IP Alerter

March 2024

DOWNS
SOLICITORS AND NOTARIES

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Welcome to the Spring edition of Downs IP Alerter. We try and bring a mix of educational and interesting articles to this bulletin and hope we have done that this time around. Highlights include:

- **Future regulatory landscape of the insolvency profession.**
- **Litigation funding in the spotlight and what it means for IPs.**
- **Will a slimmed-down Body Shop be enough to save the cosmetics brand?**
- **Answers to some recently-asked insolvency questions**

Administrators hope to save and slim-down the Body Shop

The future of another of the UK's best-known and much-admired High Street brands appears uncertain as the Body Shop's UK business entered administration on 13 February 2024.

The owners of The Body Shop, Aurelius, took the decision just weeks after completing the £207 million takeover of the cosmetics retailer. FRP Advisory, a private equity firm, has been appointed to handle the insolvency in Britain, where the Body Shop has over 200 stores and c2,500 staff.

The priorities for FRP Advisory are to scale down the High Street operation and scale up the online sales and marketing. Proceeds from the sale of assets will go in part to paying down debt. The Body Shop posted a loss of £71 million in 2022.

The decisions being taken by FRP Advisory appear drastic. But the brand remains popular and relevant. Only time will tell what form the Body Shop takes in the months and years ahead, however, all indications appear to be it will be significantly slimmed down.

2023 Corporate Insolvency Statistics

Following the pandemic in March 2021, there were 814 monthly appointments but by the end of last year this had increased to 2,312 monthly appointments, with a total for the year of 25,160, being the second highest since 1986.

The majority of the appointments related to the hospitality, manufacturing and construction sectors, although the retail sector had a number of big-named closures. The appointments have shown an increasing number of CVL's as opposed to Administrations.

Reforms to the regulation of Insolvency Practitioners

Between December 2021 and March 2022, the Government invited responses on the future of insolvency regulation. Insolvency regulation started in 1994 and the self-regulation approach has been successful since then. However, after 30 years, any organisation or process should be reviewed to ensure it remains fit for purpose.

What were the potential insolvency reforms?

The Insolvency Service suggested several possible reforms that were considered as part of the consultation process:

- A single register of insolvency practitioners.
- A financial compensation system for those who had suffered loss or distress.
- A single regulator, compared to the existing four Recognised Professional Bodies (RPBs).
- Future regulation to include the insolvency firm as well as individual office holders.

What are the proposed insolvency reforms?

The results of the consultation were published by the Insolvency Service in September 2023. The highlights were:

- A register of insolvency practitioners will be set up, although not immediately.
- A compensation scheme will not be introduced. A further consultation will be held regarding this, addressing how in particular to distinguish between distress caused by an insolvency itself, and that caused by an office holder.
- The Insolvency Service will **not** be appointed as the single regulator of the insolvency profession. The insolvency profession has succeeded in showing that self-regulation by the existing four RPBs is best for the profession. However, material changes are needed to the way self-regulation is carried out with RPBs expected to 'deliver significant and measurable improvements to the quality of regulation'.
- Responsibility for the ethical and professional standards for the profession to be switched to the Secretary of State from the RPBs.

It is interesting to note that despite self-regulation being the continued modus-operandi, legislation is to be brought in to enable a single insolvency regulator to be introduced should this become necessary in the future. The RPBs are expected to deliver improvements in the quality of self-regulation now, and the Government will be watching.

Further reading

12 September 2023. The Future of Insolvency Regulation – Government Response.

Should insolvency practitioners be concerned by the Supreme Court's decision regarding the enforceability of Litigation Funding Agreements (LFAs)?

In the long-awaited and decision in R (on the application of PACCAR Inc and others) v Competition Appeal Tribunal and others [2023] UKSC 28 ("PACCAR"), the Supreme Court held, that litigation funding agreements ("LFAs") under which a litigation funder receives a percentage of any damages recovered by the claimant are damages-based agreements ("DBAs") within the meaning of section 58AA of the Courts and Legal Services Act 190 ("CLSA"). As a consequence, unless the LFAs satisfy the requirements for valid DBAs as set out in section 58AA CLSA and the Damages Based Regulations 2013 ("DBA Regulations 2013") they will be unenforceable.

Background

The issue arose from the applications of two claimants, UKTC and RHA, to bring collective proceedings against DAF for breaches of competition law. To obtain the collective proceedings order, UKTC and RHA needed to show that they had adequate funding arrangements in place. UKTC and RHA relied on LFAs to meet this requirement. The LFAs provided that the funder's maximum remuneration was calculated with reference to a percentage of the damages ultimately recovered. DAF argued the LFAs were unenforceable because they did not comply with the statutory rules governing DBAs. The Competition Appeal Tribunal and the Division Court both rejected DAF's arguments.

However, the Supreme Court allowed DAF's appeal. It held by a majority of four to one (Lady Rose dissenting) that where funders are entitled to a percentage of any damages recovered under LFAs, these constitute DBAs. Section 58AA CLSA provides that where a LFA takes the form of a DBA it will be unenforceable unless certain conditions are complied with. It was common ground in this case that the LFAs at issue did not satisfy the relevant requirements and therefore, if the agreements were found to be DBAs, they would be unenforceable.

Under section 58AA CLSA, as amended in 2013, DBAs are defined as "an agreement between a person providing advocacy services, litigation services or claims management services and the recipient of those services […]". The question before the court was whether "claims management services" include the provision of litigation funding, which was the funder's only involvement in the proceedings. The Supreme Court adopted a conventional approach to statutory interpretation and held that the words "claims management services" referred to in section 58AA CLSA were capable of including the provision of litigation funding. As a result, the LFAs fell within the definition of DBAs under the legislation and were unenforceable.

Impact on Insolvency Practitioners

A natural outcome of such a decision would be for most Insolvency Practitioner's to undertake a detailed review of their own LFAs. However, this exercise ultimately places greater pressure on the insolvency litigation funders who, up until recently, have enjoyed a relative 'cornering' of the litigation funding industry. The short-term impact on the litigation funding industry will be funders rushing to review and re-negotiate existing LFAs. Furthermore, whilst the Supreme Court decision was not a direct criticism of litigation funding per se, more an example of the law of unintended consequences, it is likely new and correcting legislation will follow. This is of course, a development that Insolvency Practitioners will want to keep a keen eye upon over the following years.

While this decision is unlikely to impact the availability of litigation funding outside of

collective opt-out proceedings in the long term, it is going to cause significant ripples in the short term, as funders, funded parties and their litigation opponents work through the implications for existing and future funded cases.

Litigation Funding and Insurance

Regarding the article above, we have arrangements to secure litigation funding and legal costs insurance for IP's if required. The PACCAR case in the Supreme Court [2023] UKSC 28 concluded that litigation funding agreements in which funders are entitled to a percentage share of damages fall within the statutory definition of damages-based agreements. Accordingly, in the future there is an element of uncertainty as to the best model for underpinning funding arrangements, though assignment of the cause of action is still very much an option.

Insolvency Service in successful prosecution against a Director who dissolved a company seven days after receiving Covid-19 bounce back loan

The Insolvency Service was granted new powers in December 2021 to investigate Directors of dissolved companies suspected of closing their businesses to avoid re-paying Covid-19 support loan, most commonly known as the government bounce-back loan.

Amongst seven successful cases, we highlight RKV Consultancy Ltd and its Director, Rajesh Dhirajlal Vaghela. The company was incorporated in March 2019. 14 months later Vaghela applied, through his bank, for a £25,000 bounce-back loan. The loan was paid into the company bank account. But within a week of receiving the money Vaghela filed paperwork with Companies House to have the business dissolved. He later transferred all of the loan money to personal bank accounts.

The striking-off application to dissolve a company makes clear that creditors e.g. a bank with an outstanding loan, should be notified within seven days of applying to close the business. Failure to notify interested parties is a criminal offence.

Vaghela pleaded guilty to the charges in February 2023. Two months later he was sentenced to six months in prison (suspended for 18 months) and ordered to pay £2,150 costs. This case shows that the Insolvency Service remains very much alive to carrying out investigations into not only bounce-back loans, but all Covid-19 funding provided by the government.

Recent case updates

Darty Holdings SAS v Geoffrey Carton-Kelly; re CGL Realisations Ltd [2023] EWCA Civ 1135

The Court of Appeal determined that with reference to whether a transaction is voidable as a preference under Section 239 of the Insolvency Act 1986, the directors concerned must have been "influenced in deciding to give [the preference] by a desire [for such purpose]".

That meant the timing and nature of the decision had to be identified, together with the related issue as to whether that decision was motivated by a desire to prefer. If the two elements are not connected in time, Section 239 may not be transgressed.

Brake v The Chedington Court Estate Ltd [2023] UKSC 29

The Supreme Court concluded that an Application pursuant to Section 303(1) of the Insolvency Act 1986 [ie where a bankrupt or creditors or any other person are dissatisfied with any act, omission or decision of the Trustee in Bankruptcy, on an application the Court may make such Order as it thinks fit] was restricted in respect of "any other person" to a party having some tangible interest in the outcome of the bankruptcy as opposed to otherwise being simply "substantially affected".

The related case of "Patley Wood Farm LLP v Kicks" [2023] EWCA Civ 901 considered the ambit of a successful Application under Section 303 following the Court of Appeal decision in Re Edengate Homes (Butley Hall) Ltd [2002] 2 BCLC which required the presence of perversity or bad faith on the part of the Trustee in Bankruptcy. The Court of Appeal re-affirmed that a Trustee in Bankruptcy (and their corporate equivalents) owes a duty to act in the interests of creditors, but not at all costs. An office-holder is not required to work for free nor to take unreasonable risks, particularly if any action may result in little relative benefit to the creditors.

Ntzegkoutanis v Kimionis [2023] EWCA Civ 1480

The Court of Appeal has clarified that where a shareholder seeks relief by bringing a claim for unfair prejudice under Section 994 of the Companies Act 2006, he can also claim relief for loss suffered by the company in the same proceedings i.e. by bringing a derivative claim against the directors in respect of a cause of action vested in the company and seeking relief on behalf of the company (Section 260 of the Companies Act 2006). The Court's permission is however required to continue such a claim contained in the Petition and must be supported by evidence to substantiate the basis of the claim.

In this case, the Petitioner claimed that the directors had diverted assets of the company to another company solely owned by the directors, in breach of their fiduciary duties to the company.

Some recent questions

Q: Is the liquidation of a company effective if the resolution to enter CVL was passed after the company was struck off but before it was dissolved?

A: The answer simply is that the company has been dissolved and so does not currently exist. It cannot therefore be considered to be in any form of liquidation until and unless it is restored to the register. The restoration process, whether under Section 1028(2) or 1032(a) of the Companies Act 2006 should validate the prior liquidation process, but if via a Court restoration, you should seek the Court's declaration that the liquidation was properly instituted. It follows that after the company name has been struck off the register, but before it has been dissolved upon publication of a Notice in the Gazette, the company will exist as an unregistered company for the purposes of the Insolvency Act 1986 and cannot be wound-up voluntarily.

Note, however, that if the company had been compulsorily (rather than voluntarily) wound-up, this would still be effective (Section 1000(7)9b)) of the Companies Act 2006.

Q: Does a CVA bind contingent creditors?

A: Whether, and the extent to which, a creditor is bound by a CVA will be a function of its terms. This will always be fact-specific. In the recent case of Snoozebox Ltd v Health and Safety Executive [2023] EWHC 851 (Ch) it was held that liquidators with a preference claim were bound by, and entitled to participate in the Respondent's CVA.

Q: On what grounds can an Administrator appoint a director to the company in administration?

A: Paragraph 61 of Schedule B1 to the Insolvency Act 1986 does not prescribe any specific grounds to remove directors from office or appoint directors to the company, irrespective of whether there is a vacancy. In the absence of fraud, the Court will usually only interfere if the office-holder has done something unreasonable and absurd that no reasonable person would have done.

Save the Date

We will be hosting our seminar for IP's on **19 June** from 4pm onwards at **Dorking Rugby Club**. Our guest speaker will be from Radcliffe Chambers. More details to follow.

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