Property receivership and borrower insolvency

1. The past year has been exceptionally difficult for many individuals and companies. We have seen a raft of measures passed with the aim of offering temporary relief from covid-related financial difficulties. However, it is very likely that we will be seeing a large number of people and businesses entering one or more of the various insolvency processes.

2. This article will consider the interaction of those processes with receivership (specifically fixed charge and Law of Property Act receivers) – and the effect on four issues in particular:

    i. The lender's power to appoint a receiver
    ii. The appointment of a receiver which predated the entry of the borrower into the insolvency process
    iii. The deemed agency of the receiver
    iv. The receiver's ability to commence and continue legal proceedings, specifically for possession

3. These issues overlap to a considerable degree. There are also perhaps fewer cases addressing them than one might expect. Where there are gaps in the authorities, it is necessary to reason from first principles and draw analogies.

4. Ultimately, the important 'take home' message from this article should be that whenever one is confronted with a borrower who has become subject to an insolvency process, questions need to be asked about the effect of that process on the receivership and any pending or potential proceedings, at the earliest possible opportunity. It should not be assumed that it is safe or sensible to proceed as normal, ignoring the borrower's status.

Insolvency processes – a brief summary

5. Before considering their effect on receivership, it is useful to begin with a brief overview of the key insolvency processes and their legal effects.

6. This article will focus on:

Company insolvency processes

i. **Administration** – when a company is placed in administration, an insolvency practitioner is appointed as administrator of the company, with a view to fulfilling one of three statutory objectives;
    i. first, rescuing the company as a going concern;
    ii. if that is not possible, then, achieving a better result for the creditors than likely if the company were wound up;
    iii. or if that is also not possible, realising property in order to make a distribution to one or more secured or preferential creditors.

    On the making of an administration order, the company's property will remain vested in the company, but importantly, a statutory moratorium is imposed which prevents the taking of steps to enforce security over the company's property, as well as the commencement and continuation of legal proceedings – without either the administrator's consent or the court's permission.

ii. **Liquidation** – (and I will be focusing on compulsory liquidation). When a winding up order is made, a liquidator is appointed to run the company. Unlike an administrator, who is seeking to rescue the company if possible, the role of the liquidator is to secure and realise the company's assets, distribute them to the company's creditors; and then dissolve the company. As in the case of administration, the company's property remains vested in the company (up until the company is dissolved, when, if it has not been disposed of, it will pass to the crown as *bona vacantia*). Liquidation does to some degree involve the imposition of a moratorium, but it is of a different scope to the moratorium imposed on administration.

iii. **CVAs.** In each of these, the company continues to exist, can enter into new contracts and incur new debts, and no moratorium is automatically triggered, although may be.

Other company insolvency processes include the appointment of a receiver or a manger; Schemes of Arrangement under Part 26 of the Companies Act 2006; and the new Part 26A Restructuring Plans. It is also important to be aware that the Corporate Insolvency and Governance Act 2020 has introduced moratoriums (initially for 20 days but subject to possible extension) during which no steps to enforce any security over the company's property can be taken (except steps to

enforce a collateral security charge), and no legal process can be started or continued, save with permission of the court. Whilst the Act provides that no application can be made for permission in respect of a debt for which the company has a payment holiday, a company will not be entitled to a payment holiday in respect of debts or liabilities arising under a contract or other instrument involving financial services- which fortunately, for lenders, is a fairly broad carve out.

Individual insolvency processes

iv. **Bankruptcy:** notably, unlike company liquidation, a bankrupt's estate, including the mortgaged property, will vest in the trustee in bankruptcy.

v. **IVAs**: just like in the case of CVAs, the debtor's property remains vested in him, and he can enter new contracts and incur new debts.

Finally, we have the new **Breathing spaces** – introduced by the Debt Respite Scheme (Breathing Space Moratorium and Mental Health Crisis Moratorium) (England and Wales) Regulations 2020. If a breathing space is initiated, a moratorium will commence, during which a creditor cannot take steps to enforce moratorium debts. These include mortgage arrears which predate the breathing space.

7. So, those are the key insolvency processes. We will not be able to consider the effect of all of them on all of the issues above – but the key point to note is that whenever you are confronted with a borrower subject to one of these processes, the effect of that needs to be considered.

Right to appoint a receiver

8. With that in mind, we now consider the first of our four key issues: if the borrower enters one of these processes, what effect does that have on the lender's right to appoint a receiver?

9. Looking first to liquidation, subject to any problems with the validity of the charge (note in particular the requirement to register any company charge with Company's House within 21 days of creation, failing which the charge will be void as against a liquidator, administrator or creditor), the making of a winding up order does not affect the lender's power to appoint a receiver (*In Re Northern Garage Limited*, pg 191) – although, as we

will consider later, it does not follow from that principle that once appointed the receiver can simply proceed to ignore the fact that the borrower has gone into liquidation.

10. If the borrower has instead entered administration, it is clear that the effect of the statutory moratorium (Insolvency Act 1986 Schedule B1 paragraph 43) is that a receiver cannot be appointed without the administrator's consent or permission of the court, which has a discretion.

11. A key case on the principles a Court should apply when considering whether to grant leave is *Re Atlantic Computer Systems* [1990] BCC 859. In that case it was noted that, unlike liquidation, administration is a process designed to give a company a temporary breathing space. As such, unless granting leave would in any event further the purpose of the administration, the Court must think carefully before granting leave, and should carry out a delicate balancing exercise, of the interests of the secured creditor on one hand, and other creditors on the other. The Court set out twelve helpful guidelines:

> (1) It is for the person who seeks leave to make out a case for him to be given leave.
> (2) The requirement for leave is to assist the administrator in achieving the statutory purpose of the administrator. If granting leave is unlikely to impede that, leave should normally be given.
> (3) Otherwise, the court has to carry out a balancing exercise, between the interests of the secured creditor and those of the other creditors
> (4) In carrying out that balancing, great importance is to be given to the proprietary interest of secured creditors
> (5) It will normally be a sufficient ground for the grant of leave if significant loss would be caused to the secured creditor by a refusal. Conversely, if substantially greater loss would be caused to others by the grant of leave, or loss which is out of all proportion to the benefit which leave would confer on the secured creditor, that mitigates against giving leave
> (6) In assessing these respective losses the court will consider matters such as: the financial position of the company, its ability to pay the arrears and continuing instalments, the administrator's proposals, the period for which the administration order has already been in force and is expected to remain in force, the effect on the administration if leave were given, the effect on the applicant if leave were refused, the end result sought to be achieved by the administration, the prospects of that result being achieved, and the history of the administration so far.

(7) In considering these matters it will often be necessary to assess how probable the suggested consequences are.

(8) This is not an exhaustive list. For example, the conduct of the parties may also be a material consideration sometimes

(9) The above considerations may be relevant not only to the decision whether leave should be granted or refused, but also to a decision to impose terms if leave is granted.

(10) The above considerations will also apply to a decision on whether to impose terms as a condition for refusing leave.

(11) On such applications an important consideration will often be whether the applicant is fully secured. If he is, delay in enforcement is likely to be less prejudicial than in cases where his security is insufficient.

(12) In some cases there will be a dispute over the existence, validity or nature of the security which the applicant is seeking leave to enforce. It is not for the court on the leave application to seek to adjudicate upon that issue, unless (as in the present case, on the fixed or floating charge point) the issue raises a short point of law which it is convenient to determine without further ado. Otherwise, the court needs to be satisfied only that the applicant has a seriously arguable case.

12. Care does need to be taken when applying these however, as they predate the changes enacted by the Enterprise Act 2002, the objective of which is to facilitate company rescues wherever possible – such that the guidelines may actually be said to place excessive weight on the interests of secured creditors.

13. An example of the guidelines being applied is *Sinai Securities Ltd v Hooper* [2003] EWHC 910, which involved a charge which the administrator had indicated it intended to dispute as a transaction at an undervalue. Neuberger J considered that the first question to addressed was the strength of the attack on the charge. He considered there to be a reasonably good prospect of at least a substantial part of the charge remaining (a successful attack would probably just reduce it), such that it was appropriate to go on to exercise the statutory discretion. He framed the issue as one of the merits of receiver versus administrator. On the facts, the most important point was that the land had development potential. Due to availability of funds the receiver stood a much better prospect of obtaining planning permission, which would substantially enhance the value of the land to the benefit of creditors of the company, both secured and unsecured. The lender offered undertakings to procure that sufficient funds were available to enable a

planning application to be made and that the land would not be disposed of until planning permission had been granted. The administrator was unable to give equivalent undertakings (again due to lack of funds). As such, permission was granted for the appointment of a receiver, subject to those undertakings.

14. It seems unlikely that a CVA would end the lender's powers to appoint a receiver (although it will be important to consider the effect of any moratorium by which the appointment of a receiver might be caught).

15. Turning to individuals, there are even fewer cases. It seems likely that the position of a bankrupt borrower would be considered analogous to the company liquidation cases.

16. Finally, it should be noted that where the ground relied upon for the appointment of a receiver is winding up or bankruptcy, the effect of sections 110 and 205(1)(i) of the Law of Property Act 1925 are that leave must be sought before appointment in any event.

What if a receiver has already been appointed?

17. Where a receiver has already been appointed, and the borrower enters an insolvency process, the position is as follows:

    i. It is clear from the cases that the receivership will survive the borrower going into liquidation.
    ii. Likewise, a CVA should not end the receiver's appointment.
    iii. Administration is trickier. The position seems to be that the administration itself will not end the receivership. The case of *In Re Fivestar* [2015] EWHC 2782 (Ch) states this but admittedly does not explain why. It is however consistent with the fact that the administrator has a power, under paragraph 41 of Schedule B1, to require the receiver to vacate office, which if exercised will end the appointment. It should be noted that this does not preclude the making of a subsequent application for permission for the receiver to be reappointed, as was done successfully in *Promontoria (Chestnut Ltd v Craig* [2017] EWHC 2405.
    iv. The position as regards individuals would presumably again follow the company liquidation cases.

The effect on the deemed agency

18. Even if a receiver can be appointed or the receivership survives, the entry of the borrower into insolvency may well affect the deemed agency (and it is this issue with which most of the cases on this topic have been concerned).

19. In particular, the authorities make clear that where a winding up order has been made, the receiver will no longer be deemed agent of the borrower (*Gosling v Gaskell* [1897] AC 575). Although there are a number of consequences which follow from this, the effect is perhaps less drastic than one might think. The winding up does deprive the receiver of the power to bind the company personally (presumably because the entry by the company into any new liability would exceed the company's powers). However, it will not affect the receiver's powers to hold and dispose of the company's property comprised in the debenture/charge, including (it would seem – see *Barrows v Chief Land Registrar*, unreported) his power to use the company's name for that purpose – those powers are given by the charge. Case law establishes that the receiver can even issue and continue a lease extension claim under the 1954 Act, even though that would impose liabilities on the borrower (*Gough's Garages Ltd v Pusley* [1930] 1 KB 615). Tozer and Crampin suggest that the key distinction is that the receiver cannot impose liabilities on the borrower which would be provable in the litigation against the unsecured assets.

20. There do not appear to be any cases considering the effect of an administration order on the deemed agency. Because the administrator is expected to run the company (unlike the liquidator who is winding it up), there is a good argument that the arguments which explain why the deemed agency terminates on liquidation do not apply to administration (although of course, given that any exercise of the receiver's powers has to be with the administrator's consent, this may be of little practical use).

21. Likewise, a CVA leaves management of the company with the directors; there is merely oversight by an insolvency practitioner. As such, the reasoning in the authorities on the end of deemed agency in liquidation would again not appear to apply.

Enforcement proceedings

22. Finally, we turn to the effect of an insolvency process on legal proceedings (focusing specifically on possession claims).

23. Where the borrower has gone into liquidation, s130(2) of the Insolvency Act 1986 provides that "When a winding-up order has been made or a provisional liquidator has

been appointed, no action or proceeding shall be proceeded with or commenced against the company or its property, except by leave of the court and subject to such terms as the court may impose."

24. One interesting question is the applicability of this provision where the receiver's claim has been brought not against the insolvent borrower, but against a third party in occupation– is that a claim against the company's property? It might be said not, as a key theme on the cases dealing with the effect of insolvency on receivership is the fact that, as Goulding J said in *Sowman v David Samuel Trust* [1978] 1 WLR 22, "in truth the rights and powers given by the debenture are themselves property, but not property of the company" (it is this which explains why dispositions by receivers are not caught by the avoidance of disposition provisions in s127 of the Insolvency Act 1986). However, there are other provisions which suggest that such a claim *is* caught by s130 – for example, the power of a liquidator to disclaim onerous property under s178 expressly includes (as is clear from s179) a power to disclaim leasehold property subject to a mortgage – which must be on the basis that that property is that of the company, notwithstanding that it has been mortgaged.

25. Where leave does have to be sought, the cases suggest that it should be granted as of right – although there is an important caveat which is sometimes overlooked, namely that leave should be granted *unless the secured creditor would obtain the same relief in the winding up* (*In Re David Lloyd* (1877) 6 Ch D 339).

26. The cases suggest that leave probably can be sought retrospectively, although there are some cases which suggest it cannot, and the limits of are not entirely clear.

27. There are similar requirements to seek leave where an individual is bankrupt (s285 of the Insolvency Act 1986) – although there is an express carve out for secured creditors seeking to enforce their security in s285(4)- and where a company is in administration (paragraph 43 of Schedule B1).

28. Finally, it should be noted that there is also an older line of cases (e.g. *Re Pound, Son & Hutchins* (1889) 42 Ch D 402) which establish that it is a contempt of court to take possession from an officer of the court without leave – a further possible pitfall for receivers, and yet another reason why, wherever the borrower has entered an insolvency process, and particularly if any incumbent insolvency practitioner is court appointed, alarm bells should be sounding.

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7 June 2021