

Feature

KEY POINTS

- If there is not going to be a full return to secured creditors this ought to have a bearing on how administrators approached a para 71 application.
- A para 71 application requires a balancing act between the rights of fixed charge holders and other creditors. The court will not simply defer to the administrators' commercial judgment.

Author James Bailey

A warning to administrators: the Insolvency Act applies in Hollywood too

Office holders have been given a firm reminder of their obligations, and the potential consequences of not keeping them in mind, in the two recent decisions in *Rubin and anor v Cobalt Pictures Limited and ors* [2010] EWHC 2240 (Ch) and [2010] EWHC 3223 (Ch).

In the current economic climate, administration is a popular insolvency regime by which a company's business can be plucked from the sinking ship, leaving the unsecured creditors to fend (and typically flounder) for themselves. However, much of the administration process operates outside court which potentially allows for abuse. The decision in *Rubin v Cobalt Pictures Limited* serves as a warning to office holders that there are limits to the extent they can hide behind the purported exercise of their commercial judgment and highlights the cost to the office holder of misjudging the position.

In particular, the court noted that office holders need to ensure that they 'act expeditiously and with the robustness of purpose ... which one is entitled to expect' (per Rimer LJ in *Coyne and Hardy v DRC Distribution Limited* [2008] BCC 612).

THE FACTS

The case concerned the administration of a company incorporated in England under the name Capitol Films Limited ('Capitol'). Capitol was one of a well known group of companies, the ultimate parent being a California incorporated company called R2D2 LLC, which was engaged in the business of the production and distribution of motion pictures. Until at least January 2009 the group was owned jointly by a Mr David Bergstein (a prominent figure in the film industry in the USA) and a Mr Ron Tutor (reported recently to have joined in the acquisition of Miramax and its film library for \$660m).

Capitol's main assets primarily consisted of the contractual rights to distribute films owned by various production companies. The films included many lesser known titles such as 'The Trial', 'The Secret Chargee', 'Rogue Trader' and 'Cover-Up', as well as more mainstream films such as 'Lucky Number Slevin'.

The group came under certain financial pressure and Capitol in particular encountered severe cash flow pressure from the beginning of 2008. Matters deteriorated and in January 2010 an approach was made to Mr Rubin, an insolvency practitioner, with regard to a possible administration. Capitol's liabilities to its secured creditors appeared to be of the order of US\$100m. An administration order was ultimately made on 18 January 2010.

Very shortly after the commencement of the administration, it became apparent that there was controversy regarding precisely which films Capitol had rights to. Whereas it had been understood immediately prior to the administration that Capitol had rights to at

least 100 films or possibly more, it transpired that perhaps only 44 films remained with the company, the others appearing to have been transferred to a company called Pangea Media Holdings Limited.

Administrators need to bear in mind when exercising their commercial judgment in relation to the sale of assets that they are still officers of the court and must have clear rationale for proceeding in a particular way the more so if there is opposition from secured creditors.

The Administrators took steps to sell Capitol's film library, although it was not entirely clear which films they considered they were selling. An attempt to circumvent the problem was made by framing the contract for sale along the lines of 'such films as Capitol might have' without giving any warranties in that respect. However, marketing efforts appeared only to have been made in respect of the retained 44 films.

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THE APPLICATION

The films were the subject of numerous security interests that had been registered against the Company – the charges register at Companies House reflected 89 such interests. The Administrators wished to sell the film interests free of such security and, whereas they were freely able to do so in respect of floating charges pursuant to para 70 of Sch B1 of the Insolvency Act 1986, permission of the court was required pursuant to para 71 with respect to fixed charges.

In May 2010 the Administrators issued an application seeking, among other things, para 71 permission as well as a declaration that they could sell to such offeror as they chose in their reasonable discretion.

Although more than one offer was received for the films, in June 2010 the Administrators entered into a conditional contract for sale with a company called Exodus Film Company Limited ('Exodus') for such film rights that Capitol had, together with any claims that it might have against any 3rd parties – the evidence at the hearing indicated that Exodus was controlled by David Bergstein. The contractual condition was that para 71 permission was obtained by the Administrators from the court by 31 August 2010 on account of the risk that the value of the film rights was depreciating – various production companies were purporting to terminate Capitol's rights in respect of their films on account of its insolvency.

THE PARA 71 HEARING

At the hearing in August 2010 the Administrators encountered resistance from the court, as well as from 9 secured creditors who vigorously opposed the sale. The Administrators invited the court to find that the transfer of some 81 films to Pangea was effective

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James Bailey was called to the bar in 1999. His practice covers a broad range of commercial and chancery work and his areas of specialism include personal and corporate insolvency, company law (in particular, directors' duties and s 994 petitions), commercial disputes and partnership matters.

('the Pangea Assignment') such that the price being offered by Exodus should be treated as the purchase price for the remaining 44 films.

The resistance was such that the Administrators withdrew their application during the course of the hearing and in a reasoned judgment dated 3rd September 2010 (*Rubin v Cobalt Pictures Ltd* [2010] EWHC 2440 (Ch)) in support of observations made during the course of the hearing, Mr Richard Snowden QC (sitting at a Deputy Judge of the High Court) highlighted a number of concerns about the assignment to Pangea although he stressed that without Pangea having been joined as a party, he could not make a positive or binding determination.

COSTS

Perhaps unsurprisingly, the secured creditors sought their costs of the application. However in the course of submissions, the secured creditors made significant criticisms of the Administrators with regard to their conduct of the administration generally and of the decision to bring the application which, it was argued, could not possibly have succeeded given the uncertainty regarding the assets that were being sold. Accordingly, the secured creditors sought an order:

- for their costs on an indemnity basis against the Administrators;
- that the Administrators not be permitted to recoup their own costs or any adverse costs from the assets of Capitol.

Noting that the costs involved were likely to run into several hundreds of thousands of pounds, the learned judge gave a detailed judgment examining the Administrators' conduct (*Rubin v Cobalt Pictures Ltd* [2010] EWHC 2440 (Ch)) and made a number of observations and findings:

1. The manner in which the administration order had been obtained was not satisfactory, the directors giving evidence in support of an administration order having been in office for a matter of days prior to the administration and remaining silent as to that fact;
2. Mr Rubin seemed to appreciate around the time of the administration order that certain matters, including the Pangea Assignment, cried out for investigation;
3. The need for such an investigation had been emphasised by at least one major secured creditor, which had expressly referred the Administrators to the recent Court of Appeal decision in *Coyne and Hardy v DRC Distribution Ltd* [2008] BCC 612 regarding an office holder negotiating with a director to sell the business to that director where the director had caused the company to enter into transactions for little or no value;
4. The Administrators had given the clear impression in correspondence that they were investigating the Pangea Assignment whereas in fact they had conducted no such investigation. The Administrators evidence justifying this on account of lack of funds was evidence that was rejected by the court;
5. Typically para 71 would be invoked where an administrator wished to sell a business as a going concern. In this case the Administrators knew that there would not be a full return to secured creditors which ought to have had a bearing on how the Administrators approached the application (the implication being that they should

have worked with them and/or for them, rather than against them);

6. The Administrators concluded the contract with Exodus without engaging in discussion with the fixed charge holders;
7. There were fundamental difficulties with the para 71 application since the merits of various bids were being considered with regard to 44 films, whereas what was being sold were the rights to all Capitol's films, whatever they might be. The Administrators did not give an indication of their view as to the value of any of the 81 Pangea films;
8. Surprisingly, the Administrators did not provide any evidence as to the Pangea Assignment even though they were well aware of its significance;
9. The secured creditors had opposed the application throughout and, having succeeded, would without more be entitled to their costs;
10. The Administrators were not entitled to rely on cases such as *Re Edennotte Ltd* [1996] 2 BCLC (the court should be reluctant to interfere with the commercial judgment of office holders providing they are behaving rationally) – the para 71 application involved a balancing act between the rights of fixed charge holders and other creditors. The court would not simply defer to the Administrators' commercial judgment;
11. In any event, the Administrators' conduct in making and pursuing the application was neither rational nor reasonable. The manner in which they deal with the Pangea Assignment was not appropriate. The Administrators never had any realistic prospects of obtaining the relief sought. Held: the Administrators should pay the secured creditors' costs;
12. The Administrators approach was irrational and misconceived, and they adopted an uncooperative and hostile attitude to the secured creditors in whose interests they were supposed to be acting. They ignored details and specific warnings, pressing on regardless. Held: the adverse costs should be paid on the indemnity basis;
13. By analogy with the liquidation cases, a court plainly has a discretion to deprive an administrator of recoupment of his costs from the assets of the company, eg in the case of misconduct, a 'blunder' or a serious mistake (see eg *Re Silver Valley Mines* (1882) 21 Ch D 381). In this case the Administrators' conduct amount to such a 'blunder' or serious error. Held: the Administrators should not be entitled to recoup their own costs or the adverse costs liability from the company's assets (which would also have been unjust since there was no evidence that the unsecured creditors who would otherwise lose out would have received anything from the sale contract anyway).

The moral of the story is a simple, if not expensive, one. Administrators cannot use a 'commercial judgment' justification in bringing an application under para 71 and, irrespective of who caused them to be appointed, they ignore the wishes of secured creditors at their peril. Whereas much of the business of an administration may operate outside court, office holders should expect their 'robustness of purpose' to be examined if the matter does find itself before a judge. ■