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‘Stop right now, thank you very much’ – The application of the Schedule B1 statutory moratorium

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Introduction

Legal proceedings may, subject to certain statutory restrictions, be pursued against a company or an individual even though they are insolvent. The primary restriction arises from the statutory moratorium against creditor action that applies to an insolvent company in administration, under Schedule B1 to the Insolvency Act 1986 (“Schedule B1”).

This article summarises the purpose and operation of the statutory moratorium, and discusses the recent case of *CargoLogicAir Ltd v WWTAI AirOpCo 1 Bermuda Ltd* [2024] EWHC 508 (Comm), which has clarified the scope of the moratorium in an important respect.

Statutory moratorium

A company in financial difficulty will face considerable pressure from its creditors, who will want to take steps to protect themselves should the company fail. However, a unilateral action by a creditor to protect its own interests can prejudice the prospects of successfully rescuing an insolvent company or its business. For example, if a landlord forfeits the lease of the premises from which the company trades, it may prevent the continuation of the company’s business as a going concern.

It is therefore important to give a company breathing space when it enters an insolvency process designed to rescue it or its business, if that rescue is to succeed. Administration is a corporate insolvency procedure intended to promote the rescue and rehabilitation of companies in financial difficulty. Administration allows a company that is insolvent to be reorganised or to have its assets realised for the benefit of its creditors.

Accordingly, Schedule B1 provides that a company has the benefit of a moratorium, preventing most creditor or other third-party action against it or its assets, from the point at which the administration process is instigated. Between the instigation of the administration process and the company entering administration, the company is usually subject to an interim moratorium.

The moratorium is effectively a freeze on creditors taking action against the company or its assets for the duration of the administration process. A creditor must either seek the consent of the administrators or the court to pursue an action against the insolvent company. This applies to secured and unsecured creditors alike.

Lifting the moratorium

Under paragraph 43(6) of Schedule B1, “*no legal process may be instituted against the company without the consent of the administrator or with the permission of the court*”. What are the circumstances in which that consent will be given?

The leading authority on the factors to be taken into account is *Re Atlantic Computer Systems plc* [1992] 2 WLR 367. In that case, Atlantic Computer Systems plc had hired computers before becoming insolvent. The company lending the computers attempted to repossess them, and the administrators argued that this was impermissible.

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The Court of Appeal held that the computers could not be repossessed. Nicholls LJ, giving the leading judgment, provided guidance on exercising rights against companies in administration.

The judge started by noting that the court is undertaking a balancing exercise between the legitimate interests of a single creditor and the legitimate interests of the other creditors of the company as a whole. The exercise is not a mechanical one. Each case calls for an exercise in judicial judgment, in which the court seeks to give effect to the purpose of the statutory provisions, having regard to the parties' interests and all the circumstances of the case.

In carrying out the balancing exercise great importance is normally to be given to the proprietary interests of the creditor. So far as possible, the administration procedure should not be used to prejudice those who were secured creditors when the administration order was made in lieu of a winding up order. The underlying principle is that an administration for the benefit of unsecured creditors should not be conducted at the expense of those who have proprietary rights which they are seeking to exercise, save to the (usually strictly limited) extent that this may be unavoidable.

Nicholls LJ continued that it will normally be a sufficient ground for the moratorium to be lifted if significant loss would be caused to the creditor by a refusal. For this purpose, loss comprises any kind of financial loss, direct or indirect, including loss by reason of delay, and may extend to loss which is not financial. However, if substantially greater loss would be caused to others by the lifting of the moratorium, or loss which is out of all proportion to the benefit which would be conferred on the single creditor, that may outweigh the loss caused by a refusal.

In assessing those losses, the court would have regard to matters such as: (i) the financial position of the company, (ii) its ability to pay its liabilities now and in the future, (iii) the administrator's proposals, (iv) the period for which the administration order has already been in force and is expected to remain in force, (v) the effect on the administration if the moratorium is lifted, (vi) the effect on the applicant if it is not, (vii) the end result sought to be achieved by the administration, (viii) the prospects of that result being achieved, and (ix) the history of the administration so far.

Where the court's attention is drawn to a number of potential consequences of the moratorium being lifted, the court will have to assess how probable each of the alleged consequences is. Thus, if loss to the creditor is virtually certain if the moratorium is lifted, and loss to others a remote possibility, that will be a powerful factor in favour of granting the application.

Finally, the conduct of the parties may also be a material consideration. If a party initially accepts the benefits of administration but only later attempts to enforce their claim when it is beneficial to them, that is a factor which would weigh against lifting the moratorium.

Defensive steps

Schedule B1 protects a company in administration from legal processes, but that company remains free to commence or continue proceedings that it has brought against another party. In that case the defendant would, *prima facie*, be prevented from defending itself under the statutory moratorium prohibiting any legal process against the party in administration.

To avoid such obvious unfairness, the court has interpreted the statutory moratorium to exclude legal processes by which a party is defending a claim made by a party in administration. David Richards LJ explained this in *Mortgage Debenture Ltd v Chapman* [2016] 1 WLR 3048 (CA):

“It follows, as a matter of basic fairness, that defendants to proceedings where the claimant is a company in administration should be able to defend themselves without restriction. This causes no difficulty in taking steps such as serving a defence or witness statements or participating in a trial. However, an issue could be said to arise where defence takes the form of an active step against the claimant company. It is established that essentially defensive steps are not within the statutory moratorium.”

The court gave examples of these “defensive steps”, such as an application by the defendant for security for costs, an application for the recovery of costs, an application for summary judgment, or a counterclaim pleaded solely to raise a defence by way of set-off.

The last of these examples was the subject of the recent case we are looking at, *CargoLogicAir Ltd v WWTAI AirOpCo 1 Bermuda Ltd* [2024] EWHC 508 (Comm). This concerned whether permission should be given retrospectively to lift the statutory moratorium to allow a counterclaim to proceed.

Offensive counterclaim

The claim in that case related to a Boeing 747 aircraft, which the defendant, *WWTAI AirOpCo 1 Bermuda Ltd* (“WWTAI”) had leased to the claimant, *CargoLogicAir Ltd* (“CLA”). The lease was meant to conclude in April 2027. However, following the imposition of a flight ban on Russian-owned or controlled aircraft in February 2022, WWTAI gave notice of termination to CLA. CLA did not accept the termination was justified. WWTAI subsequently took possession of the aircraft and sold it to a third party.

CLA claimed to be entitled to the return of the security deposit of US\$ 2 million, and to unquantified damages for having been deprived of the chance to restructure the ownership of its business to avoid the effect of sanctions. WWTAI counterclaimed for damages for loss of rent for the unexpired part of the lease, and for delivery of certain aircraft documents retained by CLA. WWTAI maintained that its damages claims could be set off or deducted from any obligation to return the security deposit.

CLA became insolvent and was placed into administration in late 2022. The claims and counterclaims were all made during 2023. WWTAI did not seek either the administrators’ consent or the court’s permission to make its counterclaim. WWTAI originally pleaded its damages claim without giving any credit for the benefit of having the aircraft returned early. It subsequently sought to give credit for market rent without advancing any case as to what the market rent was at the time, before advancing a case as to market rent but not one which matched the state in which it alleged it had retrieved the aircraft.

CLA therefore contended that the counterclaim had been issued in breach of the statutory moratorium that applies in respect of proceedings against companies in administration, that absent retrospective consent or permission being forthcoming the counterclaim should be struck out, and that permission should only be given once WWTAI’s damages claim was properly pleaded, advancing its case as to market rent for the aircraft in the state it had been in.

Paul Stanley KC, sitting as a Deputy Court Judge, heard the application. After reiterating that no legal process could be instituted or continued against a party in administration without the consent of the administrator or permission of the court under paragraph 43(6) of Schedule B1, the judge held that the fact that a counterclaim was instituted contrary to that provision was not determinative. The court had the power to give permission retrospectively (*Bank of Ireland v Colliers International UK plc* [2012] EWHC 2942 (Ch)).

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With that power in mind, the judge turned to WWTAI's argument that no permission was required from the court because their counterclaim was a "*defensive step*" within the meaning of the *Mortgage Debenture* case. WWTAI contended that their counterclaim fell within the scope of the defensive step exception because it was a direct response to the claim made by CLA.

The court disagreed, holding that the *Mortgage Debenture* exception only applies if the counterclaim is "... *pleaded solely to raise a defence by way of set-off*". Even if the counterclaim was pleaded primarily to raise a defence by way of set-off, if there is any other purpose behind the counterclaim, then permission will be required to lift the statutory moratorium.

On the facts, WWTAI did not plead the counterclaim to set-off CLA's claim. The potential value of the counterclaim exceeded the claim, therefore by definition it did more than set-off CLA's claim. The counterclaim for damages was not limited to any sum due from WWTAI, in order to limit the amount to set-off CLA's claim. Further, WWTAI's counterclaim for delivery of aircraft documents could in no way be construed as a set-off relating to CLA's claim.

It could not therefore be credibly claimed that WWTAI's counterclaim was a solely defensive step within the meaning of the *Mortgage Debenture* decision. The counterclaim had an offensive element. Permission was therefore required to lift the statutory moratorium on claims against CLA, which was in administration.

The court turned to the question of whether permission for WWTAI's counterclaim should be granted retrospectively. The starting point was the balancing exercise of the legitimate interest of the sole creditor and the collective interests of the creditors as a whole, following the *Atlantic* case. The first consideration of the court was that:

"Where a prospective creditor has a claim for unliquidated damages there will often be a strong argument that it is just for the claim to be resolved by the court."

That did not mean that the creditor would be permitted to enforce any judgment it obtained. The court held, however, that it will often be in the creditors' collective interests, as well as in the individual claimant's, for the parties to have a definitive decision about what the liability is and therefore understand the company's financial position.

The second material consideration was that the court attaches great importance to the determination and preservation of proprietary interests of the creditor. Third, even if the counterclaim was not entirely defensive, it was relevant that it was partly defensive. It would never be equitable to prevent a party from defending a claim brought by a company in administration. If amounts were found due to the defendant over and above what would be due by set-off, the court would have the option of refusing to permit any judgment to be immediately enforced, at least in part.

Taking these matters into account, the court came to the firm conclusion that permission should be given for WWTAI's counterclaims. The counterclaim for delivery of the aircraft documents engaged consideration of proprietary interests and it would clearly be inequitable if CLA were allowed to retain such documents, which had no value to them.

As for the counterclaim for damages, that claim was primarily defensive. Most, if not all, of the issues raised by that claim would have to be decided in any event under CLA's claim. It would not be in anyone's interest if these claims had to be resolved separately, with the duplication in time and cost that would involve.

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The court did, however, agree with CLA that WWTAI's counterclaim for damages had been inadequately drafted. As the court explained:

"If the applicant for permission is unable or unwilling to say with reasonable clarity what relief it expects to obtain, it cannot reasonably ask that power to be exercised in its favour."

The permission given was therefore conditional on WWTAI providing further particulars of its damages counterclaim, including WWTAI's best estimate of the market rent of the aircraft in the condition it was left by CLA.

Comment

This case is a good example of the court's practical approach taken to the grant of permission to pursue a counterclaim in circumstances where the facts and issues involved were, in substance, the same as the claim being pursued by the company in administration.

The decision reaffirms that the courts will be careful to weigh in the balance the importance of maintaining the statutory moratorium to give breathing room to the administrators, while ensuring that defendants in actions brought by insolvent companies have the ability to fairly defend themselves.

The development illustrated by the *CargoLogicAir* decision is that making a counterclaim against a party in administration is not automatically treated as a defensive step such that permission is not required to lift the statutory moratorium. To the extent that the counterclaim can be characterised as offensive, the court will have to be convinced that permission should be granted in the normal way.