on 14 December 2011 Justice Floyd allowed the appeal and ordered that the bankruptcy order be set aside and that the hearing of the bankruptcy petition be adjourned pending the debtor's repayment of the debt owed to Davenham.

The order did not release the trustee or address payment of his remuneration and expenses indeed, it is not even clear if the Court was aware that a trustee had been appointed. The trustee had no notice of this hearing up until he received a telephone call from a debtor in January 2012 notifying him that the bankruptcy order had been set aside had continued to fulfil his duties in relation to the bankruptcy estate.

The Decision

On an application by the trustee for directions the High Court directed that the trustee be released from office with immediate effect. More significantly, it also directed that the trustee was entitled to recover expenses incurred up to the point at which he had notification that the bankruptcy order had been set aside and that the debtor's re-vested estate be charged as security for recovery of his reasonable expenses.

The Court made it clear that expenses incurred by the trustee after he had had notification, in making statutory reports to the debtors' creditors, would not be recoverable and that the trustee should have sought directions from the Court under section 363(3) of the Insolvency Act immediately on becoming aware of the setting aside of the bankruptcy order.

Comment

This case highlights the importance of dealing with and being mindful of the trustees expenses in the course of bankruptcy proceedings and demonstrates the ambiguities in the existing legislation for dealing with a trustee in bankruptcy's expenses on appealing the bankruptcy order and emphasises the need to inform trustees of anything that may impact on the bankruptcy estate in general as well as in relation to their duties as a trustee in bankruptcy.

For more information, help or advice on any of the above cases mentioned in the webinar please contact Andrew Cawkwell on 0191 211 7957 or email andrew.cawkwell@muckle-llp.com, or Kelly Jordan on 0191 211 7899 or email kelly.jordan@muckle-llp.com.

[11] Appleyard v Wewelwala [2012] EWHC 3302