Hat & Mitre PLC: Still *in Administration* (Despite Efforts from Majority Shareholders)[1]

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Synopsis

This is, in the court's own words, 'a most unusual' case, involving stakeholder standoffs, a difficult administration and procedural irregularities. The court's judgment provides welcome relief for the administrators of Hat & Mitre PLC (the 'Company') and interesting reading for those operating in the field of insolvency, holding that:

(a) the director who, as part of a directors' out-of-court administration application, made the statutory declaration on insolvency was entitled to take the view that the Company was insolvent, but had he not been so entitled, this would not have affected the validity of the administrators' appointment;

(b) the directors who exercised their power to appoint administrators did not do so for an improper purpose, but had they done so, this would have rendered the administrators' appointment voidable rather than void ab initio; and

(c) the administrators did not cause unfair harm to the Company's majority shareholders and that, if considering returning a balance sheet solvent company to solvency, administrators are right to: (i) seek to ensure that any proposal for doing so will achieve the statutory objective of rescuing the company as a going concern; and (ii) consider the interests of all shareholders (including minority shareholders).

Facts

The Company's board of directors comprised Mr Kitchen, Mr Kebbell, Mr Young and Mr Thoburn. Mr Kitchen and Mr Kebbell (the 'Majority Shareholder Directors') were also majority shareholders, while Mr Young and Mr Thoburn (the 'Minority Shareholder Directors') held minority interests. In instances of deadlock, the chairperson held the casting vote.

The Company's sole income was rental income in respect of two commercial properties, which it let to an associated company ('MSP'). MSP's shares were held by the same parties in the same proportions as the Company's. Both the Company and MSP were encountering financial difficulties and, in early 2017, MSP stopped paying the Company rent.

The Majority Shareholder Directors and the Minority Shareholder Directors clashed over potential solutions to the Company's financial difficulties. The Minority Shareholder Directors proposed that the Company should either find a new tenant for, or sell, the properties, but the Majority Shareholder Directors wished to use the properties to raise funds to on-lend to MSP (and indeed went on to obtain a conditional offer from a third-party funder for a loan (the 'Potential Third Party Loan')).

Amid these tensions (and somewhat surprisingly), Mr Kebbell (one of the Majority Shareholder Directors) handed the role of chairperson, and therefore the casting vote, to Mr Young (one of the Minority Shareholder Directors) in November 2018. In December 2018, a validly constituted board meeting was held at which the Minority Shareholder Directors voted in favour of, and the Majority Shareholder Directors voted against, appointing administrators using the directors' out-of-court appointment route. The vote was carried by the casting vote of Mr Young, who then went on to make a statutory declaration that the Company was, or was likely to become, unable to pay its debts. The Company's assets (worth c. GBP 6.5 million) very significantly exceeded the amounts of its liabilities (c. GBP 200 000), which in turn exceeded its cash (c. GBP 2000).

Notwithstanding initial objections from the Majority Shareholder Directors as to the validity of the appointment (based primarily on their belief that the Company was not insolvent), the Majority Shareholder Directors refused the administrators' offer to apply to the court for an all-parties' directions hearing on the validity of the appointment and stood by, and indeed actively

Notes

1 *Kebbell & Anor v Hat & Mitre PLC & Ors (As Joint Administrators of Hat & Mitre PLC)* [2020] EWHC 2649 (Ch) (the 'Judgment').

engaged with the administrators, while the administration proceeded.

However, over a year later, the Majority Shareholder Directors and the Minority Shareholder Directors were still in disagreement. The Majority Shareholder Directors proposed that the Company should exit administration after paying off all 'legitimate' liabilities. However, their proposal did not provide for a proper business plan for the Company going forward. The Minority Shareholder Directors opposed this proposal arguing that it would not be in the interests of the Company's shareholders as a whole if the Company was unable to pursue potential misfeasance claims against the Majority Shareholder Directors in respect of how the Company had come to be exposed to such large amounts of unpaid rent from MSP.

The administrators attempted to facilitate an agreement between the directors to return the Company to solvency and to trading as a going concern. In September 2019, when it became clear that no such agreement could be reached, the administrators made plans to sell the properties and to finalise their investigations into the Company's potential misfeasance claims against the Majority Shareholder Directors.

In January 2020, 14 months after the Company had entered administration, the Majority Shareholder Directors applied to the court to obtain a judgment that the Company was not, or no longer should be, in administration. At court, counsel for the Majority Shareholder Directors sought an order that the administrators' appointment:

(a) was void ab initio because the Minority Shareholder Directors were, contrary to section 171(b) of the Companies Act 2006, exercising their powers for the improper purpose of furthering their interests as minority shareholders at the expense of the majority shareholders;

(b) should cease to have effect pursuant to paragraph 81 of Schedule B1 to the Insolvency Act 1986 ('Schedule B1') because the Minority Shareholder Directors were motivated by an improper motive; or

(c) should cease to have effect pursuant to paragraph 74(4)(d) of Schedule B1 because the administrators had acted, and continued to act, in a way that unfairly harmed the Majority Shareholder Directors' interests as shareholders.

Despite arguing that the Minority Shareholder Directors were motivated by an improper purpose and/or motive, and much to the court's open frustration, the Minority Shareholder Directors were not joined as respondents to the proceedings nor were they called as witnesses.

The judgment

Insolvency

The court held that the Minority Shareholder Directors were entitled to take the view that the Company was or was likely to become unable to pay its debts. The Majority Shareholder Directors' counsel argued, among other things, that the availability of the Potential Third-Party Loan meant that the Company could have continued to meet its liabilities. The court, applying *In re a Company* [1986] BCLC 261, acknowledged that a need to borrow to pay short-term liabilities is not necessarily an indication of a present inability to pay debts. However, the court continued that 'merely because a particular form of funding would save a company from cash-flow insolvency does not mean that directors who procure it will be acting… so as to comply with their duties'. Indeed, the Majority Shareholder Directors' Potential Third-Party Loan involved on-lending the proceeds to MSP, which the court held demonstrated the 'Majority Shareholder Directors' unrelenting focus' on 'getting any cash raised out of the Company and into MSP'.

In addition, the court held that even if the Minority Shareholder Directors were not entitled to take the view that the Company was, or was likely to become, unable to pay its debts, the effect would be that Mr Young had perjured himself and not that the administrators' appointment was invalid. In doing so, the court distinguished between in-court administration appointments (where the *court* must be satisfied that a company is or is likely to become unable to pay its debts) and directors' out-of-court administration appointments (where the *director* who makes the statutory declaration must have a conscientious belief in the truth of what s/he declares).

Improper purpose

On the facts, the court held that the Majority Shareholder Directors had not 'come anywhere near establishing that the power was not in fact exercised for a purpose for which it was conferred' (i.e. one of the objectives specified in paragraph 3 of Schedule B1). More interestingly, the court held that even if the Minority Shareholder Directors had exercised their power to appoint administrators for an improper purpose, the effect would be that the administrators' appointment was voidable rather than void ab initio.

In doing so, the court, applying *Howard Smith Ltd v. Ampol Ltd* [1974] AC 821, held that in order to determine the consequences of improperly exercising a power, it was first necessary to identify the source of that power, which in this instance was Schedule B1. Counsel for the administrators and the Company drew the judge's attention to the wording of paragraph 81(1) of Schedule B1 which provides that '[o]n the application

of a creditor of a company the court may provide for the appointment of an administrator of the company to cease to have effect at a specified time'. They argued that the words 'cease to have effect' was evidence that the statute did not anticipate that any appointment made pursuant to an improper purpose would be void ab initio. The court agreed, holding that the wording of paragraph 81 was a 'powerful indication' that the statute did not envisage any situation in which an appointment is rendered automatically void. In addition, the judge considered academic texts (such as Palmer's Company Law which states that '[a]n exercise of power for improper purposes is voidable not void') and the 'real practical difficulties' which would arise if an administration, a class remedy, could be held to be a nullity on the basis of an improper purpose 'which may or not have been discernible by the administrators at the time of the appointment'.

The judge added, obiter, that had he been satisfied that the Minority Shareholder Directors' purpose was indeed improper, the delay in bringing the application would have been 'highly relevant' to the question of what relief could be granted. He added that 'it is incumbent on those who wish to challenge the appointment of administrators to take steps to do so as soon as practicable' and that, in this case, the challenge should have come 'no later than the time at which the administrators sent out their statutory proposals'.

Improper motive

The court also dismissed the Majority Shareholder Directors' late additional argument that the administrators' appointment should cease to have effect due to the Minority Shareholder Directors' alleged improper motive, holding that it would be 'quite wrong' to make a finding in respect of this claim. Paragraph 81 of Schedule B1 empowers a court to provide that an administrator's appointment should cease to have effect where a creditor proves an improper motive on the part of the person who made that appointment. As Mr Kebbell was also a creditor of the Company, he was able to seek to advance this claim. The court agreed with the counsel for the administrators and the Company: it would be procedurally unfair to be required to deal with such a claim for a number of reasons including that the Minority Shareholder Directors had not been joined to the proceedings despite being accused of serious wrongdoing.

Unfair harm

The court held that the administrators had not caused unfair harm to the Majority Shareholder Directors as shareholders; instead, the administrators had approached a 'difficult administration' in an appropriate way. First, the court dismissed the argument made by the Majority Shareholder Directors' counsel that the administrators had not properly considered whether the Company should have entered into administration in the first place and that, had the administrators done so, they would have been obliged to apply to court under paragraph 79 of Schedule B1 to bring the Company's administration to an end. To the contrary, the judge found that the administrators had properly considered the Majority Shareholder Directors' arguments and pointed to their invitation to the Majority Shareholder Directors to fund an all parties' directions hearing on the point as evidence in support of this.

Secondly, the court agreed with counsel for the administrators and the Company that, per *Davey v Money* [2018] EWHC 766 (Ch), the administrators could not accept any proposal for returning the Company to solvency unless the proposal would achieve the statutory objective of rescuing the company as a going concern. The court held that the Majority Shareholder Directors' proposal 'had no regard to what would happen once the creditors had been paid in full' and so was 'not properly capable of acceptance in the form put forward'. In addition, the court held that the administrators were justified in regarding the need for a proper business plan going forward as all the more important in light of the allegations of the potential misfeasance of the Majority Shareholder Directors.

Finally, the court held that where a company in administration is balance sheet solvent, its administrators have a duty to consider the interests of the Company's shareholders as a whole when deciding the appropriate course of action. As such, it was appropriate for the administrators to seek to broker an agreement between the two factions of shareholders, especially because such an agreement would have increased the prospects of the Company continuing as a going concern in the future.

Comment

In summary, this judgment contains important lessons for lawyers, administrators and those seeking to challenge administration appointments. For the lawyers, this judgment establishes that the validity of a directors' out-of-court administration appointment will not be affected by a director who perjures themselves when making the statutory declaration on insolvency. In addition, any such appointment made for an improper purpose will be voidable rather than void ab initio.

For those wishing to challenge administration appointments, this judgment serves as an important reminder that they are well-advised to take steps to do so as soon as practicable. In addition, for those wishing to establish an improper purpose and/or motive on the part of the appointing directors, they are well-advised

to join the appointing directors to the proceedings or, at the very least, invite them to submit evidence.

Finally, the judgment serves as a useful reminder to administrators that, where a company is balance sheet solvent, they are right to consider the interests of shareholders as a whole and to insist that any proposal to restore the company to solvency goes beyond simply settling its debts and extends to meeting the statutory objective of rescuing the company as a going concern.