Out of court administrations: a cautionary tale

In a recent case[1] the High Court held that the purported out of court appointment of administrators over a Guernsey registered limited partnership was void because the appointor used the incorrect form when giving notice of its intention to appoint.

Background

Kaupthing Capital Partners II Master LP Inc. (**"Master"**) was a limited partnership which was registered and ostensibly had its principal place of business in Guernsey. Master formed part of an investment fund (the **"Fund"**) established by the Icelandic bank Kaupthing Bank hf and was administered by an English registered limited partnership acting as general partner (the **"GP"**). In addition to the GP four limited partnerships were members and investors of the Fund. The investors were various other Kaupthing entities. Master was financed, in part, by a facility in the amount of £67 million (the **"Facility"**) provided by Kaupthing Banque Luxembourg (**"KB Lux"**).

KB Lux made a written demand on Master for repayment of the Facility. Master did not have sufficient funds to pay the amount due under the Facility and was insolvent in the sense that it was unable to pay its debts as they fell due. The GP purported to appoint English law administrators to Master, using the out of court procedure available under Schedule B1 to the Insolvency Act 1986.

Issues

Master's three largest creditors (collectively representing 99.8% of Master's liabilities) brought an action challenging both the validity of the appointment and the conduct of the purported administrators[2].

The validity of the appointment of the administrators was challenged on three grounds, namely that:

(i) Master's centre of main interest (**"COMI"**) was in Guernsey and not England so that Master could not be subject to an administration in England;

(ii) the GP, which had itself resolved to place Master into administration was not authorised to do so without obtaining the formal agreement of all limited partnerships which were members of the Fund; and

(iii) the form purporting to give notice of the intention to appoint administrators was that prescribed for placing companies into administration rather than that prescribed for effecting an administration of a partnership, for which there is a specific form prescribed under paragraph 29(5) of the Insolvent Partnerships Order 1994 (**"IPO"**).

Decision of the Court

In the recent decision of the Court of Appeal in *Stanford International Bank Limited (in receivership)*[3], the Court held that in order to rebut the presumption that the COMI of an entity is the place of its registered office it must be established by factors which are ascertainable by third parties that the COMI is somewhere other than the registered office. The factors which may be relied on are those which are objective, already in the public domain and which may be learnt from dealing with the entity in question. These factors exclude those that may be ascertained on enquiry.

Applying these principles to the facts, the Court found that, although Master was registered in Guernsey, through a network of contracts it had delegated the performance of its administrative and business functions to Kaupthing entities, principally based and operating in London. Other than entering into an initial contract which delegated the performance of its functions to the GP, Master itself did not enter into transactions or arrangements. The contracts which delegated the business functions of Master to an English entity were not in the public domain, but the filings at the Guernsey company registry were. This raised the question as to the identity of the relevant third parties for the purposes of determining the question of COMI. The Court held that the relevant third parties are those who conduct business with the

debtor in question, being the debtor's creditors, rather than those who were technically *"industry insiders"* such as the investors in this case. On the facts, the Court found that it would have been clear to third parties conducting business with Master, that Master had nothing more than a letterbox presence in Guernsey and that in substance its business was conducted out of London. Consequently, Master had its COMI in London, the presumption that COMI was at the place of the registered office had been rebutted and Master could be subject to an English administration.

The question as to whether the GP had authority to independently place Master into administration depended on whether, as a matter of Guernsey law, the powers granted to the GP to manage Master extended to causing such a fundamental change in the operational status of Master as to place it into an insolvency process. It was submitted on behalf of the creditors that, although the GP could direct the ordinary day to day matters of Master's business, taking a step that would change the nature of Master (such as placing it into administration) was a step which needed to be taken by all members of the Fund, rather than the GP alone. In the absence of clear expert evidence as to the position under Guernsey law in this regard, the Court was not willing to assume that the GP did not have the authority to place Master into administration without reference to the other limited partners.

The Court then considered whether the form giving notice of the intention to appoint administrators used by the GP was the correct form. On behalf of the purported officeholders it was suggested that Master was a 'hybrid' entity being a company for some purposes and a partnership for others, with the consequence that the GP, in making an out of court appointment, could have used either form and that it was not wrong to have used the form applicable to companies. The Court did not accept the proposition of the existence of a hybrid corporate entity and held that Master was a partnership. The IPO prescribes a separate form and, although the GP as appointor had considered the company form to be a better 'fit' than the form prescribed for partnerships, the form it used was the incorrect one. Consequently, no administration in relation to Master had commenced. The purported administration was thus void.

Comment

This decision highlights the risk faced by an appointing party and the proposed administrators in pressing ahead with an out of court appointment, where the circumstances regarding the validity of the out of court appointment are not beyond doubt. In this instance the apparently simple error of using the incorrect form led the Court to declare an administration, which had ostensibly been on foot for the best part of 18 months, to be void. The Court stated that this *"is the risk that an appointor and proposed administrators take if they use the out of court procedure in a difficult case."*

The out of court procedure for appointing administrators continues to have its place and remains a valuable means of effecting an appointment of administrators in appropriate circumstances. However, this decision makes it clear that, where there are serious questions regarding how and if the appointment of administrators can be effected, it may be prudent to mitigate against the possibility of a subsequent challenge by seeking an administration order from the court.

Mayer Brown International LLP acted for the creditor applicants in this matter. If you would like to know more about the issues raised in this case please contact:

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1 *Re Kaupthing Capital Partners II Master LP Inc,* Unreported, 1 April 2010 (*ex tempore*)
2 This note concentrates exclusively on the validity of appointment issue.
3 [2010] EWCA Civ 137

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