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Keay, A and Walton, P (2019) British Steel: is it a wind up? Corporate Rescue and Insolvency, 12 (4). pp. 125-128. ISSN 1756-2465

British Steel – is it a wind up?

Professor Andrew Keay is Professor of Corporate and Commercial Law, Centre for Business Law and Practice, School of Law, University of Leeds and a Barrister at Kings Chambers and 9 Stone Buildings.

Professor Peter Walton is Professor of Insolvency Law at the University of Wolverhampton

Key Points

- **The recent compulsory liquidation of British Steel raises a number of fundamental questions about the nature of compulsory liquidation.**
- **Is it possible for compulsory liquidation to be used in a manner similar to administration to rescue (part of) a company's undertaking with the costs of the process being picked up by the taxpayer rather than met by secured creditors?**
- **In this article we consider the reasons why the court ordered the liquidation of British Steel and more broadly consider the nature of compulsory liquidation and on whose behalf and for what purposes it may be ordered.**

Introduction

Media outlets in Great Britain are frequently guilty of confusing administration with liquidation. To the eyes and ears of insolvency specialists, it often seems that most journalists are incapable of understanding that administration is a temporary procedure which companies may enter with the aim of being rescued or at least achieving for the company's creditors a beneficial realisation of its assets. As can be seen from the evidence provided to the Graham Review into Pre-pack Administration, administration will often involve the running of the company's business for a period of time with the object of selling the company's business as a going concern along with (at least some of) its employees. Liquidation has a different set of priorities. Its aim is to wind up the company's assets. There is no statutory requirement to consider rescue of the company. By definition, the company will not survive liquidation.

In recent times, we have seen two very large concerns, Carillion plc and British Steel Ltd ('British Steel') enter compulsory liquidation (that is, a winding up has been ordered by the court) when administration may have appeared to be a more likely route for the respective companies to take. In both cases the Official Receiver ('OR') was appointed automatically as liquidator. In both cases, private sector insolvency practitioners ('IPs') were appointed as special managers to assist the OR in conducting the winding-up. The Right Honourable Frank Field MP, chair of the House of Commons Work and Pensions Committee, is reported in the Times (7 February 2019) as commenting on the payment in fees of £44.2 million to special managers by the Government in the Carillion compulsory winding up in the following terms:

> "In this way they are ably assisted by a merry little bank of advisors and auditors, conflicted at every turn and with every incentive to milk the cash cow dry."

Although the court's reasoning in ordering the liquidation of Carillion is not publically available, we do have the judgment of Snowden J in explaining his reasons for putting British Steel into compulsory winding up (*Re British Steel Limited* [2019] EWHC 1304 (Ch)). It is his Lordship's decision which will be discussed here. Although there are a number of largely unexplored consequences of using compulsory liquidation in the circumstances of British Steel, this article will analyse the case in light of the previously accepted wisdom as to the purpose of compulsory liquidation and on whose behalf it is generally believed that compulsory winding up is carried out. It has been previously observed that administration is the new liquidation (A Keay, 'The future for liquidation in light of the Enterprise Act reforms?' [2005] JBL 143). This note will consider whether, equally, it is possible to observe that liquidation is the new administration.

Facts

British Steel, based in the North East of England, was one of Europe's largest steelmakers with about 20 subsidiary companies and over 4,000 staff employed (with a further 1,300 agency and sub-contact workers). Its accounts to March 2018 showed a turnover of nearly £1.2 billion but with a loss recorded of nearly £19 million. In the latter part of 2018, British Steel suffered a number of financial blows. There was a fall in sales causing severe cash flow difficulties. The decline in demand was partly a result of the uncertainties around Brexit, competition from alternative suppliers in Europe, falling demand from car makers, and falling revenue from the French railway industry as well as an increase in commodity prices. In early 2019, British Steel's free allocation of carbon credits under the EU Emissions Trading Scheme was suspended by the EU pending approval of the UK's draft withdrawal agreement. Although the UK Government stepped in to purchase carbon credits to surrender on British Steel's behalf to prevent the company from being fined this did not assist the company's finances as it had previously raised finance on its carbon credit allocation.

British Steel had potentially two main sources of credit available to it but both facilities were in default and neither its asset-based lenders nor its parent companies were willing to provide any further financial support. The UK Government was approached for assistance including support to fund a possible administration process. In the absence of confirmation that such support would be on a commercial basis such state aid was not forthcoming. The company had cash sufficient for less than one week's continued trading. The directors of British Steel petitioned for the winding up of British Steel on the grounds that it was unable to pay its debts according to the meaning of that phrase found in section 122(1)(f) of the Insolvency Act 1986 ('IA 1986').

The Decision

The Court was satisfied that British Steel was, or would in the immediate future be, unable to pay its debts as they fell due and so made a winding-up order. Evidence from the directors was that unsecured creditors were unlikely to receive any dividend in the company's insolvency beyond the maximum payment of £600,000 under the prescribed part provisions of section 176A of IA 1986.

An immediate winding-up order (without the usual notice to creditors under rule 7.10(1) of the Insolvency (England and Wales) Rules 2016 ('the Rules')) was appropriate due to the trading difficulties (the grounds mentioned under section 122(1)(f)). However, in addition to finding the company to be insolvent, the Court also recognised the significant environmental and health and safety issues connected to British Steel's business. The Court stated that, without careful and continued supervision, there was a risk of gas explosion, a safety risk of flooding to surrounding areas as well as the inherent dangers of having very significant amounts of hazardous materials on site.

The possibility of placing the company into administration rather than liquidation was briefly discussed. It was not seen as a viable option on the facts. The asset-based lenders, who were the only creditors entitled to appoint administrators out of court under their security, did not agree to fund an administration. A majority of them did, however, support the proposed liquidation with the OR, a Government employee, being appointed automatically as liquidator. As an aside it may be useful to be aware that although ORs are members of the Insolvency Service and usually act as civil servants within the Department of Business, Energy and Industrial Strategy ('BEIS') before they are appointed, but they cease, when appointed:

> "to be civil servants in the proper sense of servants of the Crown employed in the business of government within (in this case) a department of state." (*Re Minotaur Data Systems Ltd* [1999] 2 BCLC 766 at 772, per Aldous LJ).

Due to the potential environmental and health and safety issues, neither Ernst & Young, which had been advising the asset-based lenders, nor PwC, which had been advising British Steel, were prepared to accept appointment as administrators.

Immediately after the winding-up order was made, the OR applied for the appointment of special managers. The OR's request was on the grounds that the OR's office did not itself have either the necessary expertise or manpower to cover the various tasks likely to be necessary in the liquidation. The Court appointed partners in Ernst & Young as special managers. The special managers provided a letter to the Court that they were satisfied that in accordance with their professional conduct obligations they did not have any conflicts of interest by reason of having acted for the asset-based lenders. The details of the order appointing the special managers appears to be a private order, the details of which are not publically available.

Analysis

In a nutshell, liquidation is a process whereby the assets of a company are collected and realised, the resulting proceeds are applied in discharging all its debts and liabilities, and any balance which remains after paying the costs and expenses of winding up is distributed among the members according to their rights and interests, or otherwise dealt with as the constitution of the company directs (*Ayerst v C & K (Construction) Ltd* [1976] AC 167); typically it is a process which prepares the company for its dissolution. There are several grounds on which liquidation may be ordered by a court but by far the most common is an inability of the company to pay its debts, that is, insolvency. The party who normally seeks a winding-up order on the basis of insolvency is a creditor. Interestingly in the case of British Steel the directors of the company were the petitioners who sought the order. This is unusual, although far from unheard of. Given the fact that the thinking at the time of the winding-up order was for the company's business to continue to run and then to be sold as a going concern (R Davies, 'What went wrong at British Steel?' Guardian, 22 May 2019), it is, at first blush, somewhat surprising that the company decided to seek a winding-up order as one might be justified in taking the view that administration would have been more suitable.

The explanation of the reason for what transpired is that to enter administration there must be an IP willing to act as administrator and, of course, that appointment may have to be funded if there are not likely to be sufficient funds available in the company to cover expenses and remuneration. As Snowden J remarked, the asset-based lenders, who were the only creditors able to appoint an administrator, were not willing to fund an administration (at [13]). Also, neither of two of the 'big four accounting firms' (which undertake large scale insolvencies and had been involved with British Steel prior to the petition to court) were willing to take on the role of administrator. The reason for this appears to be the potential environmental and health and safety issues to which the company's business gives rise (at [13]). Of course, British Steel could have instigated administration itself, either out of court or by obtaining a court order. Possibly it did not seek to do so because it could not find an IP who was willing to take on the administration.

Given the circumstances facing British Steel and its creditors it might be thought that a winding-up order with the concomitant appointment of three Ernst & Young partners as special managers was the best way forward, and certainly Snowden J was willing to accede both to the petition and to the application for the appointment of special managers. While this might be thought to be a practical solution to a difficult situation it does raise some issues and poses some interesting questions.

First, liquidation is an insolvency regime that is designed to have the assets of the company sold off as expeditiously as possible and for any businesses which the company operates to be wound up. According to the Privy Council in *Cambridge Gas Transport Corporation v Official Committee of Unsecured Creditors of Navigator Holdings Plc* ([2006] UKPC 26; [2007] 1 AC 508; [2006] 3 WLR 689): 'The purpose of bankruptcy [and liquidation by analogy] proceedings … is… to provide a mechanism of collective execution against the property of the debtor by creditors whose rights are admitted or established.' Thus, winding-up is a collective procedure designed to bring about the distribution of the assets to the creditors according to their pre-liquidation entitlements; at the core of liquidation is distribution of the assets. Yet, the rationale for the British Steel liquidation appears not to be to provide for a distribution as Snowden J was told that the unsecured creditors are unlikely to get anything from the liquidation save, possibly, a share of the prescribed part, under section 176A of the IA 1986, which would constitute a maximum of £600,000. Rather, the reason was concern over environmental and health and safety issues and the possible liability of an officeholder (at [11]) together with the fact that the secured creditors would not take any action through any of the avenues open to them, such as administration.

Unlike administration which often involves having as an aim the continued running of a company's business in order to secure a buyer, liquidation is not a regime with such an aim and so the use of liquidation might appear surprising. However, perhaps the making of a winding-up order is not as surprising in this case as it first seems to be. The courts have stated that while liquidation is, from a financial point of view, carried out for the benefit of the creditors, it is a public act or process in which the public has an interest. In the Court of Appeal in *Whitehouse v Wilson* ([2006] EWCA Civ 1688; [2007] BPIR 230) all of the members of the Court emphasised the public interest in the liquidation process. Earlier, Robert Walker LJ (as he then was), sitting in the Court of Appeal in *Faryab v Smith* ([2001] BPIR

246), observed that there was a public interest in pursuit of meritorious claims in a bankruptcy and, by analogy, liquidation.

Liquidation plays a vital public role (A Keay, 'Insolvency Law: A Matter of Public Interest?' (2000) 51 NILQ 509; R Mokal, 'What Liquidation Does For Secured Creditors, And What It Does For You' (2008) 71 MLR 699) and it is particularly the case where either a company is hopelessly insolvent, as it is not good for the public to have such companies operating in society, or where, on the petition of the Secretary of State for BEIS under section 124A of the IA 1986, a court is convinced that a company should be wound up as it is just and equitable so to do. Although British Steel was clearly insolvent and Snowden J so found, it is questionable whether one would say that it was hopelessly insolvent. Yet, while Snowden J said nothing about the public interest, perhaps it was felt that there was a public interest factor in the case, and this might have been the concern that was expressed in relation to environmental and health and safety issues (at [11]).

Of course, one interpretation of what has happened could be that British Steel is nothing more than an unusual case, involving a company that has, as set out in the judgment, a complex business (at [20]), and it is a case that will be replicated very rarely, if at all. After saying that, perhaps it is not so much of a one-off as one might think. It was only on 15 January 2018 that a winding-up order was made in relation to Carillion after the company had sought such an order. Again, this was an insolvency that one might have thought would have been handled via administration and not liquidation, and one in relation to which no private sector IPs were ready to take up an appointment.

Are British Steel and Carillion forerunners of a new era where we see liquidation become more prevalent in situations where administration once was employed and expected? Is compulsory liquidation the new administration, particularly where public interest issues are involved? Does British Steel provide a signal that more companies might be forced to seek a liquidation order rather than enter administration, perhaps because of the existence of concerns over some aspect of their business or because no IP will take on an appointment as administrator? This situation might occur as, arguably, public interest issues are involved in many insolvencies and particularly where large companies are concerned. For instance, the insolvency of a large company can devastate a local or even a regional area. Take MG Rover as an example where the administration of the company caused great upheaval in parts of Birmingham to employees, their families and facilities in the local community. The large amounts that are owed by large companies might mean that secured creditors will not be willing to fund administration and if that is the case compulsory liquidation is the only alternative. This begs the normative question whether compulsory liquidation should be employed in this kind of case.

Clearly there might be advantages in entering liquidation compared with administration in a case like British Steel, at least for the secured creditors. First, where a company like British Steel has environmental obligations, a liquidator, unlike an administrator, would be able to disclaim an asset that produces such obligations, as in the case of *Re Celtic Extraction Ltd* ([1999] 2 BCLC 555). A liquidator could disclaim any of the company's property that would attract environmental obligations and this would move the risk of environmental clean-up or other action from the creditors to the public. Here it would be the secured creditors who benefit from the disclaimer.

Secondly, there is a possible advantage as far as costs are concerned. It is not clear who will end up paying for the liquidation if British Steel's business is unable to be sold, or even if it can be sold. The cost of a liquidation will figure as a preferential payment under rule 7.108 of the Rules, but any claim for costs can only be recovered in relation to unsecured property, save for costs related to the preservation and sale of secured property (*Buchler v Talbot (*[2004] UKHL 9; [2004] 2 AC 298). The only use that the OR could make of assets that are charged is to pursue litigation in some circumstances (see section 176ZA). The House of Lords said in *Buchler v Talbot* that generally each fund, that is, the fund covering secured property on the one hand, and the fund that relates to unsecured property on the other, bears its own costs and, as the chargeholder/secured creditor has no interest in the liquidation (dealing with unsecured property), it should not have to contribute towards the liquidation expenses (at [30] and [31]). It would seem likely that many secured creditors in cases like British Steel would stand aside and not instigate administration so that the company has to enter liquidation, and by doing this they save themselves the cost of paying an administrator and the aggravation of having to make decisions about the administration.

They would have to bear the costs of the preservation and sale of the secured property if an administration occurred so what difference does it make if the company enters liquidation? They do not potentially have the same control as in administration but does it really matter? They have the advantage of not being liable for the costs, which with large companies are difficult to estimate.

There are likely to be many costs that cannot be directly related to the preservation and realisation of secured property and so these will have to be paid out of the prescribed part or the public purse. What is of particular interest is who is going to pay the fees of the special managers, because this is likely to be where one of the major costs will lie. Snowden J recognised that the value of the business was limited to the value of the assets available to the unsecured creditors which under the section 176A prescribed part provisions was a maximum of £600,000 (at [22]). Should the unsecured creditors, in effect, be required to pay for the special managers when undoubtedly part of the work of the special managers will be administering property over which the secured creditors have charges? Should their fees not be partly paid out of the secured property?

Clearly there will be other costs, in addition to those of the special managers and their remuneration, namely the expenses of the OR who may engage other parties. One assumes that these costs, once the £600,000 prescribed part is used up, will have to be paid out of the public purse. This seems unfair when, as is the case with British Steel, there is a lot of money tied up in assets, but they are secured to the hilt. It seems almost certain that the majority of the costs of the special managers (and others) will be paid by the taxpayer which may lead to similar commentary as that made by Frank Field in the context of the Carillion liquidation quoted in the Introduction above.

It is notable that Ernst & Young were not willing to act as administrators (and one would assume liquidators) because there were potential environmental and health and safety issues to which the company's business gave rise, yet they were willing to act as special managers. Does this mean that any risk in relation to the health and safety concerns are externalised and are placed, in effect, on the public purse and not the private sector in the form of the secured lenders or the IP, and if so, is that appropriate?

The facts of British Steel suggest that the company is being liquidated for the sole benefit of the secured lenders and the public may well end up funding, at least in part, a liquidation that will only bear fruit for the lenders. It is not clear from the judgment how the debt to the asset-based lenders is secured. If they have the benefit of legal title to chattels and debts, these assets will fall outside the assets of the company altogether. They will not be subject to the floating charge prescribed part deductions under section 176A and will not be available to fund the costs of the liquidation (and would not have been available to any administrator had the company entered administration). The widespread use of asset-based lending, whereby assets fall outside any floating charge as they are not assets of the company, limits the assets available to fund any potential rescue of a company. There is a strong argument in favour of limiting the rights of such asset-based lenders to those of a floating charge holder (P Walton 'Fixed and floating charges: the Great British fund-off?' (2015) 8 CR & I 18-21). It remains possible that in the future, where creditors are asset-based lenders, such creditors will favour a compulsory liquidation rather than an administration. No IP will take office as administrator if the IP is not going to get paid. If the company's free assets are likely to be no more than the maximum prescribed part under section 176A (£600,000) there would be no incentive for an IP to take a large administration appointment. It makes far more commercial sense to put the company into compulsory liquidation with the IP being appointed as special manager whereby the IP's fees will be underwritten by the taxpayer as, appears to be the situation, in the cases of British Steel and Carillion.

Ordinarily when a winding up order is made it is envisaged that the liquidator will liquidate the assets of the company in a timely fashion. Is it appropriate for a company to enter liquidation when there is a hope, if not a strategy, that the company's business is disposed of? Is that not the role of administration? Liquidation is not a regime, unlike administration, that embraces as an aim the continued running of a company's business in order to secure a buyer, and certainly it is not the norm for a liquidator to continue to keep a company's business operating, certainly for a period of any length. However, there is no law which governs the period that a liquidator may conduct a business and, according to the IA 1986, a liquidator is empowered to carry on the business of the company so far as may be necessary for its beneficial winding up (para 5 of Sch 4). While in *Re Wreck Recovery & Salvage Co* ((1880) 15 ChD 353 at 362) Thesiger LJ said that the liquidator's statutory authority to carry on business is to be construed liberally, the power is only to be exercised where it is clearly necessary and will benefit the winding up, and it does not cover activity that involves speculation with the assets in the hope of making a profit for the benefit of the creditors or shareholders. In this context 'necessary' means something more than beneficial, and it will be determined by the court, having regard to all the circumstances of the case (*Re Wreck Recovery & Salvage Co* at 360). The Court in *Re Centralcast Engineering Ltd* ([2000] BCC 727) held that a liquidator needs to have reasonable grounds for believing that carrying on the business is beneficial or else he or she may be held personally liable for any loss sustained.

As the foregoing suggests, there are a lot of questions that the ordering of the winding up of British Steel has precipitated and at the moment the decision to wind up British Steel leaves many issues unresolved. It will be interesting to see what unravels with the liquidation process, and if any more of the same ilk eventuate.