Provisional liquidations: kill or cure?

Daniel Lewis and **Nyla Yousuf** look at provisional liquidation as an alternative rescue procedure.

As an insolvency procedure, provisional liquidation is usually an emergency measure, directed to recovery in the sense of preservation of assets rather than as a means of business rescue or asset realisation. The appointment of a provisional liquidator as the 'caretaker of assets' can (and usually does) bring an end to the business of the company (a fact that the applicant for appointment must draw to the court's attention and explain why it is not considered appropriate to seek an injunction or to give the company notice of the application (*Re City Vintners*, unreported 10 December 2001, Etherton J)).

There are, however, an increasing number of instances in which the court has used the appointment of a provisional liquidator as an alternative to administration. Although this approach is not perhaps as novel as it first appears, recent cases emanating from the Birmingham District Registry in particular, show that provisional liquidation may be used for the purpose of achieving a more favourable realisation of a company's business or assets than might be achieved in either administration or liquidation.

Developments in the use of provisional liquidation

It is not ordinarily within the powers and duties of a provisional liquidator to realise assets. In *Ashborder BV* v. *Green Gas Power Limited* [2005] EWHC 1013 (Ch) an injunction was granted preventing the provisional liquidators from selling the company's rights in litigation to the same creditors who appointed them. Etherton J considered it:

'*…neither a straightforward nor obvious proposition… that the duty of the provisional liquidators is to realise the assets of the companies for the best value they can achieve at the time. Provisional liquidators are, as the name indicates, appointed provisionally, pending the hearing of the winding up petition. Their appointment… is usually to preserve assets pending the hearing of the winding up petition. They are not liquidators following a winding up order, seeking to realise the assets of the company for the best value they can reasonably obtain.*'

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The courts have, however, been prepared to entertain the use of provisional liquidation more flexibly. In *MHMH Ltd* v. *Carwood Baker Holdings Ltd* [2005] BCC 536 the appointment of a provisional liquidator was sought by a group of FSA-regulated companies providing financial advice to the public and subject to substantial claims for mis-selling. The companies had (before the appointment) entered into an agreement for the sale of the business that was subject to a term providing that if the companies were subject to 'a relevant insolvency event' the buyer would be released from further payment of the consideration. Unusually, a 'relevant insolvency event' was not defined as including the appointment of a provisional liquidator. Moreover, the appointment would enable members of the public to initiate claims under the FSA compensation scheme.

It was contended by the buyer that the use of provisional liquidation was an abuse of process and that it was not open to them to sell the assets. Evans-Lombe J did not agree. He made the appointment, holding that the categories of case in which a provisional liquidator might be appropriate under section 135 of the Insolvency Act 1986 (the Act) was not closed and that the authorities demonstrated 'the flexibility of the remedy'. Enabling the sale of the business protected an asset (the rights to payment under the sale agreement).

A similar flexible approach was adopted in the following cases where administration was either inappropriate or unavailable:

In *Re Daewoo Motor Company Limited* (No. 366 of 2001) (unreported, 18 January 2001) a provisional liquidator was appointed to achieve an orderly disposal of assets under the protective mantle of an automatic stay of proceedings.

In *Re Bank of Credit and Commerce International SA* [1992] BCC 83 a provisional liquidator was appointed to administer the UK affairs of BCCI for a period of over two years so that investigations could be undertaken to see whether it was possible to arrive at a worldwide Scheme of Arrangement.

In *Smith* v. *UIC Insurance Co. Ltd* [2001] BCC 11 provisional liquidators were appointed because administrators could

not be appointed in respect of an insurance company.

More recently, in *Re Arm Asset Backed Securities SA* [2014] BCC 252 provisional liquidators were appointed, not because the assets of the company were in jeopardy, but because they were in a better position than the company's directors to progress proposals for a CVA or other arrangement and for an orderly realisation of the company's assets.

The Birmingham cases

Recent cases in the Birmingham District Registry demonstrate a greater preparedness to appoint provisional liquidators not only because administration is inappropriate or unavailable, but where provisional liquidation is regarded as *preferable*. Provisional liquidators are subject to direct court oversight, which may be directed to achieving both a speedy realisation of assets and greater scrutiny of fees.

In *Data Power Systems Ltd* v. *Safehosts (London) Ltd* [2013] BCC 721 His Honour Judge Simon Barker QC was faced with (in effect) two opposing applications for an administration order by rival factions within the company (a shareholder and creditor on one side, a director and creditor on the other). The only issue on which there was agreement was that the company was insolvent. The parties were engaged in a 'turf war' as to the debts owed by the company and as to who should be appointed administrator.

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The evidence before the court was unsatisfactory in a number of respects. The judge concluded that it had not been demonstrated that the purposes of administration (set out in paragraph 3(1) of Schedule B1) would be met. The company had never traded and (aside from an expressed hope) there was no evidence that it could be established as a going concern. There was insufficient evidence to enable the court to conclude that administration would achieve a better result from creditors than being wound up; on the contrary, the evidence suggested that the costs of administration would absorb whatever assets became available to administrators, leaving nothing for unsecured creditors. As there were no secured creditors, the third objective of administration was also not engaged. The court declined to make an administration order holding that, while the threshold for the grant of an administration order is not a high one:

'The circumstances of this case serve as a reminder that insolvency alone is not sufficient to engage the jurisdiction for an administration order to be made, and further that the requirement of para. 11(b) of Sch. B1 is not a mere formality capable of being satisfied by assertions unsupported by cogent evidence sufficient to enable the court to be satisfied that, if an administration order is made, the purpose of administration is reasonably likely to be achieved.'

There was, however, significant plant and machinery that might be realised for the benefit of creditors, but for that to be meaningful the realisation would have to be achieved sooner rather than later. Accordingly, the judge treated the administration application as a winding up petition and appointed a provisional liquidator as a 'neutral person to come in, take over the company, and be charged with realising its assets with a view to raising as much as realistically possible for distribution to creditors as a whole'. That appointment was made with a view to increasing speed and limiting costs. Indeed, the judge kept a watchful eye over the fees of the provisional liquidator, which had to be approved by the court at the outset. The practical considerations of such an appointment for a provisional liquidator are considered further below; one other case is worthy of mention.

In *Re Brown Bear Foods Limited* [2014] EWHC 1132 (Ch) (also before His Honour Judge Simon Barker QC) the court declined to make an administration order and appointed a provisional liquidator. This was despite the fact that (unlike Safehosts) the preconditions for making an administration order *had* been made out. It appeared that the applicant company had made a number of payments to connected parties or for non-business purposes after presentation of a winding up petition. The court was concerned that an administration order would neutralise the effect of section 127 of the Act (so that the dispositions would cease to be void). Although the court could have made an immediate winding up order, this might have had the effect of preventing a more favourable realisation for creditors (since two potential purchasers of trade and assets had already been identified). Instead, a provisional liquidator was appointed with powers to get in and realise the assets of the company, to investigate the circumstances of the questionable dispositions and to apply for a validation order if appropriate.

Practical considerations

1. ***Powers and functions***

Sections 135(4) and (5) of the Act provide that the provisional liquidator shall carry out the functions conferred on him and that his powers may be limited by the order appointing him. Orders defining the scope of the provisional liquidator's powers should be drafted as comprehensively and permissively as possible, albeit consistent with the stated functions, to avoid creditor challenge. Where provisional liquidation is used as an alternative to administration, it is tempting simply to include the administrator's broad powers in Schedule 1; however, that is unlikely to be approved where (at least in part) the provisional liquidator has been appointed with a view to limiting the duration and costs of the appointment. There are also powers for which specific provision should be obtained (in particular those exercisable only with sanction in a winding up by the court, for instance the power to continue to trade).

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2. ***Section 127 of the Act***

Where the purpose of the provisional liquidation is the sale of assets, section 127 is potentially engaged (as a disposal post-petition). Providing that the power of sale is specifically provided for in the order, sanction will already have been provided.

3. ***Control and payment of remuneration***

Often the court will wish to retain control of costs and this may form part of the reason for the appointment. It is sensible to prepare a costs budget and seek an order fixing remuneration under rule 4.30(1) and (2) of the Insolvency Rules 1986. A crucial point is that without an order the expenses will not be paid out immediately but instead will rank as an expense in the liquidation. Upon the winding up order being made the Official Receiver will be appointed liquidator under section 136 of the Act (there is no equivalent provision to section 140 of the Act, which allows the court to appoint as liquidator of the company the person whose appointment as administrator has ceased to have effect). Before the provisional liquidation concludes, therefore, approval for the totality of the remuneration and costs should be obtained together with an order for payment out. □

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