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# Technical Bulletin

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## Burke & Ors v Peabody Construction Ltd [2024] EWHC 392 (Ch)

- 23 February 2024

The case considered an appeal against a decision made by ICC Judge Prentis regarding the allocation of costs in a Company Voluntary Arrangement ('CVA') dispute.

The central issue of the appeal was whether the Joint Supervisors should be held jointly and severally liable for the costs of Peabody Construction Ltd from the trial onwards. The lower court had ordered the Joint Supervisors to be jointly and severally liable for these costs, a decision they appealed.

The Joint Supervisors argued that: they were named as parties only in their capacity as supervisors, not in their personal capacities; the general rule was for costs to be awarded against the unsuccessful party and that was the company and not the supervisors; they had a limited capacity in proceedings and there had been no criticism of their conduct; and the judge had erred in placing reliance on their failure to attend a consequentials hearing, and therefore they should not be personally liable for costs.

Peabody Construction Ltd countered with several points, including allegations of misconduct on the part of the Joint Supervisors indicating a lack of independence/ neutrality.

### The Decision

The appeal was allowed and the order against the Joint Supervisors was set aside. The court determined that the lower court had misdirected itself in concluding that the Joint Supervisors had abandoned their neutrality and adopted a hostile litigation stance. The judge emphasised that the joint representation and the tone of legal arguments did not necessarily indicate a departure from neutrality.

Furthermore, the judge highlighted that personal misconduct is generally required to justify a costs order against a nominee in such cases. The judge found no evidence of such misconduct by the Joint Supervisors.

The decision highlights the importance of demonstrating personal misconduct to justify a costs order against a nominee in CVA proceedings. The emphasis on neutrality and the need for clear evidence of wrongdoing provides guidance for future cases involving the allocation of costs in similar disputes.

**Judgment**

## Taylor v Savik & Anor [2024] EW Misc 15 (CC)

- 5 April 2024

The undischarged bankrupt applied for an order that the county court trial of an ongoing Insolvency Act 1986 ('IA86') case be heard by a jury rather than a judge alone. This request was opposed by the applicant, the trustee in bankruptcy.

The central issue in the IA86 case was the ownership of a property known as The Grange. The trustee claimed that the property, though registered in the bankrupt's wife's name, was held in trust for the bankrupt and should be considered an asset available to his creditors. The bankrupt and his wife denied this claim. Initially, neither party cited section 66 of the County Courts Act 1984 (the 'CCA') relating to jury trial. The judge adjourned the hearing and asked the parties to lodge written submissions, noting that the respondent was a litigant in person but that the same substantive law and legal rules applied.

The bankrupt had already pleaded guilty to a charge of defrauding HMRC and had been sentenced to a term of imprisonment. The bankrupt argued for a jury trial on the basis that a judge would be prejudiced against them as a convicted criminal and that a judge lacked the ability to take a 'holistic view' of the overall situation. The trustee also included paragraphs in the present claim relating to VAT fraud.

HHJ Paul Matthews referred to section 66(3) of the CCA, which directs a jury trial on a charge of fraud subject to a specific exception where the 'court is of the opinion that the trial requires any prolonged examination of documents or accounts or any scientific or local investigation which cannot conveniently be made with a jury'. The judge concluded that the trustee's paragraphs relating to VAT fraud did amount to a charge of fraud against the respondent, albeit he was also of the view that these paragraphs could have been omitted.  However, the judge concluded that the statutory exception applied on the facts, and so denied the application.

**Judgment**

## UKCloud Ltd, In the Matter Of (Re Insolvency Act 1986) [2024] EWHC 1259 (Ch)

- 24 May 2024

In this case, the court addressed the issue of whether a debenture granted by the company to Harbert European Specialty Lending Company II SARL ('Harbert') created a fixed or floating charge over certain internet protocol ('IP') addresses.

### Background

UKCloud Ltd, a subsidiary of Virtual Infrastructure Group Ltd, provided cloud computing services to government entities, utilising IP addresses for service delivery. IP addresses are unique identifiers that enable data routing across networks. The company held numerous IP addresses, primarily IPv4 addresses, which are finite and in high demand. The company's use of IP addresses was governed by agreements.

UKCloud Ltd faced financial difficulties and entered into a loan agreement with Harbert, secured by a debenture. The company was subsequently wound up, and the Official Receiver was appointed as liquidator.

The dispute arose regarding the classification of the charge over the IP addresses as fixed or floating, as this determination would impact the distribution of assets to creditors.

### Legal Principles

The court emphasised that the label used in a debenture to describe a charge was not conclusive and therefore the court had to ascertain the nature of rights and obligations the parties intended to create.

A fixed charge involves the permanent appropriation of assets as security. A floating charge, on the other hand, allows the chargor to deal with the charged assets in the ordinary course of business until crystallisation.

The court highlighted key distinctions between fixed and floating charges, emphasising the element of control over the charged assets. If the chargor can freely deal with the assets without the charge holder's consent, it indicates a floating charge. The court also addressed the "*all or nothing*" principle, stating that all assets within a charging clause must be subject to either a fixed or floating charge, not a combination of both.

### Decision

The court ultimately concluded that the charge over the IP addresses was a floating charge. This determination was based on several factors, including the absence of evidence that Harbert exercised control or sought to exercise control over the IP addresses.  It was relevant to consider post-contractual conduct, and the control provisions in the debenture were a 'sham', not in the sense of a fraud but in the sense used in *Re Avanti* demanding consideration of whether control rights in a charging document have been adhered to in practice. While the IP addresses were not explicitly mentioned in the debenture, the court determined that they could fall within a clause that purported to grant a fixed charge over 'all licences, consents and authorisations' of the company. However, the court also considered the "*all or nothing*" principle and concluded that certain assets covered by this clause could not realistically be subject to a fixed charge, thus necessitating the classification of the entire charge over all assets covered by it as floating. The debenture also contained a clause granting floating security over all property, assets and rights not caught by the fixed charges.

It is worth noting that ICC Baister emphasised how difficult he had found it to resolve this case.

**Judgment**

## Hobson and another v OAS Realisations (2022) Ltd (formerly known as Open Administration Systems Ltd) (in creditors' voluntary liquidation) [2024] EWHC 1491 (Ch)

- 17 June 2024

The case revolved around the validity of a notice that initiated the transition of OAS Realisations (2022) Ltd from administration to creditors' voluntary liquidation ('CVL'). The joint administrators of the company, anticipating they could only pay a dividend to a preferential creditor (HMRC) and not to ordinary unsecured creditors, filed this notice at Companies House.

### Background

With the administration period ending, the administrators concluded that it was more suitable for the company to move from administration to CVL. The solicitors acting for the administrators advised that they were entitled to convert to CVL by sending the Registrar of Companies a notice under paragraph 83(3) of Schedule B1 of the Insolvency Act 1986 ('IA86') on the basis that a preferential creditor was an 'unsecured creditor' for the purposes of paragraph 83(1) of Schedule B1 of the IA86, by reference to the statutory definitions in section 248 of the IA86.

Following the conversion to CVL, the liquidators were advised by an external compliance reviewer that they believed the solicitors' interpretation of 'unsecured creditor' was incorrect and therefore their appointment as liquidators was invalid.

### Decision

The root of the matter was the interpretation of 'unsecured creditor' within the context of the IA86. The court needed to determine if a preferential creditor, and specifically HMRC as secondary preferential creditor, fell under this definition, thereby allowing the move to CVL.

The court referred to the definition in section 248 of the IA86, which provides that '"secured creditor" in relation to a company means a creditor … who holds in respect of his debt a security over property of the company, and "unsecured creditor" is to be read accordingly'. It concluded that, unless the context otherwise requires, an unsecured creditor is a creditor who does not hold security and therefore includes a preferential creditor.  These statutory words apply to all types of preferential creditor, including HMRC. The judge considered that the context of paragraph 83 does not require the meaning of unsecured creditor to be restricted to non-preferential unsecured creditors.

If this were wrong, the judge noted that paragraph 83 applies where the administrator 'thinks' a distribution will be made to unsecured creditors.  While this did not necessarily require that the administrator 'reasonably' thinks the conditions are satisfied, in this case the administrators had relied on legal advice and the wording of the statutory definition was clear, so the administrators did have reasonable grounds for taking the view they did.

Consequently, the court declared the notice filed by the administrators as valid, and therefore legitimising the company's transition from administration to CVL.

### Thoughts of the Regulatory Professional Bodies (ICAEW, IPA and ICAS) (15 October 2024)

*The collective thoughts are as follows:*

- *"under the section 248 of IA86 definition, a preferential claim is an unsecured claim; and*
- *there could be cost savings in doing so, in terms of progress reporting (fewer are needed) and an administration could need a court extension which could be expensive.*

*Equally we wouldn't have significant concerns if the distribution was made through the administration, but would expect the IP to have considered the costs, particularly if that approach resulted in the need for an extension by court.*

*As ever though, we'd expect an IP to document their thought process / rationale for their decisions."*

**Judgment**

## Hellard and others v OJSC Rossiysky Kredit Bank and others (2024) EWHC 1783 (Ch)

- 10 July 2024

The application was brought by Kevin Hellard, Robert Starkins and Nick Nicholson of Grant Thornton UK LLP, the Joint Trustees of Anatoly Leonidovich Motylev. It was prompted by the Court of Appeal decision in Mints v PJSC National Bank Trust (2023) EWCA Civ 1132 ('Mints').

Four Russian banks are creditors in the English bankruptcy of Mr Motylev. The bankruptcy order was made in 2020 and the four banks became members of the creditors' committee. The four banks are all in liquidation in Russia.

Post Mints, the Joint Trustees found themselves in a situation with serious ramifications, where unknowingly they could be both guilty of a criminal offence and subject to a substantial civil liability, a situation described by Deputy Judge Nicholas Thompsell as Kafkaesque[1]. As a result they were left with no alternative but to seek directions from the court as to

> (1) whether the banks were sanctioned entities within the meaning of the Russia (Sanctions) (EU Exit) Regulations 2019 (the Sanctions Regulations);
>
> (2) if so, whether the banks would or would not be entitled to participate in the bankruptcy proceedings to the extent of voting as creditors and being eligible for membership of, and participation in, the creditors' committee; and
>
> (3) whether, in carrying out their functions as trustees in bankruptcy, the trustees were providing financial services in breach of regulation 18A of the Sanctions Regulations.

The respondents to the application were the four banks, and the Office for Financial Sanctions Implementation ('OFSI'). None of the respondents, including OFSI, appeared or was represented at the hearing. OFSI stated that it would not participate by reason of *"constraints on resources and our need to prevent unnecessary costs to public funds"*. Indeed, OFSI asked to be removed from the list of respondents, but the trustees did not think this to be appropriate and the court stated its agreement with the trustees in this regard.

The court declined to provide a definitive ruling as to whether the Russian banks were sanctioned entities. The banks are not designated on the UK Sanctions List, but difficult questions arose as to whether they might be controlled or potentially controlled by designated persons, namely by senior sanctioned persons in the Russian state. In the light of the trustees' research into the structure and control of the Russian banking sector, and with an explanatory analysis of the scope of regulation 7(4) as to the potential for designated persons to take control, the court ordered and directed that the trustees should deal with the banks on the understanding that they are not sanctioned entities. Importantly, post Mints, it was also ordered that they were to be treated as not owned or controlled by any designated person.

It was ordered that the trustees would need to remain alert to any change of circumstances, including new facts of which they may become aware, any new notice or requirement from OFSI and any new guidance that might emerge from the court, including potentially from the Supreme Court as a result of the further appeal in Mints. The trustees were required also to continue to check the UK Sanctions List no less than once a week. When considering a dividend distribution from the bankruptcy, the trustees would need to undertake further due diligence to look for any identifiable change of the circumstances or available knowledge regarding the status of the banks.

If the banks had been found to be sanctioned entities, the court held that they would, nevertheless, be entitled to vote as creditors and would be eligible for membership of the creditors' committee and as such to participate in the proceedings of the committee in the normal way. These matters do not amount to dealing with funds or economic benefits for the purposes of the Sanctions Regulations.

The trustees were not providing financial services to the banks within the meaning of regulation 18A of the Sanctions Regulations.

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[1] Kafkaesque means something is bizarre, illogical, or nightmarishly complex.

## Haw & Anor v QM Systems Ltd [2024] EWHC 1944 (Ch)

- 29 July 2024

### Overview

The case concerned an application by the Joint Administrators of QM Systems Limited ('the Company') seeking an order from the Court to confirm the validity of their appointment. The appointment was challenged due to certain procedural irregularities:

1. Incorrect Heading on the Notice of Appointment ('NOA'): The NOA incorrectly suggested that the Company appointed the administrators, whereas it should have stated that the directors made the appointment.
2. Filing of the NOA: Only one copy of the NOA was filed, instead of the required three copies. * Additionally, the NOA did not include the written consent from the holder of Qualifying Floating Charge over the Company's property.

### Decision

The Court, relying on relevant legal provisions and case law, determined that the errors were procedural defects rather than fundamental flaws that would invalidate the appointment. The Court emphasised the importance of not having numerous circumstances where appointments could be invalidated, especially when the errors are minor and do not cause substantial injustice.

The Court specifically addressed each irregularity:

1. Incorrect Heading - The Court viewed this as a trivial error that did not mislead anyone. The substance of the NOA clearly indicated that the directors made the appointment.

2. Filing Issues - The Court acknowledged the failure to file three copies and exhibit the consent but considered them procedural defects that could be remedied. The Court sought a detailed explanation for the inability to file these documents electronically.

The Court ultimately granted the application, confirming the validity of the administrators' appointment. It emphasised that the errors were procedural and did not impact the substance of the appointment or cause any prejudice and could be remedied pursuant to Rule 12.64 IR 2016. The court also highlighted the need to avoid situations where minor procedural errors could invalidate appointments, especially in the context of business rescue proceedings where efficiency is crucial.

### Reminder

The case is a useful reminder that procedural defects rather than fundamental flaws in the administration application process may ultimately be remedied by the court upon a formal application being made. The decision also acts as a reminder that three copies of the NOA are to be filed, even though this requirement appears to be derived from the historic practice enabling them to be sealed and served on the relevant parties. However, now documents are filed and sealed electronically, the requirement for three copies to be filed appears to be an anachronism. The case could be seen as an example of the fact that the IR 2016 may be inconsistent with the some of the practical and more modern approach facilitated by the CE filing system. There have been a few recent applications for validation orders, which have highlighted other discrepancies between the IR 2016 and practice. Until the mismatches are resolved, practitioners ought to follow the IR 2016 even though they may appear to serve little purpose in practice.

### Judgment

* The judgment does not provide a definitive answer as to why three copies of the NOA were not filed. The judge notes that the Applicant's solicitor stated they were unable to file the required number of copies electronically, but the judge could not understand the reason for this inability. The judge intends to order a detailed explanation of the steps taken and the reasons for the inability to file the documents correctly, to ensure that others do not face similar issues in the future.

## Just Recruit Group Limited (in administration) and in the matter of the Insolvency Act 1986, [2024] EWHC 2242 (Ch).

- 30 August 2024

### Overview

Manolete, an assignee of the Joint Administrators of Just Recruit Group Limited ('the Company'), brought an action against Mr. Norman Freed a director of the company, and two companies connected to him.

The Claim alleged that Mr. Freed had caused payments to be made by the Company to the connected entities in breach of his duties as a director, particularly at a time when he knew, or ought to have known, that the company was insolvent. (Reference is made to the so called creditor duty as articulated in *Re BTI v Sequana* [2022] UKSC 25).

The payments were also claimed to be transactions at an undervalue and/or preferences under the Insolvency Act 1986 ('IA86').

Mr. Freed argued that the defendants' liability should be limited to the shortfall in the administration as the claim was based upon the assignment of the causes of action by the administrators.

### Decision

The Court held that Mr. Freed breached his duties as a director in causing the payments to be made. The payments were also found to be transactions at an undervalue and/or preferences under IA86. The connected entities were held liable for knowing receipt of the sums. The Court rejected the argument that recovery should be limited to the shortfall in the administration and emphasised the fact that the legislative safeguards were aimed at the recovery of property improperly paid away. In this case, any limit of liability relating to the deficiency in the administration, would have allowed the defendants to retain the proceeds of their wrongdoing, thereby reducing sums available for creditors and relieving the director of his liability.

### Policy aspect

The decision refers to the fact that there is no existing authority which imposes any limitations on the court to impose a cap on recoveries in relation to causes of action that may have been assigned by office holders. A company or its assignee may often be in a position to recover from more than one party, as in this case, and it is not uncommon for claims for breach of duty to be combined with claims relating to transaction at an undervalue or preferences in insolvency situations. In this case the director's breach made him liable for the entirety of the sums paid and jointly and severally liable with the two companies for the amounts they had received as recipients of the wrongfully paid funds pursuant to section 238 and 239 IA 1986.The decision emphasises the importance of not limiting the recovery of misappropriated funds solely to the amount needed to cover the deficiency in the insolvent estate. This policy serves several purposes:

- **Deterring Wrongdoing:** It acts as a deterrent to directors and connected parties who might be tempted to misappropriate company assets,
- **Upholding Corporate Governance:** It promotes better standards of corporate governance by ensuring that those who engage in wrongful conduct are held fully accountable for their actions.
- **Encouraging Claim Purchases:** It encourages third parties to purchase claims from insolvency practitioners, as they can be assured of recovering the full amount they are entitled to, thereby increasing the funds available to creditors.

**Paragraph 142 -**

*"Where the office-holder has assigned a cause of action such a restriction will cause prejudice to creditors while allowing the Defendants to retain a greater proportion of the proceeds of the wrongdoing. It also would prejudice the claimant, as an innocent third party purchaser of the claim, and has the potential more generally to discourage potential purchasers of claims from doing so. As noted in Totalbrand there is a public interest in wrong-doers being pursued and standards of corporate governance upheld. To place a limitation on recovery in the form proposed by the Defendants would discourage the pursuit of claims that the 2015 Act was intended to facilitate, as well as reducing the sums available for other creditors. In the circumstances I decline to impose such a limitation. I will direct that the sums be paid in full. If any part of them does fall in due time to be repaid to a defendant, that will be a question for the office-holder at the conclusion of the administration of the company's affairs."*

**Judgment**

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