FinancialRecovery

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Court refuses Application to Disapply Prescribed Part

The joint administrators of Castlebridge Plant Limited ('the company') applied for an order under section 176A(5) of the Insolvency Act 1986 disapplying section 176A(2) of that Act which requires them to make a prescribed part of the company's net property available to satisfy the claims of the unsecured creditors.

Section 176A(5) provides that the office holder may apply to the court for an order under the subsection on the ground that the cost of making a distribution to unsecured creditors would be disproportionate to the benefits.

Lord Doherty observed that the exercise of the court's discretion to make such an order involved questions of balance and judgement, and the application of common sense. The circumstances of applications may vary enormously. Rather than be over prescriptive, Parliament had recognised that the court is best able to determine when the requirement is met. It had also recognised that even if the requirement is met it may not be appropriate in the whole circumstances for the court to exercise the power.

In the present case 76 claims had so far been submitted, and the sum available for distribution would be about £81,000. On the basis of information provided to the court, the dividend would be about 0.58p in the pound and the average dividend payment would be about £1,065. Of the 76 claims so far noted, 61 were below £50,000, and the dividend in respect of these claims would be at most £290, and in many cases much less. The administrators thought that further claims were likely to be made, which would reduce the dividend.

Whether calculated on the basis of claims so far received, or possible additional claims, Lord Doherty found it impossible to accept that the cost of making a distribution to unsecured creditors would be disproportionate to the benefits. On either basis the global sum payable to unsecured creditors would be substantial (£81,000 and £71,000), and the sums receivable by a significant number of individual creditors would be worth having. In each case the estimated costs of making the distribution (£15,000 or £25,000) represented only a fraction of the prescribed part – between one-sixth and just over one-quarter. The requirements of section 176A(5) were accordingly not satisfied, and the application was refused.

Section 214 – *Wrongful Trading*

Section 214(1) of the Insolvency Act 1986 gives the court a discretionary jurisdiction to declare that a director of a company in insolvent liquidation is,

'liable to make such contribution (if any) to the company's assets as the court thinks proper'

Under section 214(2) the power may be exercised where the court is satisfied in relation to the director that,

'at some time before the commencement of the winding up of the company, that person knew or ought to have concluded that there was no reasonable prospect that the company would avoid going into insolvent liquidation'.

If section 214(2) is triggered, consideration must then be given to section 214(3) which provides that after the relevant time at which the director first knew or ought to have concluded that there was no reasonable prospect of avoiding insolvent liquidation, the director,

'....took every step with a view to minimising the potential loss to the company's creditor as (assuming him to have known there was no reasonable prospect that the company would avoid going into insolvent liquidation) he ought to have taken.'

'The question is not whether the directors knew or ought to have known that the company was insolvent. The question is whether they knew or ought to have concluded that there was no reasonable prospect of avoiding insolvent liquidation. The answer to this question does not depend on a snapshot of the company's financial position at any given time; it depends on rational expectations of what the future might hold. But directors are not clairvoyant and the fact that they fail to see what eventually comes to pass does not mean that they are guilty of wrongful trading.'

Furthermore, in deciding what conclusion a director ought to have come to as regards the prospects for his company, the court have been prepared to place some weight upon the evidence as to whether the directors took professional advice, and if so, what the advice was.

From an analysis of the previous cases Snowden J concluded that the correct approach to determining whether the directors should be required to make a contribution under section 214(1) was whether the company suffered loss which was caused by the continuation of trading by the company after 31 August 2010 until it went into administration on 13 October 2010. As a starting point this should be approached by asking whether there was an increase or reduction in the net deficiency of the company as regards unsecured creditors between the two dates.

In addition there had to be some causal connection between the amount of any contribution and the continuation of trading. Losses that would have been incurred in any event as a consequence of a company going into a formal insolvency process should not be laid at the door of the directors under section 214 (this factor was of particular importance in the present case because of the particular difficulties in dealing with customers in the insolvency of a construction company). However, there were reasons to believe that a period of continued trading to complete existing contracts during the summer months was likely to have produced a significantly better result for the company as a result of the enhanced collection of contract debts than would have occurred if there had been an immediate cessation of trading. Whatever criticism could be made of the manner in which the directors conducted the company's business between 31 August and 13 October, it was entirely plausible that such continued activity did not cause loss to the company overall or worsen the position of creditors as a whole. Accordingly, an order for a contribution to the assets of the company was not justified under section 214(1).

It requires a director who wishes to take advantage of the defence offered by the subsection to demonstrate not only that continued trading was intended to reduce the net deficiency of the company, but also that it was designed appropriately so as to minimise the risk of loss to individual creditors. In the present case the defence was not made out, because the directors had continued trading in a way that caused the bank and some other unsecured creditors to be paid at the expense of new creditors, who were not. The judge remarked that the difference in wording between the two subsections may be thought to be a shortcoming in the structure of section 214, but any remedy would be a matter for Parliament.

After the Event – *Insolvency Litigation Funding*

The insolvency exemption under the Legal Aid, Sentencing and Punishment of Criminal Offenders Act (LASPO) has ceased to exist from April 2016. This ends Insolvency Practitioners' ability to recover conditional fee agreement (CFA) uplifts and after the event insurance premiums (ATE) from unsuccessful defendants.

Insolvency cases have traditionally relied on CFA uplifts and ATE premiums being fully recoverable. The market may well now develop to encourage IPs considering litigation to engage with litigation funders and with related or third party assignees in order to identify the solution most aligned with creditors' interests.

SERVICES WE CAN PROVIDE

Business Rescue and Turnaround:

We use an extensive range of options, strategies and solutions to stop your business failing and shield the Directors, owners or managers from the firing line, putting you back in control.

Administration:

Usually instigated by the Directors or the bank, and used to provide protection whilst a solution is found.

Company Voluntary Arrangement:

Useful where a company has accrued aged debt which it is unable to service, but is profitable moving forward. An offer is then made to creditors for settlement based on affordability (requires 75% of creditors voting to vote in favour).

Liquidation of solvent or insolvent companies:

Results in the formal closure of the business entity

-solvent liquidations often provide tax advantages

Re-finance:

Seek new funding via bankers and private investors.

Individual or Partnership Voluntary Arrangements:

An alternative to bankruptcy, which allows individuals to offer to repay what they can afford to creditors and freeze the aged debt (requires 75% of creditors voting to vote in favour).

Bankruptcy advice:

We can advise on the options available and implications of bankruptcy on the individual.

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