International Corporate Rescue

Published by:
Chase Cambria Company (Publishing) Ltd
4 Winifred Close
Barnet, Arkley
Hertfordshire EN5 3LR
United Kingdom

www.chasecambria.com

Annual Subscriptions:
Subscription prices 2017 (6 issues)
Print or electronic access:
EUR 730.00 / USD 890.00 / GBP 520.00
VAT will be charged on online subscriptions.
For 'electronic and print' prices or prices for single issues, please contact our sales department at:
+ 44 (0) 207 014 3061 / +44 (0) 7977 003627 or sales@chasecambria.com

International Corporate Rescue is published bimonthly.

ISSN: 1572-4638

Valuation of Services for the Purposes of Section 245 of the Insolvency Act 1986

Robert-Jan Temmink QC, Barrister, Quadrant Chambers, London, UK, and **Victoria Kühn**, Associate, Proskauer, London, UK

Synopsis

Section 245 of the Insolvency Act 1986 ('IA 1986') declares certain floating charges automatically invalid if they were created within a specific time before the commencement of an administration or winding-up of the chargor, subject to certain exceptions. Floating charges are not invalid to the extent that they secure new value provided in the form of money, goods or services or a reduction (including a discharge) of a debt of the chargor.

In *Re Peak Hotels and Resorts Ltd Crumpler and another (joint liquidators of Peak Hotels Resorts Ltd) v Candey Ltd* [2019] EWCA Civ 345 the Court of Appeal (the 'Court') provided clarification and guidance in relation to the valuation of services provided to a chargor under a fixed fee agreement where payment for those services had been secured by a floating charge.

The Court made clear that a floating charge is valid only to the extent of the value of the services actually supplied under the fixed fee agreement. That was so irrespective of the fact that the fixed fee arrangement might provide for a facility for the chargor to draw on as many services under the fixed fee agreement as required. To the extent that the value of the services actually supplied fell short of the full amount of the fixed fee - and the floating charge therefore did not cover the whole of the fixed fee - the difference remained provable in the insolvency proceedings as an unsecured claim.

Section 245 of the Insolvency Act 1986

A common method under English law of taking security over an asset is to encumber the asset with a charge. A charge entitles the charge-holding lender to such amount of the proceeds of sale of the encumbered asset as is required to discharge the debt secured by the charge. English law distinguishes between fixed and floating charges. A fixed charge attaches to a specific asset, or assets, while a floating charge 'hovers' over a shifting pool of assets (present and future), e.g. inventory, allowing the chargor to use or trade the assets in the ordinary course of business until some future step is taken by or on behalf of those interested in the charge. At that point, the floating charge crystallises and the chargor is no longer permitted to use or trade the assets without the charge-holder's consent. A charge is not categorised as fixed or floating merely by dint of the label creating it; instead, the court will consider whether a charge-holder has sufficient control over the charged assets. Where there is control the charge will be considered a fixed charge, otherwise it will be a floating charge. The distinction becomes particularly important when a chargor becomes insolvent.

Section 245 IA 1986 provides that a floating charge is invalid if it was created within one year (or two years where the chargee is a connected party) before an administration or winding-up of the chargor is commenced unless, and to the extent that, the charge secures new money's worth provided by way of consideration at the same time or after the creation of the charge ('New Value Exception'). New money's worth can be provided in the form of new money (as the name suggests), the discharge or reduction of existing debt, or by goods or services supplied to the chargor.

In an insolvency situation, the classification of security is of critical importance for the ranking of the creditor's debt claim in the subsequent payment to creditors out of the insolvent's assets. The general position is that the proceeds from the realisation of any company assets which are subject to a fixed charge are distributed first to satisfy the debt secured by the relevant fixed charges, followed then by the expenses of the administration or winding-up, and after that by debts secured by floating charges (subject to a relatively small deduction of the prescribed part which is made available to unsecured creditors) and, lastly, *pari passu* to the unsecured creditors.

Facts of the case and findings of the High Court

British Virgin Islands-incorporated holding company Peak Hotels and Resorts Limited ('Peak') held a stake via a joint-venture vehicle in the luxury Aman Resorts hotel group. Shortly after purchase of the hotel group in January 2014, the joint venture partners' relationship broke down and international litigation in relation to control of the hotel group and funding arrangements ensued. Candey Ltd, a small firm of solicitors, acted for Peak in that litigation which involved proceedings in the English High Court, international arbitration in Hong Kong and proceedings in the BVI courts.

Peak had experienced cash flow issues and faced a potential bill for Candey's fees at the conclusion of the litigation in a sum estimated to be £5 to £6 million if no settlement could be reached. Peak and Candey agreed that Candey would be entitled to a fixed fee of circa £3.86 million (plus interest of 8% p.a. from judgment or settlement) for its legal services provided in the proceedings and the payment of outstanding fees would be rescheduled. The fixed fee would not have to be paid until a judgment on liability was handed down or a settlement was agreed in the subset of the proceedings referred to by the Court as the 'London Litigation' unless Peak obtained cash from elsewhere (the 'Fixed Fee Agreement'). To secure Candey's claims under the Fixed Fee Agreement, on 21 October 2015 Peak executed a deed of charge and security in favour of Candey (the 'Charging Deed') creating continuing security by way of fixed and floating charges over all of Peak's assets, undertakings, any damages and any other sums flowing from the claims.

In February 2016, Peak entered liquidation proceedings in the BVI while the London Litigation was at a critical stage. The Liquidators subsequently managed to achieve a settlement in the London Litigation so as to prevent further costs being incurred. Upon Peak's entry into liquidation, the fixed fee became due under the Fixed Fee Agreement and, relying on the Charging Deed, Candey claimed to be a secured creditor for the full £3.86 million in the liquidation. Candey claimed the whole sum despite the fact that, based on its standard hourly charging rates, the value of the services provided by Candey had been significantly lower.

While not challenging the fixed fee in their application before the English High Court, the Liquidators challenged the asserted security. The English court had recognised the BVI liquidation proceedings in relation to Peak in February 2016 as main foreign proceeding under the Cross-Border Insolvency Regulations 2006 and the parties agreed that the matter should be conveniently dealt with in the English court.

The main issues before the High Court were (1) whether certain properties fell within the relevant charges of the Charging Deed; (2) to the extent the property fell within the charge, whether the charge was a fixed or floating charge; and (3) to the extent the charge was a floating charge, whether s.245 IA 1986 applied to limit the sums secured.

In a judgment dated 23 June 2018[1] the Deputy Judge in the High Court, His Honour Judge Davis-White QC, found that (1) both the monies paid into the court by Peak and received by the Liquidators upon settlement of the London Litigation, and the monies formerly held on trust for Peak in a bank account, were 'property' falling within the terms of the Charging Deed; (2) the charges over that property were floating charges because there was inadequate control over the assets for the charges to be considered fixed; and (3) the threshold conditions of s.245 IA 1986 were satisfied so as to limit the sums secured to the value of the services supplied at or after completion of the Charging Deed. The judge considered that further evidence was required to determine the value of the services supplied and that matter would have to be dealt with separately. A separate hearing on the valuation of the services was heard by His Honour Judge Raeside QC on 22 November 2017 who held that the value of the services supplied was to be measured by reference to the Fixed Fee Agreement and was therefore the whole of the fixed fee.

The Liquidators' appeal of HHJ Davis-White QC's decision that the monies paid into court and subsequently paid out to the Liquidators were subject to the charge was dismissed. The Liquidators also appealed the valuation of the services by HHJ Raeside QC with permission granted by the judge.

Judgment

The Court (judgment by Lord Justice Henderson with whom the others agreed) allowed the Liquidators' appeal of HHJ Raeside QC's judgment and remitted the question of the valuation of the services supplied by Candey after completion of the Charging Deed to the High Court.

The Court rejected the submission by Candey that the Fixed Fee Agreement was akin to a facility by which Peak could draw on Candey's legal services regardless of the amount of work that would be required and should consequently be valued on that basis for the purpose of ascertaining the extent of the floating charge. Instead, the Court relied on the wording in s.245(6) IA 1986 which focused on the services actually supplied after the creation of the charge ([36-37]). The charge would be valid only to the extent of the value of those services actually supplied while the consideration agreed in the Fixed Fee Agreement would merely determine the extent of Candey's claim in the liquidation as an unsecured creditor.

With respect to the test for determining the value of the services supplied, the Court referred to s.245(6) IA 1986 and considered that the test was an objective one. '[T]he exercise required by section 245 […] is

Notes

1 [2017] EWHC 1511 (Ch).

retrospective, and requires a valuation with the benefit of hindsight of the work which has actually been done.' ([39])

Value, therefore, must be ascertained by 'an objective and retrospective assessment of the amount that Candey could reasonably have charged for those services in the ordinary course of business' on the same terms as they had been supplied save for the consideration agreed ([40]). For the purpose of determining what Candey could reasonably have charged, the Court considered that Candey's standard terms, charging on a time-basis with monthly invoices, would be 'likely to provide an appropriate basis' ([40]) for valuation. At the same time the Court cautioned that the service supplier's standard terms could only serve as guidance and could not be conclusive because, given that the test was objective, it could not necessarily be assumed that the supplier of the services would have been Candey itself rather than another firm with comparable expertise and resources ([41]).

Analysis

The Court recounted the legislative history of s.245 IA 1986, tracing its history from s.212 of the Companies (Consolidation) Act 1908 (when floating charges created within a specified time before entry into insolvency were invalid *ab initio* save when cash was provided at or after their creation) to s.245 IA 1986 (in which the provision of goods and services was accepted as an equivalent of cash for the purposes of the New Value Exception). In contrast to the view presented by the authors of *Sealy & Milman: Annotated Guide to the Insolvency Legislation* in their commentary on s.245(2) IA 1986 who consider it is hard to see why other value provided, e.g. real property, is not to be taken as as providing good value for the purposes of the New Value Exception, at [17] the Court approved the passage in Goode, *Principles of Corporate Insolvency* (5th Edition, 2018, para 13-111) which explicitly states that the extension of the New Value Exception to goods and services is expressly restricted to 'those forms of benefit to the company which arise from day-to-day trading and finance and have readily ascertainable value. Excluded are a wide range of other assets, both tangible and intangible, including land and buildings, intellectual property rights, debts and other receivables and rights under contracts.'

From this analysis the Court distilled the purpose of s.245 IA 1986 as being:

(i) the prevention of the preferential treatment of a floating charge-holder in the payment waterfall vis-à-vis the company's unsecured creditors; where

(ii) the charge is created at a time when the chargor is already in financial difficulty and is later placed into administration or liquidation; and where

(iii) such charge-holder has obtained the charge without providing value equivalent to the charge in addition to the assets existing at the time of creating the charge. ([33])

The valuation test in s.245(6) IA 1986 prescribes that 'the value of any goods or services supplied by way of consideration for a floating charge is the amount in money which at the time they were supplied could reasonably have been expected to be obtained for supplying the goods or services in the ordinary course of business on the same terms (apart from the consideration) as those on which they were supplied to the company'.

In the light of that explicit wording, the Court considered that the valuation test should be the sole guide to the valuation of the services. It rejected the approach of adducing other standards as aides for measurement, as HHJ Raeside QC had done when he considered whether the fee in the Fixed Fee Agreement was reasonable within the meaning of s.61 of the Solicitors Act 1974.

Analogy to facility

The Court rejected the argument that the Fixed Fee Agreement was a facility provided by Candey under which Peak could draw legal services as and when Peak required them. And consequently rejected the argument that the valuation of the service should take that call-off arrangement into account when determining the extent to which the floating charge is valid under the New Value Exception.

The Court concluded that the Fixed Fee Agreement did not, in fact, create a commitment on the part of Candey akin to a facility: the legal work which Candey had undertaken to provide was specifically related to specific proceedings and did not allow Peak to draw whatever legal services it might require. Additionally, Candey had the right to withdraw from the Fixed Fee Agreement at any time.

Notwithstanding the Court's conclusion as to the nature of Candey's commitment under the Fixed Fee Agreement, the Court made clear that whether or not there was a facility-like commitment was irrelevant. The words 'at the time [the services] were supplied' in s.245(6), presumably as interpreted in light of the section's purpose, required the valuation to be based on the work actually done by Candey at or after the creation of the floating charge. Services 'promised' but not supplied under the Fixed Fee Agreement would not be value for the purpose of the New Value Exception.

To hold otherwise would, of course, have given Candey an unwarranted windfall: it would have jumped the queue of unsecured creditors for a *pari passu* distribution in respect of fees it hoped to receive for work it hoped to carry out, but which in fact it had not done and for fees which had not, in fact, been incurred.

That said, whilst the Court's conclusion that the valuation should be based on the actual work done by Candey is unassailable in this particular case, it remains to be seen whether another Court could be convinced to find that a fixed fee agreement by which a client could draw on legal services as and when required could, as a matter of principle, amount to a valuable service for the purpose of the New Value Exception. That position appears to have been contemplated by HHJ Davis-White QC. At [119] of his judgment he explained that he 'accept[s] what has to be valued is the services supplied to the company and not the services contracted to be supplied, but that of course does not determine what services were, for these purposes, 'provided'.'

As ever in these situations, everything will depend on the context and what, precisely, has been agreed. On the one hand, a call-off arrangement for legal services required from time to time, subject to an overall cap on fees, is likely to result in a Court considering what has been called-off and what the value of those services were. On the other hand, a fixed-price fee for work over a period of time, however much work was done, might well amount to the provision of a service sufficient to trigger the New Value Exception.

Guidance on the valuation of services

The Court provided further guidance on the valuation of Candey's services since creation of the floating charge.

In respect of the term 'ordinary course of business', the Court clarified that this denoted the ordinary course of the supplier's business, i.e. Candey's business as solicitors, irrespective of the enhanced credit risk associated with Peak as the purchaser of the services ([44, 45]). Therefore, neither a charge for credit in the form of compensation for delayed payment nor increased charging rates or other special terms of business attributable to the risk of non-payment can enter the valuation considerations for the purposes of s.245.

The Court reached this conclusion on the basis that the purpose of the words 'ordinary course of business' clearly had a function to perform, part of which was to insulate the valuation of the services actually provided from any increase in the supplier's normal charging rates or other special terms of business caused by an increased risk of non-payment.

Similarly, the objective standard did not, in the Court's view, permit consideration of the particular circumstances which led Peak to negotiate the Fixed Fee Agreement to be taken into account. Accordingly, the value pursuant to s.245(6) IA 1986 could not include compensation for the delay in payment. Instead, s.245(2)(c) IA 1986 provided a saving for contractually-agreed interest and it would have been inconsistent with that express statutory right if Candey were also able to include such charge by means of the definition of the services supplied.

In this respect, by excluding any special terms of business attributable to the increased credit risk, the Court seems to have concluded that the valuation test in s.245(6) IA 1986, by reference to 'the ordinary course of business on the same terms [...] as those on which they were supplied', requires that the terms assumed for the purposes of valuation be the same as would be agreed with a healthy solvent company. However, it is not obvious that the valuation test does require that such terms should be assumed, nor is it clear why it should. Why should service-providers not put in place either extra security, or additional terms to protect themselves, or to compensate them for the unwelcome effects of insolvency as part of their normal course of business? If it is market practice to provide services to financially distressed companies on different terms compared to financially healthy companies, why should the former be considered to be supplied outside the ordinary course of business?

Moreover, if the legislators had intended that the value of services for the purpose of the New Money Exception be determined by reference to a healthy going-concern, would it not be expected to have said so expressly and without adding 'on the same terms (apart from the consideration) as those on which they were supplied'?

By including services in the New Value Exception, the legislators added a source of value supporting a floating charge which is more flexible than the mere provision of money. *Goode* stated that the value of services in day-to-day trading is readily ascertainable and was therefore added to s.245 as another foundation of value for the purposes of the New Money Exception. However, the assumption that value is readily ascertainable is only correct where the valuation basis is taken either to be the actual consideration agreed for the services supplied, or fair market value determined for the service actually delivered. In either case, at least certain special terms of business that take into account the increased credit risk, e.g. increased rates, should not reasonably be disregarded in such consideration and valuation. If they were to be disregarded, the legislators could and should have expressly stated as much.

In fact, the statement that the legislators intended to insulate the valuation of the service for the purpose of s.245 from any terms of business occasioned by an increased credit risk also appears inconsistent with the saving provision for interest in s.245(2)(c). In the case of cash provided to a company under a new money facility, it is accepted market practice for the lender to charge higher interest if lending to a financially distressed entity than if lending to a financially healthy company. Section 245(2)(c) saves all of such interest charged without restriction as to the portion of interest attributable to the higher credit risk of the borrower-chargor.

Conclusion

The Court in *Re Peak Hotels and Resorts Ltd Crumpler and another (joint liquidators of Peak Hotels Resorts Ltd) v Candey Ltd* helpfully provided further guidance in relation to the definition of services supplied for the purposes of s.245 IA 1986 where a fixed fee was agreed and in relation to the terms which can be taken into consideration when determining the value of the services supplied for the purpose of the New Value Exception.

While the Court's conclusions in respect of the facts of the case are readily understandable, the Court's statements of principle may have inadvertently excluded perfectly reasonable agreements and intentions between supplier and consumer/chargor and chargee where the price of services was agreed between the parties and legally secured prior to any insolvency. In excluding the possibility that a facility type of service could be taken into account when determining the valuation of a service actually supplied; or that special terms occasioned by working for a risky client could be taken into account, the Court may have gone slightly too far.

International Corporate Rescue

International Corporate Rescue addresses the most relevant issues in the topical area of insolvency and corporate rescue law and practice. The journal encompasses within its scope banking and financial services, company and insolvency law from an international perspective. It is broad enough to cover industry perspectives, yet specialized enough to provide in-depth analysis to practitioners facing these issues on a day-to-day basis. The coverage and analysis published in the journal is truly international and reaches the key jurisdictions where there is corporate rescue activity within core regions of North and South America, UK, Europe Austral Asia and Asia.

Alongside its regular features – Editorial, US Corner, Economists' Outlook and Case Review Section – each issue of *International Corporate Rescue* brings superbly authoritative articles on the most pertinent international business issues written by the leading experts in the field.

International Corporate Rescue has been relied on by practitioners and lawyers throughout the world and is designed to help:

- Better understanding of the practical implications of insolvency and business failure – and the risk of operating in certain markets.
- Keeping the reader up to date with relevant developments in international business and trade, legislation, regulation and litigation.
- Identify and assess potential problems and avoid costly mistakes.