



Corporate Turnaround and Insolvency

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Validation orders – when will the court sanction payments in advance of their being made, and what factors justify private hearings?

This article takes a look at the considerations laid down in *Re Sahaviriya Steel Industries UK Limited [2015] EWHC 2726* when the court is asked to make a validation against anticipated payments – what guidance can be extracted?

Section 127 of the Insolvency Act 1986 (IA 1986) combined with the retrospective effect of section 129(2), backdating the commencement of winding up to the date of presentation of the petition, provides an effective means of ensuring company assets are not dissipated between presentation of a petition and the grant of a winding up order. In certain circumstances, the court may grant a validation order to sanction disposals of company property, either in advance or retrospectively. This was done recently (both publicly and privately) in *Re Sahaviriya Steel Industries* from which some useful guidance can be gleaned.

In *Re Sahaviriya Steel Industries*, the company applied to the court to sanction certain payments which it proposed to make, in the wake of a winding up petition which had been presented against it. The company, which manufactured coke and iron and produced electricity, had become insolvent and had, prior to receiving the petition, been negotiating to achieve a restructure of its finances or else a sale of part of its business in order to maintain the power generation and coke production businesses as going concerns. Under the latter plan, the company would be placed into liquidation and preferential creditors would be paid in full and the maximum amount of the prescribed part made available to unsecured creditors. Two previously successful validation orders had been granted, but the hearings held in private. A further application was made for a further series of payments.

The issues

In the present hearing the court had to consider a further series of payments, in order to keep its coke ovens in operation. It also had

to make a public statement, in the interests of openness, about why the previous orders had been made in private.

What did the court decide?

The court granted a validation order for the further payments in respect of the coke oven operations, albeit at lesser sum than that requested. Explaining the privacy of the previous two hearings, the court set out that the success of the previous hearings depended upon the applicant setting out the basis of the restructure/business sale plans, including the gravity of their not being achieved. That involved the disclosure of commercially sensitive information which would cause damage if disclosed at a public hearing. Since the previous hearings, however, considerable publicity had been generated as to the company's financial problems, such that a limited public statement from the court was now appropriate.

Turning to the order itself, the court explained that the two previous validation orders had been granted because the company was expecting substantial tax rebates which equalled or exceeded the expenditure in respect of which validation was sought. As a result, the previously planned expenditure would not have increased the company's indebtedness and would further the interests of the unsecured creditors by enhancing its prospects of delivering at least the planned sale of the electricity business. In the current application, however, there was no guarantee of a further substantial tax rebate, and so the court made a validation order was made in respect of a lesser sum than requested so as not to exceed the sums available to the company, even if the expected tax rebate was left out of account.

What does this mean for practitioners?

Inevitably the grant of a validation order will involve a balancing exercise of the interests of creditors against the potential harm to their prospects of recovery should the order not be granted. This is thrown into even greater relief in the context of a private hearing necessitated by reasons of commercial sensitivity and the

safeguarding of confidential information. The court will require an explanation of the reasons for both requests and applicants can expect to receive rigorous examination of their reasons.

By way of a counterpoint to this case, the recent decision in *Barclays Bank plc v (1) Registrar of Companies (2) Client Connection Limited (3) Gagen Durali Sharma [2015] EWHC 2806* shows the court's unwillingness to grant unjustified applications. That case concerned a request by a company creditor to backdate a winding-up petition brought against a dissolved company (which had been restored to the register) to the date of its dissolution in order allow the nominated insolvency practitioner to challenge certain prior transactions. The company had previously been in administration, and no recoveries had been made, so the administration ended directly with dissolution, bypassing winding up. As the creditor had failed to disclose what additional information had been discovered following dissolution, it had not made out to the court that it was "just" to make the order sought, and the application was accordingly refused.

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