# Digest

SOUTH SQUARE

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***Narandas – Girdhar v Bradstock* revisited: Has *Re Plummer* survived?**

Christopher Brougham QC on whether a long-standing authority should now be relegated to footnote status

**Brexit: Where are we going? Chequers or "No Deal"?**

Following his article in the June 2018 Digest, Mark Phillips QC provides the next instalment in his Brexit saga

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SOUTH SQUARE

# From the Editor

## Welcome to the Autumn version of the South Square Digest

As the new legal term begins, Chambers is already very busy. The 12-week *Tchenguiz v Grant Thornton* trial is underway and will continue until Christmas; the *Primeo v HSBC* appeal will soon see several members decamp to the Cayman Islands to face off against each other for a two-week appeal in front of the Court of Appeal. And later this month sees the "rule in *Gibbs*" under renewed scrutiny as the International Bank of Azerbaijan case goes up to the Court of Appeal.

In the broader legal space, our own Supreme Court and the Supreme Court of the United States have recently seen new appointments in the most markedly different circumstances: the swearing-in ceremony of Lord Kitchin and Lady Arden taking place in Westminster almost the very same day as Judge Brett M. Kavanaugh and Christine Blasey Ford gave testimony to the US Senate (and a US TV audience of nearly 30 million).

The summer saw further bad news on the high street, including the collapse of House of Fraser (sold to Sports Direct and Newcastle United's Mike Ashley for £90 million), as well as several high-profile CVAs in the retail, restaurant and fashion worlds.

On 15 September, many of us exchanged "happy 10th Lehman anniversary" emails with colleagues as a full decade passed since the collapse of Lehman Brothers. Since the last edition, the administration of Lehman Brothers International Europe (or "LBIE", as we have come to know it) has seen a very significant milestone with the sanction of the scheme of arrangement by Mr Justice Hildyard, in the process bringing an end to the "Waterfall II" and "Waterfall III" litigation, and providing for the distribution of the $8 billion surplus to creditors and shareholders. Who would have predicted that during those tumultuous and slightly terrifying days of late 2008?
What goes down goes up. However, as one set of issues (at LBIE) is resolved, rival stakeholders have recently opened new battle-fronts in the estate of Lehman Brothers Intermediate 2 Limited and Lehman Brothers Holdings PLC – the so-called "Waterfall V" application. The saga continues.

Away from the legal world, there have even been some things to celebrate. Harry Kane's "golden boot" and a first World Cup semi-final since 1990; another Royal wedding. And, as the Indian summer continues, cricket fans can fondly remember Alastair Cook's heroics at the Oval test, and the best test series in England since the 2005 Ashes.

**William Willson**

Lehman is not the only long-running saga to drag on. First, Brexit continues to dominate the headlines. "Exit day" on 29 March 2019 is now less than six months away, and still there is no consensus. The autumn party conference season saw former Foreign Secretary Boris Johnson rousing the assembled masses with his "Chuck Chequers" badge, seeking to steal the crown from "Dancing Queen" (and Prime Minister) Theresa May. A second referendum seems increasingly possible – though formulating the appropriate "question" is far from obvious. Second, the Skripal poisoning. In increasingly bizarre twists-and-turns, it claimed its first life, the aliases of the would-be GRU assassins were uncovered, and in a surreal Russian TV interview they claimed to have visited Salisbury twice (in two days) to view local tourist highlights, including the "123 metre spire" (which we have all heard of) and "Old Sarum" (which none of us have).

In the season of harvest festival, this edition sees a (record) bumper crop: almost 100 pages of articles, digests and more.

Marcus Haywood (conveniently, given it runs to over 1,000 pages) summarises the judgment in *Saad Investments Company v Algosaibi*, which saw Marcus, Michael Crystal QC and Mark Phillips QC successfully defend the largest fraud claim ever issued in the Cayman Islands. Christopher Brougham QC revisits the case of *Narandas-Girdhar v Bradstock*, and consigns the case of *Re Plummer* to the dustbin. Mark Phillips QC, in his Brexit series, follows the squabbling family on their way to Brexit as the atmosphere in the car becomes one of "increasing nervousness". Mark Arnold QC and a team from Weil Gotshal explore the UK/US' different approaches to the recharacterization of contracts. Tom Smith QC looks at the current hot topic of conflicts of interest and officeholders. And Gabriel Moss QC provides his regular update from Euroland.

For an alternative window onto the legal world, we introduce a new series – "Legal Eye" – from Madeleine Jones and Rose Lagram-Taylor, the first article of which explores Shakespeare's involvement with the law, and the law's involvement with him. And former member of Chambers (and former Deputy High Court Judge) Richard Sheldon QC turns litigant-in-person, and takes on (and vanquishes) the Goliath of Shell in the County Court.

Finally, we have the ever-popular South Square Challenge, which for this edition has a ghostly theme as we approach Halloween.

Many thanks to all for their contributions (including Richard Fisher for his assistance with this editorial). As always, views expressed by individual authors and contributors are theirs alone.

Happy reading. And if you find yourself reading someone else's copy and wish to be added to the circulation list, please send an email to kirstendent@southsquare.com and we will do our best to make sure that you will get the next edition and all future editions. ■

William Willson



# Obituary:

## Professor Ian Fletcher QC (*honoris causa*)

## Academic Member of South Square

A Personal Appreciation
by Gabriel Moss QC[1]

South Square was shocked and saddened to learn of the death of its academic member Ian Fletcher on 21 July 2018 at the age of 74. The funeral took place on Friday 10th August 2018 at St. Michael's Church, Tilehurst, Reading. Our sincere and heartfelt condolences go out to his widow and fellow legal academic, Letitia Crabb, and his sons Daniel and Julian.

Some of us had been aware that Ian had health difficulties in the last few years and had undergone an operation and subsequent treatment. Ian was however a very private person and someone who never complained or wished to draw attention to himself.

I assumed that his treatment was proceeding successfully. It was thus a great shock to receive his email on 28 May 2018 to the effect that his prognosis was now short and that regretfully he was having to disengage from his various publishing commitments. At Insolvency Intelligence we resolved to bring out a special issue in his honour and emailed him to that effect.

Ian's scholarship in insolvency law and in particular cross-frontier insolvency law was profound and internationally recognised and respected. He wrote and contributed to a vast library of respected books and articles.

Ian reached the heights of achievement and recognition in every respect that one could expect. He was a distinguished professor at UCL, one of the country's top universities, with a very highly rated law faculty. He was a Bencher of Lincoln's Inn and an honorary QC. Ian was also the only person I know who had a moot set up in his honour in his own lifetime. It reflects the huge regard of the international insolvency community for his erudition and scholarship.

Over all the years of achievement he remained a very modest and unassuming person.

I would list my appreciation of Ian under some key headings, which are echoed in a number of other recent obituaries.

**Learned.** Ian was a tremendously thorough and hard-working scholar who was widely respected throughout the World for his learning on insolvency law.

**Brilliant.** Ian's statements of the correct legal position were invariably accurate and revealing and his ideas for developing legal thinking proved influential in the development of the law.

**Kind.** In his quiet manner, Ian helped and encouraged students and young lawyers.

**Modest.** For someone of his worldwide stature in academia and the legal profession Ian was incredibly modest and unassuming.

**Utterly dependable.** Publishing legal texts and articles, and in particular collaborations, require trust in the diligence, thoroughness and accuracy, as well as good judgment, of authors or fellow authors. Ian was the most dependable of authors for books and articles, always faithful to his promises. He could always be relied on to produce top quality material and in good time.

**Private.** Ian was a very private person, a devoted family man.

To sum up, Ian was not only striking in his qualities and achievements, as well as the high regard that he was universally held in, but is simply irreplaceable and will be much missed by the insolvency world. The combination of high achievement with his kindness, consideration and modesty made him a truly special person whom all of us will remember with fondness. ■

*This is an abbreviated version of Professor Fletcher's obituary, which can be read in full on our website at* www.southsquare.com

[1] With assistance from Stefanie Wilkins



# *Narandas-Girdhar v Bradstock* revisited: Has *Re Plummer* survived?

In March 2004 Mr Registrar (shortly to become Chief Registrar) Baister decided *Re Plummer* [2004] BPIR 767, a case concerned with a purported individual voluntary arrangement ("IVA") made under Part VIII of the Insolvency Act 1986 ("the Act"). In those days the relevant sections of Part VIII referred to meetings of creditors but, followingamendments made by the Small Business, Enterprise and Employment Act 2015, now refer to creditors deciding whether to approve the proposed IVA (the decision being made on the "decision date" and the whole procedure being called the "creditors' decision procedure"), but the relevant law remains essentially the same.

This article considers whether *Re Plummer* has survived.

CHRISTOPHER BROUGHAM QC

## FEATURE ARTICLE: HAS *RE PLUMMER* SURVIVED?

In *Re Plummer,* at the meeting of the debtor's creditors summoned under s.257 of the Act as then formulated, some modifications to the debtor's proposal, adverse to the debtor, were put forward. The debtor could not be contacted with a view to obtaining her consent to them, nonetheless the chairman of the meeting reported to the court under s.259 of the Act that the proposal had been approved subject to those modifications. About three weeks later the debtor gave her written consent. The debtor subsequently failed to make payments due under the IVA, so some three years after it had purportedly been approved the supervisor petitioned for the debtor's bankruptcy under s.264(1)(c) of the Act. In defending the petition the debtor relied upon s.258(2).

As then formulated, ss258(1) and (2) provided that (1) *"A creditors' meeting summoned under section 257 shall decide whether to approve the proposed"* IVA; and (2) *"That the meeting may approve the proposed* [IVA] *with modifications but shall not do so unless the debtor consents to each modification"*. The debtor contended that consequently her purported IVA was of no effect so that the supervisor's petition should be dismissed. The registrar concluded that the effect of s.258(2) was to render the purported IVA *"a nullity and void"* (at [28]) with the consequence that the 28-day time limit prescribed by s.262(3) for challenging the IVA on the grounds of *"some material irregularity at or in relation to the"* creditors' meeting was inapplicable. It was immaterial that the debtor may have ratified the modifications at some time after the meeting, since the debtor's consent was *"a condition precedent for the approval of the proposal subject to any modifications proposed"* (at [23]). *"It was not … open to* **the meeting** *to approve the arrangement with modifications since the debtor had not given her consent and did not do so until the meeting was over and done with. Subsection (1) bears that out: it is a meeting summoned under s 257 which must decide whether to approve the arrangement or not"* (at [23]). As a practitioner, deputy bankruptcy registrar and textbook author *(Muir Hunter on Personal Insolvency)*, I thought the registrar's conclusions were striking but nevertheless soundly based on the language of Part VIII of the Act.

Then over nine years later, in July 2013, HHJ Purle QC, sitting in the High Court, decided Smith-Evans v Smailes [2013] EWHC 3199 (Ch); [2014] 1 WLR 1548, in which the debtor, relying on *Re Plummer*, unsuccessfully appealed against a bankruptcy order made against her on a supervisor's petition presented under s.264(1)(c). The debtor contended that (as was a fact) two of her creditors had not, at the time of the creditors' meeting, agreed modifications to her proposal, which the chairman's s.259 report had recorded as having been approved subject to those modifications. The judge held that since, after the debtor breached her obligations under the IVA, the two creditors had voted as to what steps the supervisor should take in consequence of the breaches, the two creditors had by their conduct ratified the modifications. The judge dismissed the debtor's appeal. It had been argued on behalf of the debtor that, following *Re Plummer*, since the two creditors had not agreed to the modifications at the meeting no IVA ever came into being. It was said that s.258 expressly provided that only a creditors' meeting summoned under s.257 (not some other event or meeting) may decide whether to approve a proposal, or any modifications.

The judge, in dealing with these submissions, expressed *"considerable doubts as to the correctness of Re Plummer"* (at [23]). He deplored the use of the term *"nullity"* as opposed to *"material irregularity"* in this area of the law (at [32]). The judge concluded that the statutory framework prescribed in Part VIII of the Act permitted a challenge to an IVA to be made under s.262 within a limited time, and that that procedure was meant to be exhaustive, precluding other forms of challenge, as expressly confirmed by s.262(8) (at [23]). This subsection, as then formulated, stipulated that *"Except in pursuance of the preceding provisions of this section, an approval given at a creditors' meeting summoned under section 257 is not invalidated by any irregularity at or in relation to the meeting"*. The judge held that it was necessary to look at the structure of Part VIII of the Act as a whole:

> *"The critical stage is the report of the decision to the court under section 259. The result of the meeting as stated in that report is obviously meant to be taken at face value and accepted subject to any challenge brought timeously under section 262 … That is why section 262 is there …"* (at [25]).
>
> *"Accordingly, I would construe section 260 [(Effect of approval)], where it refers to the section 257 meeting approving the proposed voluntary arrangement as extending to a purported approval as reported to the court. It follows from this that the only route of challenge is under section 262 … Otherwise, the statutory scheme is in danger of becoming unworkable"* (at [27]).
>
> *"The time limits, which are tight, set out in both the Act and the Rules, should be applied and not subverted by a collateral attack months or even years down the line"* (at [32]).

Subsection 260(1), as than formulated, gave s.260 *"effect where the meeting summoned under section 257 approves the proposed [IVA] (with or without modifications)"*. The judge readily accepted that his construction did some violence to the literal language of s.260, but he believed it necessary to adopt a more purposive construction in order to avoid *"potential chaos"* (at [31]). He observed that any other construction of s.260 could lead *"to such a startling result that it cannot possibly have been intended by Parliament"* (at [29]).

Six months later, in January 2014, I was instructed to act for the defendant in Narandas-Girdhar and another v Bradstock [2016] EWCA Civ 88; [2016] 1 W.L.R. 2366. Had the claimants succeeded, HHJ Purle QC's worst fears would have been realised. The claimants were seeking a declaration that an IVA the second claimant (P) had entered into in December 1999 was a nullity or had failed to take effect, and were claiming damages, alternatively restitution of all the fees and expenses that the defendant (B), formerly P's nominee and supervisor of P's IVA and currently his trustee in bankruptcy, had received since August 1999 together with interest. The first claimant was P's aunt and a creditor; her claim had been stayed until P's claim was resolved.

> "Had the claimants succeeded, HHJ Purle QC's worst dreams would have been realised"

In 1999 P and his wife (Mrs P), being in financial difficulties, had sought the advice of B, a chartered accountant and licensed insolvency practitioner. They accepted his recommendation that they make interdependent proposals to their creditors under Part VIII of the Act. Accordingly, the material parts of the original clause 4.3 of P's proposal read as follows:

> *"The acceptance of my Individual Voluntary Arrangement is conditional upon the acceptance of the Arrangement for my wife/husband, following acceptance the estates shall be combined for dividend purposes and treated as one.*
>
> *I propose that, during the term of the Arrangement the Supervisor will be paid a combined contribution for the benefit of the creditors not less than:-*
>
> *£250 per month for the first year - £3,000 year total*
>
> *£300 per month for the second year - £3,600 year total*
>
> *£350 per month for the third year - £4,200 year total*
>
> *£400 per month for the fourth year - £4,800 year total*
>
> *£400 per month for the fifth year - £4,800 year total*
>
> *Total contributions - £20,400 total"*

However, after Mrs P's proposal had been circulated to her creditors there was an overwhelming expectation that it would not be approved with the consequence that P's proposal would likewise be rejected. A modification to P's proposal was therefore put forward which read as follows:

> "Clause 4.3 is to be substituted with *"I agree to pay the Supervisor for the benefit of the creditors not less than £230 per month for the duration of the Voluntary Arrangement.""*

P maintained that he had had no knowledge of this modification until he received the s.259 report from the chairman of the creditors' meeting held on 15 December 1999, which recorded that P's proposal had been approved subject to the modification by 75.82% in value of the votes cast. B's case was that the modification had been put forward only after discussion with, and with the consent of, P. P also maintained that HMRC, a significant creditor voting by proxy, had not at the time of the meeting (nor subsequently) approved the modification. P relied on *Re Plummer*, and submitted that Smith-Evans v Smailes was wrongly decided.

In January 2000 P had signed a document containing the modification and shortly thereafter made his first payment of £230 as stipulated in the modification. Twice thereafter (in 2001 and 2002) P's creditors, at his request, agreed to revised schedules for payments under the IVA. In 2005 P defaulted again and B presented a supervisor's bankruptcy petition against him upon which a bankruptcy order was made, B being appointed P's trustee in bankruptcy. P had opposed the petition, but not on the grounds that the IVA was a nullity; in fact, in a witness statement in those proceedings, P had stated that *"I entered into an IVA contract … with an understanding that I will have to pay £230 per month for 5 years"*. In November 2009, after litigation contested by P, the bankruptcy court granted B an order for the possession and sale of P's home. Then in August 2010, nearly eleven years after the meeting of creditors leading to the IVA, and nearly five years after the IVA had been terminated, P issued his claim form in the Chancery Division (not in the bankruptcy court) for a declaration that the IVA was a nullity.

P also raised an issue as to the proper construction of the proposal even as modified, claiming that it was nevertheless a condition precedent for the IVA to take effect, that Mrs P's IVA had to be approved, and that consequently the IVA was vitiated for mistake. P also asserted that it was a fundamental term of the IVA that Mrs P was required to make contributions under it, whereas P and his creditors believed she had no such obligation, again resulting in the vitiation of the IVA for mistake. However, I saw the case as principally a battle between the *Plummer* and *Smith-Evans* decisions. If the judge preferred the former, then P was likely to win the case even if the judge rejected his evidence concerning his consent to the modification, since the documentation contemporaneous with the meeting indicated that, as alleged by P, HMRC had not, at the time of the meeting, agreed to the modification.

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The trial judge was Mr Jonathan Klein (now HHJ Klein), sitting as a Deputy Judge of the Chancery Division; his decision is reported as *Narandas-Girdhar v Bradstock* [2014] EWHC 1321 (Ch); [2014] BPIR 1014. The judge rejected P's argument concerning the proper construction of the IVA, concluding with the words *"Taking a step back, it seems to me that my conclusions as to the proper construction of the IVA best reflect common sense"* (at [67]). He then went on to find that, as asserted by B, the modification had been put forward only after discussion with P and with his consent. However, the judge also found that HMRC had not approved the modification at the time of the meeting. It was therefore necessary for the judge to consider the respective merits of the *Plummer* and *Smith-Evans* decisions. He preferred the latter and adopted a purposive construction of Part VIII as opposed to the literal construction adopted in *Re Plummer*, finding "*a measure of support*" for a purposive construction in Davis v Price [2014] EWCA Civ 26; [2014] 1 WLR 2129, which the Court of Appeal had decided during the course of the trial (at [103]). He found that the chairman's unauthorised exercise of HMRC's proxy was no more than a material irregularity, observing that *"this claim may be a paradigm of the anomalies undermining the integrity of the IVA process which would arise if an unauthorised exercise of a proxy is more than a material irregularity"* (at [123]).

The judge also considered whether HMRC had ratified the chairman's unauthorised exercise of its proxy, though since the judge concluded that all P's creditors, including HMRC, had received the chairman's s.259 report (at [83]), as had P on his own admission, and no s.262 challenge to the IVA had been made, it was strictly unnecessary for him to have done so. HMRC had never expressly ratified the unauthorised use of its proxy; it was not a party to P's claim and there was nothing to suggest that HMRC was even aware of the claim. The judge noted that HMRC, having received the s.259 report, had raised no objection, and nor had it objected when it received notification of the two variations of P's payment schedule and of B's intention to petition for P's bankruptcy. The judge *"concluded that the decision, by HMRC, not to object to the exercise of its proxy, when it had at least four opportunities to do so between 1999 and 2005 was a conscious and deliberate one"* (at [87]); *"the evidence indicates, with a sufficient lack of equivocation in my view, a conscious decision by HMRC to treat the IVA as being an approved arrangement and to ratify the exercise of its proxy"* (at [88]).

The judge refused P permission to appeal but permission was subsequently granted by Briggs LJ (now Lord Briggs JSC). P did not appeal against the trial judge's finding that at the time of the meeting P had consented to the modification. I felt that with P's acceptance of the finding, P's case had moved from the extraordinary (because of the length of time it had taken P to challenge the IVA) to the bizarre. As I summarised the position in my skeleton argument, P was challenging the validity of an IVA which, he now accepted, was based on his own modified proposal, when no creditor, not even the dissenting creditor, had challenged it.

The Court of Appeal (Black (now Lady Black JSC), Ryder and Briggs LJJ) dismissed P's appeal. Briggs LJ gave the only judgment, with which the other members of the Court agreed. He identified three issues raised by the appeal: the issue as to the proper construction of the modified proposal, the ratification issue and the material irregularity issue (at [2]-[3]).

The facts relied upon by P on the construction issue were as follows. In the documents presented at the creditors' meeting the modification was set out in a separate document from the proposal. In the proposal there was a statement that a contribution would be made by Mrs P *"in accordance with the terms of her proposal"*, which would provide an estimated dividend of 70.09 pence in the pound for the joint creditors of P and Mrs P, and 32.91 pence in the pound for P's personal creditors; and a further statement that joint unsecured creditors would receive a dividend of approximately 70.09 pence in the pound *"from myself and my wife"*. These statements had been made on the basis of the original clause 4.3 and were not intended to reflect the position following the modification. However, it was argued on behalf of P that it was clear that these surviving statements meant that the modified proposal remained conditional upon the approval of Mrs P's IVA and that it was not possible to have regard to the original clause 4.3 in aid of the proper construction of the modified proposal. It was said that once the parties to a contractual negotiation agreed to remove certain provisions of a draft and replace them, then those removed provisions fell out of account for the purposes of interpretation. In rejecting P's argument Briggs LJ stated (at [19]) that the true position was summarised by Christopher Clarke J in Mopani Copper Mines plc v Millennium Underwriting Ltd [2008] EWHC 1331 (Comm); [2008] 2 All ER (Comm) 976. After quoting from the judgment of Christopher Clarke J, Briggs LJ declared that *"For present purposes, the relevant principle is that if the fact of deletion shows what it is the parties agreed that they did not agree and there is ambiguity in the words that remain, then the deleted provision may be an aid to construction, albeit one that must be used with care"* (at [20]). He held that the modified proposal by no means stated beyond ambiguity that it was conditional upon Mrs P's IVA being approved; the statements in question were *"thoroughly ambiguous"* and capable of several different interpretations. It was therefore entirely legitimate to have regard to the original clause 4.3. Doing so made it clear that conditionality was not agreed.

Briggs LJ then went on to consider the ratification issue. P argued that there had been nothing other than pure silence from HMRC and consequently the trial judge had been wrong to conclude that HMRC had ratified the misuse of its proxy. In response to this argument Briggs LJ quoted from the judgment of Moore-Bick J in *Yona International Limited v La Réunion Française SA D'Assurances et de Réassurances* [1996] 2 Lloyd's Rep 84: *"Ratification can no doubt be inferred without difficulty from silence or inactivity in cases where the principal, by failing to disown the transaction, allows a state of affairs to come about which is inconsistent with treating the transaction as unauthorised. That is probably no more than a form of ratification by conduct"*. Briggs LJ considered that the trial judge's approach to, and decision upon, this issue could not be faulted. The trial judge's conclusion that this was a case of a conscious and deliberate decision not to object, rather than mere passivity, brought the facts squarely within a recognised category of ratification (at [31]).

Finally, Briggs LJ turned to the material irregularity issue, which I had thought of as the battle between the *Plummer* and *Smith-Evans* decisions. He began by observing that since the first two issues had been resolved against P, the appeal would have to be dismissed. However, since the issue had been fully argued, and there had been first instance decisions disclosing differences of approach to it, it deserved the attention of the Court of Appeal. In fact I had thought of it as by far the most important issue in the case and I infer that Briggs LJ gave P permission to appeal only because the issue required resolution. Interestingly, I was not called upon to address the Court of Appeal on this issue or the construction issue, but only, and briefly, on the ratification issue.

Briggs LJ referred to the two *"rival interpretations"*. *"The first, narrow interpretation is that nothing in section 262 applies to anything short of an IVA which has actually (i.e validly) been approved at a creditors' meeting summoned under section 257. Thus the phrase 'material irregularity' in subsections (1)(b) and (8) means some irregularity which does not of itself render the approval of the IVA a nullity. The second broader interpretation is that section 262 applies to regulate the validity or otherwise wherever the allegedly invalidating event (or non-event) occurs at, or in connection with, a creditors' meeting summoned under section 257. Unsurprisingly* [P's counsel] *contended for the first, and* [B's counsel] *supported the second"* (at [39]). After a review of the authorities, including the *Plummer* and *Smith-Evans* cases, Briggs LJ held that the trial judge was right to prefer the more purposive approach in the *Smith-Evans* case to the more limited view of the ambit of s.262 in *Re Plummer* (at [49]). Having set out the factors which pointed convincingly to the correctness of the broader view as

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to the ambit of s.262, Briggs LJ declared that *"In re Plummer was wrongly decided"* (at [53]).

He dismissed P's appeal *"with some relief. This is a case where the debtor had … approved and supported the modified proposal, where the modification for which [HMRC] had not given voting authority was entirely for the debtor's benefit, where the debtor gained a large advantage from the IVA, by avoiding the loss of his authorisation as an independent financial advisor, and where he only sought to challenge it after a default led not merely to his bankruptcy (which he did not oppose on this ground) but to the adverse outcome of a dispute with his trustee about the extent of his interest in the matrimonial home. His challenge was mounted more than ten years after the IVA was approved. It strikes me as falling squarely within the mischief which the time limit in section 262(3) was designed to avoid"* (at [57]).

I recently investigated the aftermath of *Narandas-Girdhar v Bradstock* ("the Case") and was surprised by what I found. Although I had thought the *"material irregularity issue"* was the only important issue in the Case, textbook writers and online commentators have regarded it as a significant decision in respect of all three issues argued by P in the Court of Appeal.

The decision on the ratification issue excited the least comment. However, the Case is cited in *Bowstead v Reynolds on Agency*, 21st ed., in a footnote to para.2-079 in support of the proposition that *"ratification can be inferred from silence where the principal 'allows a state of affairs to come about which is inconsistent with treating the transaction as unauthorised'"*. On the other hand, the decision on the construction issue attracted at least as much comment as that on the material irregularity issue. The case is cited in *Lindley & Banks on Partnership*, 21st ed., in a footnote to para.10-04 in support of the proposition that *"The deletion of words or clauses in the course of negotiations are unlikely to be relevant to the construction of the [partnership] agreement as executed, save in the case of ambiguity when they may be indicative of what has **not** been agreed"*. The Case is also cited in para.3.04 of the First Supplement to *The Interpretation of Contracts* (Lewison), 6th ed. The numerous online comments are well epitomised in a Practical Law Construction Blog by Tom Coulson, a barrister at Keating Chambers. The blog is headed *"To read or not to read? Deleted words and departures from standard forms"*. The opening words of the blog are *"Two recent decisions [one being the Case] have provided a good opportunity to re-examine an old debate in interpreting contracts, to what extent is it legitimate to look at words that the parties have deleted in order to construe the remaining words?"*.

All this seemed to me ironic for two reasons. First, it was always my view that, on the facts of the Case, the ratification issue was irrelevant. If *Re Plummer* was correctly decided, any purported ratification by HMRC would be ineffective as the modification had not been approved by HMRC at the meeting of creditors. If the *Smith-Evans* case was correctly decided then HMRC's ratification would be irrelevant since there had been no application under s.262 of the Act challenging the IVA. Secondly, the Case was not concerned with the deletion of clauses; no clause had been deleted. There was the proposal and there was the modification. As B put it to me, *"there is only one proposal"*; it was not to be regarded as a draft and nothing in the Act permits an amended proposal. It seemed to me that a creditor reading the proposed modification would read, and be entitled to read, the original clause 4.3 in order to understand the modification's effect. However, P's case had been put in terms of the removal of provisions from a draft contract and the Court of Appeal had dealt with the submission on those terms.

It was what I read in certain textbooks concerning the material irregularity issue that surprised me most. It seemed that the authors could not accept that *Re Plummer*, which had inhabited the pages of their books for so long without challenge, had ultimately been held to be wrongly decided. So, for example, in *Sealy & Milman: Annotated Guide to Insolvency Legislation 2018*, in its General Note to s.257 it is stated that *"In Re Plummer … it was held by Registrar Baister that for IVA modifications to become binding it must be proved that the debtor assented to them. Therefore, a report by the chairman of the creditors' meeting held under s.257 that an IVA had been proved* [sic]*was inaccurate and the purported IVA was a total nullity. The status of Re Plummer (above) is in some doubt at the moment in view of the comments of HHJ Purle QC in* [the *Smith-Evans* case]. *These doubts have been reinforced by the view taken of Re Plummer (above) by Briggs LJ in* [the Case]". This is a major understatement of the position – Briggs LJ did not reinforce "*doubts*" as to the correctness of *Re Plummer*, all three members of the Court of Appeal declared *Re Plummer* to have been "*wrongly decided*". Again, in the same textbook in its General Note to s.262: *"Challenges under the s.262 procedure are only required where an IVA has come into existence (albeit with some irregularity). Where the flaw (whether it be procedural or substantive) is so serious as to render the purported IVA a nullity the time limits specified in s.262(3) become irrelevant … Re Plummer … See* [the *Smith-Evans* case] *where HHJ Purle QC cast doubt upon Re Plummer. These doubts were reinforced by the comments of Briggs LJ in* [the Case]". Then in *Schaw Miller and Bailey: Personal Insolvency Law and Practice*, 5th ed., at para 6.176 it is stated that *"Not only must the debtor consent to any modification, it is essential that the debtor's consent is obtained at the time of the decision procedure … To this end the statutory requirement is clear and mandatory. An IVA cannot be valid if the debtor has not approved the modification, for there is no consensual agreement between him and his creditors. Where the meeting approved a modified voluntary arrangement in the absence of the debtor's consent, and her consent was obtained only some weeks after the chairman had reported to the court indicating the proposal had been approved with modifications, the voluntary arrangement was held to be a nullity. Accordingly, the supervisor was not entitled to present a bankruptcy petition when the arrangement unravelled some two years later"*. A footnote refers to *Re Plummer* as authority for this proposition and continues with *"NB this case was disapproved on other points in* [the Case] …, *but this point would appear to have survived the disapproval"*. This is plainly wrong: "*this point*" is the very point that was disapproved in the Case. Para. 6.437 of the same textbook states that *"Where a voluntary arrangement is so flawed that it is a nullity the insolvency practitioner acting as supervisor has no locus standing to present a bankruptcy petition"*. A footnote refers to *Re Plummer* and continues with *"It should be noted that the logic that led the Chief* [sic] *Registrar to this point has since been overruled* [by the Case] *but this point would seem to stand"*. It is not at all clear to me what logic is being referred to or what point would seem to stand. If this is a reference to the cases referred to with approval in the Case at [40]-[42], where there had been no creditors' meetings lawfully summoned under s.257, citation of *Re Plummer* appears irrelevant. Finally, para.4-023 of *Fletcher: The Law of Insolvency*, 5th ed., states that *"The creditors may approve the proposal in its original form or with modifications, but in the latter instance the debtor must consent to each modification or the IVA will be a nullity and void"*.

> "It seemed that the authors of certain textbooks could not accept that *Re Plummer* had ultimately been held to be wrongly decided"

A footnote refers to *Re Plummer* and continues "*See however* [the Smith-Evans case] *in which the correctness of the ruling in Plummer was doubted. The Court of Appeal* [a reference to the Case] *have declared that the broader approach to the interpretation to* [sic] *s.262 adopted in* [the Smith-Evans case] *is to be preferred to the narrow approach in Re Plummer"*. The statement in the main text is clearly wrong.

HHJ Purle QC in the *Smith-Evans* case may have expressed *"considerable doubts as to the correctness"* of *Re Plummer*, but in the Case the Court of Appeal ruled unanimously and unequivocally that *Re Plummer* was "*wrongly decided*". It should now be relegated to footnote status as having been a long-standing authority which is now overruled. ■

# Saad Investments Company Limited v Ahmed Hamad Algosaibi and Brothers Company

MARCUS HAYWOOD

*On 31 May 2018, the Chief Justice of the Cayman Islands handed down a judgment, which runs to over 1000 pages, following the trial of the claim brought by Ahmed Hamad Algosaibi and Brothers Company ("AHAB") against Saad Investments Company Limited ("SICL"), Singularis Holdings Limited ("Singularis") and a number of other companies incorporated in the Cayman Islands (the "Defendants"), each of which is now in liquidation.*

*Michael Crystal QC, Mark Phillips QC and Marcus Haywood of South Square, assisted from London by Andrew Shaw, successfully represented SICL and Singularis in their defence of AHAB's claim for in excess of US$4 billion.*

The trial took place over 129 days before the Chief Justice in the Cayman Islands over the course of a year, ending on 27 July 2017 when judgment was reserved. The trial involved the cross-examination of over fifteen witnesses of fact and nine expert witnesses in relation to expert evidence of accountancy, handwriting and foreign law (including Saudi Arabian and Swiss law).

The trial was the largest which had ever taken place in the history of the Cayman Islands and is understood to have been the largest in the Commonwealth in 2016/2017.

The trial involved allegations made by AHAB, a Saudi Arabian partnership, that during the period from at least 2000 to 2009, Maan Al Sanea (who had married into the Algosaibi family and was once reputed to be one of Saudi Arabia's richest men) used his alleged complete managerial control of the Money Exchange, a division of AHAB, to defraud AHAB by misappropriating over US$4 billion from the Money Exchange and funding the misappropriations by causing AHAB to be liable to third parties for, and eventually in default in respect of, over US$9.2 billion in alleged unauthorised debt. The Defendants were alleged by AHAB to have been recipients of that fraud.

The Money Exchange, the Chief Justice found, in conjunction with certain Bahraini companies owned by AHAB (the "Bahraini Financial Businesses"), had been used to perpetrate one of the largest Ponzi schemes in history, with later borrowing used to repay earlier borrowing, while also providing funds for the ever-increasing indebtedness of the Money Exchange.

From 2000 until the collapse of the Money Exchange in May 2009, some US$126 billion was raised by the Money Exchange (including through the Bahraini Financial Businesses) by way of fraudulent borrowing, from at least 118 different banks around the world. From January 2000 to May 2009, the total flow of cash through the Money Exchange was over US$330 billion. The total amount of the unrepaid borrowings at the time of the collapse, as at end May 2009, was SAR 34.6 bn (US$9.2 bn). The Chief Justice said that the fraud on the banks was the "*raison d'etre of the Money Exchange*".

Dismissing AHAB's claim, the Chief Justice held that he was satisfied that the knowledge and authority of the AHAB partners was overwhelmingly and conclusively proven. The Chief Justice had no doubt that each of Abdulaziz, Suleiman, Yousef and Saud Algosaibi (each partners of AHAB) knew of and expressly authorized the issuance of fraudulent financial statements and knew of the fraud on AHAB's lending banks. Dawood Algosaibi, another AHAB partner, also had knowledge of the massive borrowing which he transacted, not only on behalf of the Money Exchange but also on behalf of the Bahraini Financial Businesses, in early 2009.

What follows is a summary of the background to AHAB's claim and the Chief Justice's findings.

## The Background

AHAB has its origins in a business began by Hamad Algosaibi in the 1940s. Hamad died in 1969 and was succeeded by his three sons, Ahmad, Abdulaziz, and Suleiman. Together, they incorporated AHAB as a general partnership and successively chaired AHAB until Suleiman's death in February 2009. AHAB has since been chaired by Yousef, Ahmad's son. Yousef, Saud (Abdulaziz's son), and Dawood (Suleiman's son) are amongst the current AHAB Partners.

From 1980 onwards, AHAB strategically expanded into financial services and other related businesses. In 1981, AHAB's board of directors established the Money Exchange as an unincorporated division of AHAB. Mr Al Sanea, who had married Abdulaziz's daughter in 1980, was appointed its Managing Director. In the 1980s, AHAB incorporated Algosaibi Investment Holdings EC ("AIH") and Algosaibi Trading Services Limited ("ATS") in Bahrain and, in 2003, AHAB incorporated a bank in Bahrain, The International Banking Corporation ("TIBC") (together with AIH and ATS, the Bahraini Financial Businesses).

From near the time of the establishment of the Money Exchange until its collapse in May 2009, financial statements, disseminated to in excess of one hundred lending banks, understated the extent of the borrowings and true extent of AHAB indebtedness to the banks and its status as a borrower. By presenting them to the banks, the false financial statements became the central instrumentality of a fraud.

In 2009, AHAB defaulted on more than 34 billions of Saudi Riyals of debt (US$9.2 billion). Shortly after that default AHAB commenced proceedings against Mr Al Sanea and the Defendants (companies established by Mr Al Sanea in the Cayman Islands and which are now in liquidation).

In essence, AHAB's claims were for fraudulent breaches of fiduciary duties allegedly committed by Mr Al Sanea and restitution, damages and compensation from the Defendants, including SICL and Singularis, on the basis of their alleged conspiracy with Mr Al Sanea, their knowing assistance in his alleged fraud upon AHAB and their alleged knowing receipt of the proceeds of that fraud. AHAB also brought proprietary claims against the Defendants on the basis that their

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Maan Al Sanea

assets were alleged to represent AHAB's property which AHAB contended it could trace into their bank accounts or other assets.

### Knowledge and Authority

The pivotal issue in the case was whether the AHAB partners knew of and expressly or implicitly authorised the enormous borrowings from banks which were obtained by fraudulent means through the Money Exchange.

The resolution of this pivotal issue was heavily influenced by the extent of the AHAB partners' knowledge of and involvement with the means by which the Money Exchange perpetrated the fraud against the banks; namely, by the dissemination to the banks of falsified financial statements.

The Chief Justice held that he was satisfied that the knowledge and authority of the AHAB partners of the fraud on AHAB's lending banks was overwhelmingly and conclusively proven. The Chief Justice had no doubt that each of Abdulaziz, Suleiman, Yousef and Saud Algosaibi knew of and expressly authorized the issuance of fraudulent financial statements and knew of the fraud on AHAB's lending banks. On the basis of his late involvement at the final stages of the crisis leading to the collapse of the Money Exchange in 2009, the evidence of Dawood's involvement was also said by the Chief Justice to be revealing of his state of knowledge.

During Abdulaziz's time, the fraudulent practices of the Money Exchange were institutionalised for the purposes of defrauding the banks. He was knowingly aware of this and was the primary architect of the practices. Not only was Abdulaziz responsible as Chairman for the adoption of the fraudulent accounting practices, he also was fully aware of their meaning and effect. During Abdulaziz's life time, Suleiman and Yousef Algosaibi were also knowingly aware of the fraudulent practices and they continued the practices after his time.

As to Saud Algsoasbi, who was cross examined by Michael Crystal QC for over 10 days, the Chief Justice held that the evidence revealed that Saud was fully aware of the fraudulent practices and of the financial position of the Money Exchange throughout the period 2000 to 2009. His assertions to the contrary were rejected by the Chief Justice as deliberately untruthful. Saud was consistently involved, not just in monitoring the financial position of the Money Exchange, but in the significant decisions taken by the Money Exchange. Saud knew of and authorised Mr Al Sanea's activities.

As to Dawood, who was cross-examined by Mark Phillips QC for over 5 days, the Chief Justice held that his evidence struck him as a false and convenient narrative aimed at avoiding the fact that his involvement, as a partner of AHAB, fixed AHAB with his knowledge of the massive borrowing which he transacted, not only on behalf of the Money Exchange but also on behalf of the Financial Businesses, in early 2009.

The Algosaibis, the Chief Justice held, were willing to allow the massive personal borrowing of Mr Al Sanea from the Money Exchange to go unchecked because it was the *quid pro quo* for his willingness also to use the Money Exchange to procure fraudulent borrowing on behalf of the AHAB partners themselves. Payments to Mr Al Sanea were not "misappropriations" but loans, which were expected to be repaid. What the AHAB partners had not reckoned on, and what shocked them in May 2009 when the global financial crisis erupted, was that Al Sanea, thought to be one of the wealthiest men in the world, would be unable to repay his debts. The reality, the Chief Justice held, was that the AHAB partners had made a bad credit decision.

### The Forgery and Manipulation Allegations

AHAB's case pivoted around allegations that Mr Al Sanea, in his alleged fraud upon AHAB, engaged in forgery "on an industrial scale". In this regard AHAB relied on, amongst other things, the presence of "matched" signatures recovered from among the records of the Money Exchange, AHAB's Head Office and the Bahraini Financial Businesses.

Dismissing AHAB's forgery allegations, the Chief Justice held that those allegations had been shown to have been made on a random scatter-shot basis without any reasonable foundation for a finding that the questioned documents and signatures were deployed by Mr Al Sanea without the knowledge and authority of AHAB partners.

> "The trial was the largest which had ever taken place in the history of the Cayman Islands"

In addition to the forgery case, AHAB also ran a document manipulation case based on 16 sets of bank facility documents. Dismissing this aspect of AHAB's case, the Chief Justice held that the bank facility documents on which AHAB's manipulation case was based could not bear the weight of inference that AHAB wished to place upon them. Whatever the reason for the alteration of these documents might have been at the time, the one thing the documents showed was that AHAB was in fact aware of the ever-increasing facilities which it procured - that, in and of itself, was inconsistent with the evidence of AHAB's own witnesses.

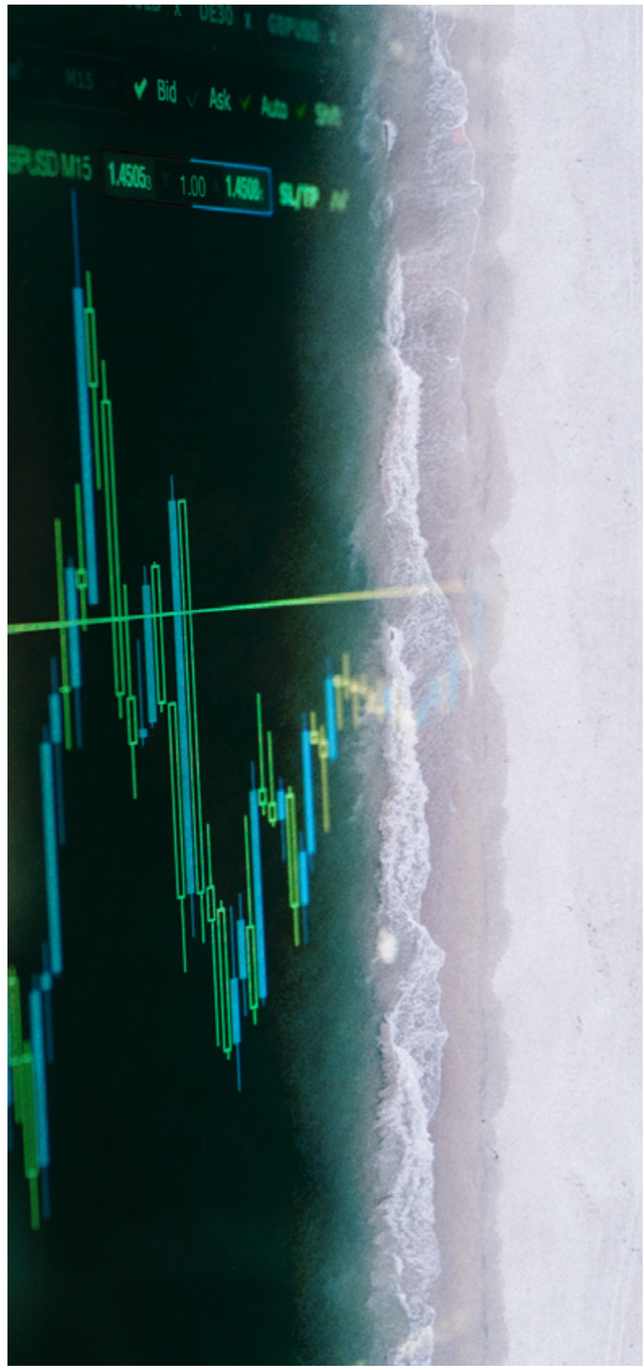
Consideration of AHAB's forgery and manipulation allegations involved the cross-examination of two handwriting experts (Dr Audrey Giles and Michael Handy) over a number of days.

### AHAB's Proprietary Claims

AHAB's tracing claim involved complex allegations relating to a multiplicity of transactions through accounts in numerous jurisdictions. Eight accountancy experts gave evidence over several weeks. The Chief Justice held that AHAB's tracing claims failed both on the facts and the law.

As to AHAB's allegation of receipt by the Defendants, even if AHAB had been able to establish the antecedent breach of trust by Mr Al Sanea (which the Chief Justice held it had not), it would still have had to prove the necessary transactional links required by the case law, between its funds taken from the Money Exchange and the accounts of the Defendants. The Chief Justice held these requirements had not been satisfied by AHAB.

Recognizing this problem, AHAB resorted, impermissibly the Chief Justice held, to a claim for equitable accounting based upon a reversal of the burden of proof. Rejecting this argument, the Chief Justice held that the duty of a constructive trustee to account did not arise where there was no receipt of monies in relation to which a constructive trust could arise. It followed that there was no duty on the Defendants to account unless AHAB established receipt. As AHAB had not established receipt, AHAB's assertion that a reversed burden of proof applied to the Defendants because of their duty to account was also held to be misconceived.



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### Saudi and Swiss Law

The Chief Justice's judgment also considered a number of issues relating to the law of Saudi Arabia and Switzerland.

The Chief Justice held that the proper law governing AHAB's equitable claims was the law of Saudi Arabia. Having accepted this principle as being applicable here, the Chief Justice found that Saudi law does not admit of a proprietary claim against intangibles (dayn). In these circumstances, AHAB could not satisfy the conflict of laws rules in respect of its receipt-based or proprietary claims for knowing receipt, dishonest or unjust enrichment/ restitution in any event.

As to AHAB's claim for damages for conspiracy, under Saudi law there is no hard and fast rule of joint and several liability for harm and damage at large for conspiracy (which itself is not recognised as a distinct tort). The Chief Justice accepted the submissions of the Defendants that in the circumstances of this case a Saudi judge would apportion liability between joint tortfeasors (i.e. "for what" they are liable) on an actual "receipts" basis. As a consequence of the "double actionability" rule, the liability of the Defendants under the law of the Cayman Islands was, therefore, also restricted to actual receipts (if any).

The Saudi law issues decided by the Chief Justice involved the cross-examination of three Saudi law experts (including Professor Chibli Mallat and Professor Frank Vogel) over a number of days.

As to claims made by AHAB in respect of intangible assets held by SICL in Switzerland, subject to a "mini - bankruptcy proceeding" there and governed by Swiss law (worth some US$225 million) AHAB, the Chief Justice held, could have had no proprietary right to these assets as a matter of Swiss law, irrespective of how it framed its claim.

### Illegality

The Chief Justice further held that the Defendants' illegality defence (the legal doctrine which prevents a claimant from pursuing a claim if the claim arises in connection with some illegal act on the part of the claimant) was entitled to succeed, not only on the basis of AHAB's continuous complicity in the fraud from beginning to end but because of AHAB's indisputable involvement through Abdulaziz Algosaibi until October 2000, in what had already become a massive fraud on the banks and one which AHAB must have known would be continued.

There could be no doubt as to the gravity of the fraud perpetrated by AHAB, the Chief Justice held. This was a fraud carried out, with increasing sophistication, from as early as 1981. The total sums borrowed pursuant to AHAB's fraud numbered in the hundreds of billions of dollars. In short, this was an enormous, long-standing Ponzi scheme which defrauded more than a hundred banks. Every single dollar or riyal that ever flowed into the Money Exchange was obtained dishonestly through fraudulently obtained borrowing. The Money Exchange was, from its very inception, a criminal enterprise. It remained so throughout its existence.

In effect AHAB's response to the illegality defence came down to the argument that AHAB was deserving of being afforded a *locus poenitentiae* for allegedly having corrected the error of its ways after Abulaziz's time.

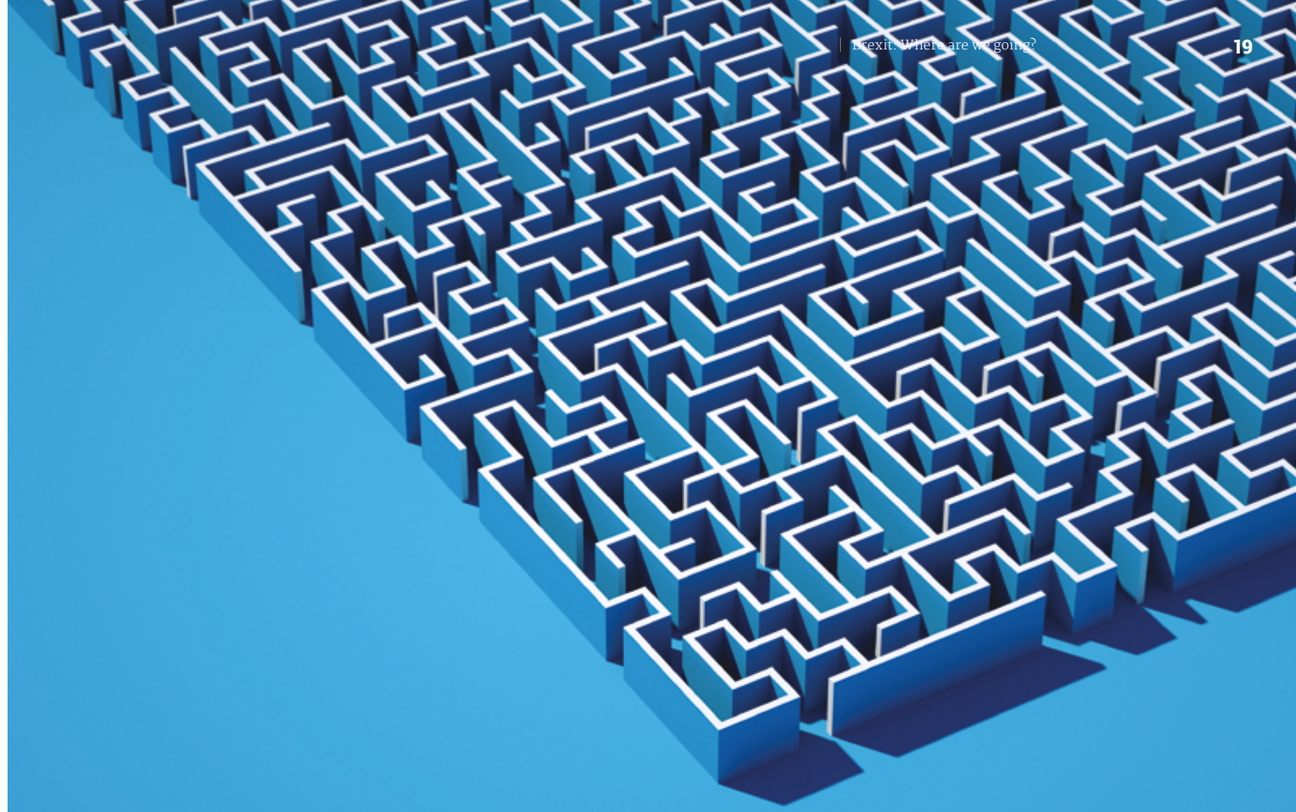
The Chief Justice held that there was no possibility of AHAB establishing a *locus poenitentiae* in the face of its conduct during Abdulaziz's time and its admitted continuing involvement in the use of fraudulent accounts to obtain loans from the banks. There could be no suggestion of repentance because AHAB had failed to make any attempt at penitence long after the fraud took place. The effects of the fraud were entirely irreversible. The loans obtained by the Money Exchange had been paid off many times with the proceeds of other dishonestly borrowed funds.

In these circumstances, the Chief Justice held that AHAB's claim was barred in any event, through the application of the Court's policy that it will not enforce an illegal arrangement and/or because AHAB lacked clean hands so that it was not entitled to invoke the Court's equitable remedies.

### Conclusion

In all these circumstances, the Chief Justice held that AHAB's claim should be dismissed. The Chief Justice also dismissed certain counterclaims advanced by SICL and Singularis against AHAB on the basis that the evidence relied upon in proof of the counterclaims was unsafe and unreliable. ■





# Brexit: Where are we going? Chequers or "No Deal"?

BY MARK PHILLIPS QC[1]

*In the last edition of the Digest I likened the Brexit negotiations to a squabbling family who had set off on a journey without knowing where they were going*

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Continuing the analogy, since then the squabbling in the back of the car has become so bad that two of the children, Boris and David, have got out and they've jumped into Uncle Jacob's car declaring that they're not playing with Michel ever again. The ever-studious Theresa has produced a new game with rules she has written out and she's invited a new friend Dominic to come along. So three quarters of the way along the journey, Dad (Nigel) has his head down and is heading for the coast, trying to keep up with Uncle Jacob, who seems to be having all the fun. But the atmosphere in the car is one of increasing nervousness. *"I think my new game will be fun"* says Theresa. *"Michel, if we don't play Theresa's game, then we're going to take all our toys and play with someone else, and then you'll be sorry"*, says Dominic. *"OK, my friends Angela and Emmanuel said you can include Ireland in the game, but you need to let us have some of the City."* And so it goes on, but it can't go on and on, 29 March 2019 is now only 6 months away.

Having examined in the June 2018 Digest what the position would be on recognition and enforcement of insolvency proceedings and schemes during the transition period and beyond based upon the EU (Withdrawal) Act 2018 and the Draft Withdrawal Agreement, I now turn to what the position might be based upon the Chequers White Paper of July 2018 and HMG's announcement of the impact of no deal made on 13 September 2018.

### The "Chequers" White Paper

The formal title of the Chequers' White Paper is "The Future Relationship Between the United Kingdom and the European Union." In her foreword the Prime Minister says that leaving the EU "*requires pragmatism and compromise from both sides*". Both she and the Secretary of State for Brexit, Dominic Raab, state that they will take the UK out of the Single Market. That is significant when it comes to insolvency procedures and schemes.

The White Paper runs to 98 pages. There are only two references to insolvency, and none to schemes. Chapter 1 is concerned with the Economic partnership. Sub-chapter 1.7 deals with *"Socio-economic cooperation"*. The sub-chapter starts (paragraph 127) by stating that there are *"many other areas where the UK and EU economies are closely linked"*, including civil judicial cooperation. The starting point is that civil judicial cooperation, which is central to the successful operation of cross border insolvency, as well as all other forms of cross border dispute resolution, together constitute an *"other area"*. The Paper goes on to say that *"the UK recognises that it will not be possible to replicate* [the close integration in these areas] *once* [the UK] *has left the EU"*. This, it is said, is because this cooperation reflects the EU Member States' membership of the Single Market. It is debatable whether the international cooperation in insolvency matters across Europe has been a result of the EU Single Market, or a response to a wider international movement, reflected by the UNCITRAL Model law and various international professional bodies. In any event, the EU Insolvency Regulation is not a necessary incident of Single Market membership.[2] The wider movement helped move cross border insolvency law from the fragmented discipline that it was in the early 90s when, for example, Sir Nicholas Browne-Wilkinson VC said in *BCCI* that *"there must be a better way"*, to an approach that embodied recognition of the processes of different jurisdictions and a number of core principles, such as the COMI. By linking insolvency to the Single Market, rather than acknowledging that our cross border insolvency regimes reflect something more international, it is arguable that the White Paper has sold our insolvency laws short.

The White Paper acknowledges that there are precedents outside the Single Market for close cooperation and says that the UK would seek to draw on these precedents in the future relationship. The most obvious precedent in an insolvency context is the UNCITRAL Model law.

Paragraph 128 sets out the UK's proposals in relation to socio-economic cooperation, which includes air transport, road transport, maritime, rail, energy, civil nuclear, intellectual property and audit and accounting. As regards civil judicial cooperation, it refers in (g) to:

*"...seeking to join the Lugano Convention and exploring a new bilateral agreement with the EU on civil judicial cooperation, covering a coherent package of rules on jurisdiction, choice of jurisdiction, applicable law and enforcement of judgments in civil, commercial, insolvency and family matters."*

The second reference to insolvency comes in paragraph 148. This comes in sub-chapter 1.7.7 on civil judicial cooperation. That starts by recording that civil judicial cooperation is mutually beneficial to both the UK and the EU. *"Businesses benefit from legal certainty in the event of disputes and are more confident trading across borders"*. This sub-chapter sets to *"protect"* the advantages of cooperation. Paragraph 146 says:

*"The UK is therefore keen to explore a new bilateral agreement with the EU, which would cover a coherent package on jurisdiction, choice of jurisdiction, applicable law, and recognition and enforcement of judgments in civil, commercial, insolvency and family matters. This would seek to build on the principles established in the Lugano Convention and subsequent developments at EU level in civil judicial cooperation between the UK and Member States. This would also reflect the long history of cooperation in this field based on mutual trust in each other's legal systems...."*

What the White Paper fails to recognise is that recognition of insolvency processes is not simply another aspect of recognition of civil judgments. Whilst an insolvency will often give rise to questions of jurisdiction and the need to enforce judgments, in an insolvency recognition is being given to an insolvency process, not to a judicial process. By focussing on the Lugano Convention and including insolvency as one of several different types of jurisdiction that the UK hopes to agree will be recognised, the White Paper has failed to take account of the very different nature of an insolvency process, and the different nature of the questions of recognition and enforcement that arise.

There is a further problem at the heart of this negotiation. The UK has enacted the Cross-Border Insolvency Regulations 2006 that give effect to the UNCITRAL Model law. 23 EU member states have not yet adopted the UNCITRAL Model Law; the 4 exceptions are Greece, Poland, Romania and Slovenia. The recognition in the UK, as main proceedings, of EU insolvency proceedings taking place where the Centre of Main Interests ('COMI') is located will continue, but under the

1. I gratefully acknowledge the assistance and advice given by my colleagues Riz Mokal and Toby Brown.

2. This is confirmed by the position of Denmark.

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> The … sentence advising that UK insolvency practitioners may want to take professional advice is something of an understatement, but I question whether this is something that should be done on a case by case basis or whether more market-wide research should be done.

Cross-Border Insolvency Regulations 2006 (unless it is going to be suggested that proceedings in EU countries are *"manifestly contrary to public policy"*). Thus, the UK will continue to give effect to EU based insolvency regimes and, if the UK signs up to the Lugano Convention, effect will be given in the UK to orders made by EU courts. The problem after Brexit is that there will no longer be a clear mechanism for recognition of UK insolvencies and judgments in much of the EU. Once the EU Insolvency Regulation ceases to have effect in relation to the UK, the UK will need to agree recognition and enforcement of insolvency processes and orders in 23 of the 27 remaining EU member states. If the UK fails to secure such an agreement, recognition and enforcement in 23 EU member states, including Germany, France, Holland and Italy, will depend upon their domestic laws. As I analysed in my previous article, in relation to several issues, once the UK is a third party and no longer a member state, there will be no mechanism for automatic recognition. What the White Paper highlights is the UK's need to secure EU agreement to recognition of UK insolvency processes and judgments.

### Her Majesty's Government's (HMG's) announcement on no deal

HMG's announcement on the impact of a no deal Brexit on cross-border insolvency is two paragraphs long. The first paragraph says:

*"The majority of the Insolvency Regulation, which covers the jurisdictional rules, applicable law and recognition of cross-border insolvency proceedings, would be repealed in all parts of the UK. We would retain the EU rules that provide for the UK courts to have jurisdiction where a company or individual is based in the UK, and the law will ensure that insolvency proceedings can continue to be opened in those circumstances. But after exit, the EU Insolvency Regulation tests would no longer restrict the opening of proceedings and so it would also be possible to open insolvency proceedings under any of the tests set out in our domestic UK law, regardless of whether (or where) the debtor is based elsewhere in Europe."*

Put this way it looks as if the UK is going to be able to take primacy in insolvency proceedings, provided we have jurisdiction, which depends on there being a connection with the UK, and we need not be concerned about the location of the COMI. However, there is (rightly) no suggestion that the UK would repeal the Cross-Border Insolvency Regulations 2006. Therefore, whilst the automatic application of the EU Insolvency Regulation would cease, if the COMI is in an EU Member state, the Foreign Representative will be able to apply to a UK court for recognition of the proceedings in the COMI as a foreign main proceeding under the Cross Border Insolvency Regulations 2006. Article 17(2)(a) provides that a foreign proceeding shall be recognised as a foreign main proceeding *"if it is taking place in the State where the debtor has* [its COMI]." Recognition of a foreign main proceeding has all the effects identified in article 20, including an automatic stay. Additional relief could be sought by the Foreign Representative under articles 21 to 25, and under articles 25 to 27 the UK court can cooperate *"to the maximum extent possible"* with foreign courts or foreign representatives. Article 28 make it clear that once the foreign main proceeding is recognised the effect of a proceeding under British insolvency law in relation to the same debtor is restricted *"to assets that are located in Great Britain and, to the extent necessary to implement cooperation and coordination under articles 25, 26 and 27, to other assets of the debtor that, under the law of Great Britain should be administered in that proceeding."* While there will be procedural differences, notably the need for an application for recognition of the EU proceedings, and there will be nuanced differences in treatment, although these can be ironed out by the court, repealing the EU Insolvency Regulation will be a matter of form rather than substance. EU insolvency proceedings in the country where the debtor's COMI is located will continue to be foreign main proceedings in the UK, and UK proceedings of the debtor's assets will continue to be restricted.

An incidental consequence of the Cross-Border Insolvency Regulations 2006 in this context is article 8. Article 8 requires the UK courts in the interpretation of the Model law, and in the present context the meaning of the COMI to have regard to *"the international origin and to the need to promote uniformity in its application and the observance of good faith."* On one view this requires UK courts to have regard to the decisions of EU courts, including the European Court of Justice when it comes to concepts such as the COMI. Clearly to some Brexiters this would be the antithesis of a certain view of the purpose of Brexit.

The second paragraph of HMG's announcement says:

*"UK insolvency practitioners would need to make applications under an EU country's domestic law in order to have UK orders recognised there. In certain circumstances, some EU countries may not recognise UK insolvency proceedings, for example if that would prevent creditors from taking action against the assets held in that country. Where appropriate, insolvency practitioners may wish to take professional advice on the prospects of successfully obtaining recognition for a UK insolvency order in an EU country. EU insolvency proceedings and judgments would no longer be recognisable in the UK under the EU Insolvency Regulation, but may be recognised under the UNCITRAL Model Law on Cross-Border Insolvency, which already forms part of the UK's domestic rules on recognising foreign insolvencies."*

The first sentence recognises that, absent an agreement, UK insolvency practitioners would need to make applications under an EU country's domestic law in order to have the UK proceedings (not just orders) recognised there. That hides an unwelcome truth. In the four countries that have given effect to the UNCITRAL Model Law, recognition is relatively certain and the underlying principles readily understood. That is Greece, Poland, Romania and Slovenia. In the 23 other EU member states, recognition is going to depend on the old pre-EU Insolvency Regulation domestic laws. Thus, for example, an insolvency that involves the UK, Germany and France, the UK insolvency practitioner needs to know how to get the UK process recognised. The insolvency practitioner will also need advice on how the UK process will fit in with processes in Germany and France that will be subject to the EU Insolvency Regulation and how that might affect the previous domestic laws of Germany and France as regards the UK process. One question HMG's statement does not address, is when the UK insolvency practitioner is supposed to get this advice. The answer may impact significantly on the effectiveness of a UK insolvency process. It follows that this is not a question that can be left outstanding and that, if there is no deal, UK insolvency practitioners will need to know in advance of any appointment what the domestic laws are in the 23 EU member states who have not given effect to the UNCITRAL Model Law. The third sentence advising that UK insolvency practitioners may want to take professional advice is something of an understatement, but I question whether this is something that should be done on a case by case basis or whether more market-wide research should be done. The second sentence recognises the sorts of problems that could arise. If creditors cannot take action against assets in EU countries, that signals a return to the days before modified universalism. As is well known, such an outcome could result in unnecessary complication and consequential costs.

As regards schemes, 'no deal' would result in the repeal of Brussels 1 insofar as it applies to UK judgments, which would raise squarely the question whether recognition of schemes of arrangement in the EU depends upon the application of choice of law rules or upon recognition of the UK court's order. On a 'no deal' Brexit, reliance cannot be placed entirely on the court order and so it will depend upon establishing that the scheme is effective by an application of the choice of law to the restructured contracts.

### A cause for concern?

In the insolvency context it is very difficult to take comfort from either the Chequers White Paper or HMG's announcement on 'no deal'. If a deal is negotiated with the EU, the UK should seek continued application to UK insolvencies in EU member states of the principles found in the UNCITRAL Model Law and if possible the EU Insolvency Regulation. Absent agreement along those lines, what the UK will be left with is an asymmetric system whereby recognition and enforcement is given to EU insolvencies, but in relation to UK insolvencies the answer will be "we do not know" and we may return to a messy system that depends upon disparate domestic EU laws.

### Yes Minister

*"Minister, I have been giving some thought to what happens to insolvencies on a no deal Brexit."*

*"Oh, do we have to deal with insolvency, it sounds rather depressing."*

*"We do Minister. What we will do is repeal the EU Insolvency Regulation and we will say we will do it 'in all parts of the UK'. We will say that we will abolish the rules that currently make the proceedings in the country where the Centre of Main Interest is located, the main proceedings."*

*"That sounds excellent, Sir Humphrey, that will show the EU we mean business."*

*"Well, the beauty of it Minister, is that in the UK we have given effect to the UNCITRAL Model Law. That means that insolvency proceedings where the Centre of Main Interests is located will be recognised in the UK as 'foreign main proceedings'."*

*"So instead of calling the EU insolvency proceedings 'main proceedings', we will call them 'foreign main proceedings'. Yes, I like that, Sir Humphrey. That's giving effect to the referendum result".*

*"It's the ideal solution, Minister. We tell the world at large that we are taking big steps to repeal the EU rules, and apart from calling them 'foreign' we change as little as we can."*

*"And what about our UK proceedings, will they call ours 'foreign'?"*

*"We haven't worked out what they will call ours, or if they will recognise them at all I'm afraid."*

*"That's the EU for you, Sir Humphrey, I knew we were right to withdraw."* ■

# Form v Function: Recharacterisation of contracts in the UK and US

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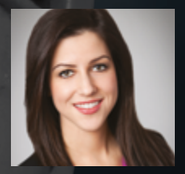

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Apart from being divided (supposedly) by a common language, the laws of the UK and the US take a different approach to the recharacterisation of contracts.

In particular, it is said that the UK takes the *formal* approach, while the US adopts the *functional* approach. Typically, the question arises when the true character of a financing agreement falls to be determined: assuming it matters, is the transaction one which creates an absolute interest (e.g. by way of sale) or one which is less than absolute (e.g. a security interest)? But what does it mean to adopt a functional, as opposed to a formal, approach in this context? In this article, we propose to explore that distinction.

## The formal approach: recharacterisation in English law

In English law, characterisation in this context is the process whereby the court determines the legal nature of a particular transaction. Recharacterisation occurs where the parties to the transaction have purportedly characterised it as creating one kind of interest but the court characterises it, as a matter of law, as creating a different kind of interest. In such instances, recharacterisation does not actually change the legal nature of the transaction, which remains the same throughout; rather it corrects mischaracterisation, and associated mislabelling, by the parties.

Typically, the English Courts have had to embark on the process of recharacterisation in circumstances where, usually by virtue of the provisions of a statute, the transaction will be void unless registered if, for example, it is to be characterised as creating a security interest. Such questions have arisen in the context of determining the application and effect of the provisions of the Companies Act 2006 and its predecessors, the Bills of Sale Acts 1878 and 1882 (in relation to individuals) and the Moneylenders Act 1927 (since repealed). In addition, however, recharacterisation becomes relevant if, while not void, the rights conferred by the transaction may be less effective if, for example, it is to be characterised as a floating rather than a fixed charge.

## There are many ways of raising cash besides borrowing

In the financing context, English law recognises that there are many ways of raising cash besides borrowing. Merely to recognise a transaction as a financing transaction, therefore, does not assist in the task of characterising that transaction because, under English law, financing can perfectly well be effected in different ways. As Lord Devlin once said[1]: *"There are many ways of raising cash besides borrowing ... If in form [the transaction] is not a loan, it is not to the point to say that its object was to raise money ... or that the parties could have produced the same result more conveniently by borrowing and lending money."*

## Substance over form means looking at the words used in the context of the transaction as a whole

Judges have often said, as Romer LJ did,[2] that the English Court is concerned with substance rather than form, but this must be understood in its proper context. In ascertaining the substance of a transaction, the English Court is concerned initially and – unless it is found to be a sham – almost exclusively with the provisions of the written agreement entered into by the parties. In other words, it is concerned with the language used by the parties considered in the context of the transaction as a whole.[3] The only apparent exception to this approach to date is that which was adopted by Knox J in *Re Curtain Dream plc*,[4] but it is suggested that this decision is now of questionable authority and it seems unlikely that it would be followed.

## The English law approach in summary

The approach adopted under English law when recharacterising a transaction may be summarised as follows:

- The English Court will first ascertain whether the written agreement between the parties is a sham;[5] that is, it neither accurately reflects the true agreement between them and nor is it intended by the parties to do so.[6]
- If the agreement is found to be a sham, the English Court will ignore the written agreement and seek to ascertain the real agreement between the parties by reference to other extraneous evidence instead.[7]
- If the agreement is found not to be a sham, the English Court will construe its provisions for the purpose of ascertaining the legal rights and obligations they create and impose. As this involves questions of interpretation, the Court is concerned to determine the intentions of the parties, ascertained objectively, by reference to the words they have used taking into account the relevant factual matrix where appropriate.
- Having determined the rights and obligations created and imposed by the written agreement, the English Court will then classify, or characterise, the agreement. That is a matter of law, rather than being dependent on the intentions of the parties.[8] If, in other words, the parties have characterised and labelled

1. *Chow Yoong Hong v Choong Fah Rubber Manufactory* [1962] AC 209 (PC).
2. *In re George Inglefield* [1933] 1 Ch 1 (CA).
3. *McEntire v Crossley Brothers Limited* [1895] AC 457 (HL); *Lloyds & Scottish Finance Ltd v Cyril Lord Carpets Sales Ltd* [1992] BCLC 609 (HL); *Welsh Development Agency v The Export Finance Company Limited* [1992] BCLC 148 (CA).
4. [1990] BCLC 925.
5. *Welsh Development Agency v The Export Finance Company Limited* [1992] BCLC 148 (CA).
6. *AG Securities v Vaughan* [1990] 1 AC 417 (HL); *Snook v London and West Riding Investments Ltd* [1967] 2 QB 786 (CA).
7. *Orion Finance Limited v Crown Financial Management Limited* [1996] BCLC 78 (CA).
8. *Agnew v Commissioner of Inland Revenue* [2001] 2 AC 710 (PC); *Smith (Administrator of Cosslett (Contractors) Ltd) v Bridgend County Borough Council [2002]* 1 AC 336 (HL).

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their written agreement inconsistently with its true legal character having regard to the rights and obligations for which it provides, the parties' own label will be ignored.

- That is not to say that the labels adopted by the parties will be ignored in all circumstances. If it is found that the true character of the transaction, as a matter of law, is consistent with the label used by the parties, the English Court will accept the parties' label.[9] Indeed, it will generally be slow to reject the label when considering a *bona fide* mercantile document issued in the ordinary course of business.[10]

### Legal substance over economic effect

When the English Court speaks of substance in this context, it refers to the legal substance of the transaction. It is emphatically not concerned with its economic substance or commercial effect, but rather with its legal nature. The economic or commercial effect of the transaction is irrelevant to the process of determining its legal character, as a matter of English law.[11]

Thus, under English law, the sale and leaseback arrangement, for example, is a well-recognised financing transaction, the purpose of which is to raise funds. In the absence of any evidence that such an arrangement is a sham, or unless it can be demonstrated that no absolute transfer of title by way of sale has taken place, the English Court will generally not recharacterise it as a loan arrangement, whether secured or unsecured. The mere fact that the economic or commercial effect of a sale and lease-back arrangement is the same as that of a secured lending arrangement is insufficient to justify its recharacterisation as such, as a matter of English law. As already stated, these matters are irrelevant to the process of determining the legal character of the transaction under English law.

### Objective determinative legal criteria

In some contexts, without there being any question of sham, there are objective criteria by reference to which English law will determine whether or not the agreement made by the parties does fall into the legal category in which they have sought to place it. For example:

- A lease will be distinguishable from a licence if the agreement, properly understood, confers on the grantee an exclusive right of occupation of the property.[12]
- A fixed charge over book debts will be distinguishable from a floating charge according to whether the chargor retains the ability to collect them and use their proceeds in the ordinary course of its business.[13]

Despite attempts, however,[14] no such determinative indicia have so far been identified which serve determinatively to distinguish a sales transaction from secured lending arrangements. In particular, the existence of what is effectively a right of redemption may not be determinative as the parties to a contract of sale can lawfully provide that, in certain circumstances and for a sum ascertained or ascertainable, the seller may repurchase from the buyer the property originally sold.[15] The same apparently holds true even if the seller is obliged to repurchase the property (e.g. as part of a repo transaction).[16]

So much, then, for the approach to recharacterisation under English law. Time now to contrast it with the approach adopted under US law.

### The functional approach: recharacterisation under US law

Recharacterisation under US law specifically applies to lease agreements and often arises in the context of US bankruptcy proceedings. In particular, a debtor in bankruptcy may seek to recharacterise a lease agreement as a security interest by establishing that the economic substance of the transaction is consistent with a security agreement as opposed to a true lease.[17] In doing so, the US court takes a "*functional*" rather than a "*formal*" approach to the interpretation of the agreement. In contrast to the position under English law, recharacterisation by the US court changes the legal nature of the transaction.

### The context of applications to recharacterise

The issue of recharacterisation often arises in the context of real estate transactions, equipment leasing and financing. In a bankruptcy context, the characterisation of the agreement is relevant as:

- if an agreement is a true lease, then the debtor would be obliged to assume the lease (i.e. continue to perform its obligations under the lease) or reject the lease; and
- if an agreement is a secured financing, then the debtor would own the property and the relevant creditor (or lessor) would have a secured or unsecured claim against the debtor.

Essentially, the US Bankruptcy Code distinguishes between financial versus economic distress, effectively treating the date of bankruptcy as the creation of a new firm unburdened by its predecessor's debts. "*The new firm must cover all new expenses, while debt attributable to former operations is adjusted.*"[18] Leases are treated as "*new*" expenses while debt service is treated as an "*old*" expense and adjusted for financial distress.[19]

Considering the US policy of affording disparate treatment to leases versus security interests, courts generally frown on attempts by parties to avoid the intended consequences of the Bankruptcy Code by entering a lease to cover what in economic substance is a secured financing. As one court put it, "[W]*hy bother to distinguish transactions if these distinctions can be obliterated at the drafters' will?*"[20] Another court noted that *"refusing to defer to the intent of contracting parties in resolving whether their agreement is a lease is particularly appropriate in bankruptcy"* because *"every dollar that is used to pay a purported lessor depletes the pool of assets available to pay other constituencies of the estate."*[21]

> "US courts generally frown on attempts by parties to avoid the intended consequences of the Bankruptcy Code by entering a lease to cover what in economic substance is a secured financing"

### Benefits of recharacterisation

There are myriad circumstances that may result in a party seeking to recharacterise a lease as a secured financing, particularly to gain a strategic advantage by using or avoiding an aspect of the Bankruptcy Code. While this article does not purport to discuss all strategic advantages, recharacterisation could accomplish any number of goals:

- By recharacterising a lease into a security interest, the debtor-lessee is now deemed to have legal title to and ownership of the asset. Conversely, the creditor-lessor would no longer have purported ownership of the asset. Instead, the creditor-lessor is left with a secured claim, or possibly even an unsecured claim.
- By owning the asset outright, the debtor-lessee could, among other things and with varying degrees of creditor consent and payment to the creditor, (1) sell the asset free and clear of all liens and interests, (2) retain the asset and devise a plan of reorganization to cram down or otherwise impair the creditors' claim, or (3) retain the asset but refinance the "*financing arrangement*" on better terms with another lender. These strategies could essentially permit the debtor to restructure the "*financing arrangement*" provisions unilaterally if advantageous, in contrast to a lease which generally cannot be modified without lessor consent.
- Without recharacterisation, a debtor-lessee is required under the Bankruptcy Code to eventually assume or reject the leased asset. This ties in directly to whether the debtor could maintain control of the leased asset: assumption would allow the debtor to keep the asset, whereas if the debtor rejected the asset, they would have to relinquish control back to the lessor.[22]

9. *Welsh Development Agency v The Export Finance Company Limited* [1992] BCLC 148 (CA).

10. *MacWilliam Inc v Mediterranean Shipping SA* [2005] AC 423.

11. *Lloyds & Scottish Finance Ltd v Cyril Lord Carpets Sales Ltd* [1992] BCLC 609 (HL); *Welsh Development Agency v The Export Finance Company Limited* [1992] BCLC 148 (CA); *Polly Peck International plc (in administration)* [1996] 2 ALL ER 433; *Socimer Bank Ltd v Standard Bank Ltd* [2008] Bus LR 1304.

12. *Street v Mountford* [1985] AC 809.

13. *Agnew v Commissioner of Inland Revenue* [2001] 2 AC 710 (PC); *Smith v Bridgend County Borough Council* [2002] 1 AC 336 (HL); *In re Spectrum Plus Ltd (in liquidation)* [2005] 2 AC 680 (HL).

14. *In re George Inglefield* [1933] Ch 1 (CA), per Romer LJ at 27-8.

15. *Welsh Development Agency v The Export Finance Company Limited* [1992] BCLC 148 (CA); *Manchester, Sheffield and Lincolnshire Railway Co v North Central Wagon Company* (1888) 13 App Cas 554 (HL, citing *Alderson v White* (1858) 2 D&J 97).

16. *Mercuria Energy Trading Pte Ltd v Citibank NA [2015] 1 CLC 999.*

17. *United Airlines, Inc. v. HSBC Bank USA, N.A.*, 416 F.3d 609, 612-15 (7th Cir. 2005) ("United Airlines I").

18. Id. at 613.

19. Id. at 612-14.

20. Id. at 612.

21. *In re Pillowtex, Inc.*, 349 F.3d 711, 722 (3d Cir. 2003).

22. Assumption and rejection each could carry material risks. Under some circumstances, assumption could lead to litigation over an amount required to cure any of the lessor's potential damages claims in connection with the lease, and could be vigorously contested—this is particularly true if the asset is essential to the debtor's business operations, and the creditor is aware of this. Alternatively, rejection could result in an outsize rejection damages claim, as rejection constitutes a prepetition breach of contract, that would have to be litigated to avoid eclipsing other claims against the debtor. This latter risk would be compounded with the fact that the debtor would no longer have control of the asset, and therefore, could no longer use the asset going forward as a method of generating income or value to the estate.

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### The test for recharacterisation

The burden of demonstrating that a lease is a financing agreement rests with the party challenging the lease.[23] Typically, "[w]*hether an agreement is a true lease or a secured financing arrangement under the Bankruptcy Code is a question of state law.*"[24] To determine which state's laws apply, US courts look first to the underlying contract at issue for provisions specifying what law governs.[25]

While resorting to state law might seem to create the potential for different approaches to addressing this issue – US bankruptcy courts almost invariably take a functional approach with respect to the issue of recharacterisation.[26] This is because (1) state law is largely consistent in this regard, and (2) if state law provided for a non-functional approach, a court would likely find such approach to conflict with the US Bankruptcy Code and disregard it.

With respect to state law, one reason for such uniformity—at least as it pertains to goods—is state adoption of Section 1-203 of the Uniform Commercial Code ("UCC")[27], which provides for determination of whether a transaction is a lease or a security interest based on a functional analysis of the economic substance of the transaction.[28] In particular, the UCC states that whether a nominal "*lease*" creates a lease or security interest is to be "*determined by the facts of each case.*"[29] It also provides a two-part test to determine if a lease creates a security interest per se: a transaction creates a security interest "*if the consideration that the lessee is to pay the lessor for the right to possess and use goods is an obligation for the term of the lease and is not subject to termination by the lessee*"[30] and one of four other factors exist. Those four factors relate to whether residual value remains for the lessor at the end of the lease. To the extent that the property has little or no remaining value at the end of the lease, the transaction is more likely to be deemed a sale of property by the lessor to the lessee that is financed by the lessor (i.e. recharacterised as a financing transaction rather than a true lease).

Where lease transactions do not create a security interest per se under the particular state's version of the UCC or if the transaction at issue is not subject to the particular state's version of the UCC, courts generally look to the economic reality of the transaction.[31] Although the precise nature of the approach, including the factors to consider and weight to afford them vary, courts will typically look for *indicia* of a security interest by considering factors such as whether the lessee assumes and discharges substantially all the risks and obligations usually associated with outright ownership and whether rental payments are essentially payments of principal and interest rather than designed to compensate for the value of the property.[32] The issue of whether the lessor has a meaningful residual interest in the goods or property at the end of the lease term will often remain a central focus.[33]

Moreover, if state law required a formal, rather than a functional approach, it would likely not be followed in the bankruptcy context because of the federal policy in favour of treating such arrangements differently. Indeed, a number of courts have stated that if state law is inconsistent with federal law and the Bankruptcy Code, federal common law will apply.[34]

### Recharacterisation in practice

A pair of cases in the context of the United Airlines bankruptcy demonstrate how recharacterisation works in practice in the United States. In each instance, the parties disputed whether the transactions at issue were loans or leases, and the Seventh Circuit determined that based on the substance of the particular transactions, they were appropriately characterised as secured loans and not leases.[35] The same five factors supported the court's ruling in each case:[36] First, United's "*rent*" was linked at least indirectly to the amount borrowed, making it more like a loan payment than a traditional rent payment where rent is based on the market value of the property.[37] Second, the transactions at issue both involved balloon payments – the Seventh Circuit noted that "*the balloon payment has no parallel in a true lease, though it is a common feature of secured credit.*"[38] Third, the agreements contained "*hell or high water*" clauses – which stand in contrast to typical lease provisions that might provide for rent to be abated if property is uninhabitable or unuseable.[39] Fourth, the arrangements provided that the lease would terminate in the event of prepayment. Notably, "*such a prepayment/termination provision would be superfluous in the context of a lease*" because "*[i]t would make little economic sense for a lessee to prepay its full rental obligations and thereby cause its lease to terminate and the value of its prepayment to evaporate.*"[40] Finally, the court considered the fact that the lessor would not have any remaining interest in the property at the end of the transaction as further indication that the true nature of the arrangements were akin to those of a loan.[41] As the United Airlines cases demonstrate, US courts will look to the facts of the case to see whether what was nominally a lease transaction appeared in substance to be a secured financing.

### Conclusion

Recharacterisation under both English law and US law, therefore, requires analysis of the substance of the transaction and, to that extent, they share a common approach. Where they differ, however, is in identifying what constitutes the substance for these purposes. While the US court will closely investigate the economic substance, its English counterpart will focus instead on legal substance to the exclusion of economic or commercial effect. ■


23. *In re Montgomery Ward*, 469 B.R. 522, 528 (Bankr. D. Del. 2012).

24. *Pillowtex*, 349 F.3d at 716; see also *Montgomery Ward*, 469 B.R. at 528-29.

25. See, e.g., *Pillowtex*, 349 F.3d at 716.

26. Although one commentator has argued that the Third Circuit does not consider substance to control, such conclusion seems questionable. See 3 *Collier on Bankruptcy* ¶ 365.02[3] (16th ed. 2018). The only authority cited by *Collier* on this point is *Revel AC, Inc. v. IDEA Boardwalk LLC*, 802 F.3d 558 (3d Cir. 2015). In that case, the Third Circuit never stated that form controlled over substance. Rather, after stating that the debtor had failed to present any argument that created an objective dispute that a "*true lease*" was absent, the Third Circuit pointed out that a provision of the applicable agreement stated that nothing in the lease should be read as creating a relationship other than that of landlord and tenant. See *Revel*, 802 F.3d at 574. Moreover, the Third Circuit has historically followed state law requiring consideration of the economic reality of the transaction. See Pillowtex, 349 F.3d at 719.

27. The UCC, which may be adopted by states with or without modification, covers a range of commercial transactions, including transactions pertaining to goods. "Goods" are defined under the UCC to mean "all things (including specially manufactured goods) which are movable at the time of identification to the contract for sale other than the money in which the price is to be paid, investment securities [] and things in action" and include "the unborn young of animals and growing crops and other identified things attached to realty as described in the section on goods to be severed from realty." UCC § 2-105. With limited exception, the UCC generally does not apply to real estate transactions. See David Frisch, Lawrence's Anderson on the Uniform Commercial Code § 1-101:44 (3d. ed.).

28. See *In re WorldCom, Inc.*, 339 B.R. 56, 63-64 (Bankr. S.D.N.Y. 2006) (noting that the UCC is intended as a uniform law, permitting courts to consider decisions from other courts).`

29. UCC § 1-203(a).

30. Id. at § 1-203(b).

31. *Pillowtex*, 349 F.3d at 717-20; *Montgomery Ward*, 469 B.R. at 529-30; *In re Grubbs Const. Co.*, 319 B.R. 698, 711, 715 (Bankr. M.D. Fla. 2005).

32. *Montgomery Ward*, 469 B.R. at 529-30; In re *PCH Assocs.*, 804 F.2d 193, 199-200 (2d Cir. 1986); S. Rep. No. 95-598, 64, 95th Cong., 2d Sess. (1978).

33. See *In re Lasting Impressions Landscape Contractors, Inc.*, 579 B.R. 43, 51-54 (Bankr. D. Md. 2017).

34. See, eg, *United Airlines I*, 416 F.3d at 615; *Montgomery Ward*, 469 B.R. at 528-29 n.3.

35. In analysing the complex series of transactions at issue in these cases, the Seventh Circuit did not analyze California's UCC; however, it noted that an approach similar to the UCC is taken under state common law in United Airlines I: "To find state law we must examine California's statute books and the decisions of its judiciary. California has enacted the UCC; there can be no doubt that it uses a functional approach to separating leases from secured credit with respect to personal property. California takes a similar approach for real property as a matter of common law." United Airlines I, 416 F.3d at 616.

36. See *United Airlines I*, 416 F.3d at 617; *In re United Airlines*, 447 F.3d 504, 507 (7th Cir. 2006) ("*United Airlines II*").

37. *United Airlines II*, 447 F.3d at 507-08.

38. Id. (quoting *United Airlines I*, 416 F.3d at 617) (internal quotation marks omitted).

39. Id. at 508-09.

40. Id. at 509.

41. Id.

# Conflicts of interest and officeholders

TOM SMITH QC

One of the practical issues which often arises in connection with administrations concerns the extent to which previous or existing professional relationships may affect the ability of practitioners to accept appointments as administrators, and the ability of administrators once appointed to engage lawyers and other professionals and agents to assist them.

In two recent cases, the High Court has provided helpful guidance on these issues – and shown that the English Courts continue to adopt a strongly pragmatic approach in dealing with conflict issues in the context of insolvency proceedings.

## Previous Engagements of Administrators

The decision in Zinc Hotels [2018] EWHC 1936 (Ch) concerned a group of companies in administration, which owned various hotels operated under the "Hilton" brand. The secured lenders to the group had appointed administrators from a firm which had previously carried out engagements for the lenders, including a "contingency planning exercise" prior to the appointments. The ultimate shareholder in the group applied for the removal of the administrators, and for relief under paragraph 74 of Schedule B1. One of the grounds relied on was that the administrators lacked the necessary independence by reason of their previous engagement with the lenders, and also that they had acted in breach of the Insolvency Practitioner Code of Ethics ("the Ethics Code").

The high point of the argument that a previous engagement with a lender in relation to a borrower may disable members of a firm from accepting appointments as administrators of that borrower are certain Australian decisions, in particular, the judgment in *Commonwealth Bank of Australia v Fernandez* (2010) 81 ACSR 262. In that case, the court emphasised that the role of administrator gave rise to fiduciary duties and that it required an administrator to act impartially as between interested groups; moreover, questions of conflict between the banks and the unsecured creditors might well arise. The court suggested that, against this context, there was much to commend a competitive tendering process being undertaken prior to the appointment of administrators, rather than practitioners nominated by the secured creditors being appointed.

However, in Davey v Money [2018] EWHC 766 (Ch at [340]) Snowden J rejected the idea that there could be any absolute bar upon the appointment of administrators who had had a prior business relationship with the secured creditors and had been nominated by them. That must be right. As a practical matter, it is to be expected that in most, if not all, cases a prospective administrator will undertake an investigation of the company's affairs and financial position and form a view on the strategy for the administration prior to their appointment. Indeed, the requirement to express a view on the likelihood of the purpose of administration being achieved requires some degree of investigation to be undertaken. It is difficult to see how that could be done without some kind of pre-appointment engagement – whether with the secured creditors, company or regulator – being in place.

In addition, as Henry Carr J pointed out in the *Zinc* case, the insolvency legislation can now be said to expressly envisage that officeholders may have undertaken pre-appointment engagements, since specific provision is now made in the 2016 rules for the disclosure and recovery of pre-appointment costs.[1] In *Zinc*, Henry Carr J therefore dismissed the argument made by the shareholder that the administrators' pre-appointment engagement by the secured lenders for the purposes of contingency planning gave rise to any conflict of interest. The administrators were under no continuing duties to the lenders which conflicted with their duties as administrators, and the previous engagement was not by itself of a nature so as to give rise to a conflict. There was, therefore, no arguable case of conflict.

It is suggested that, in light of *Zinc Hotels* and *Davey v Money*, it is clear that the normal type of pre-appointment engagement undertaken by prospective administrators will not in any way disqualify them from accepting the appointment,

1 Rules 3.35(10)(a), 3.36 and 3.52 of the Insolvency Rules 2016.

**FEATURE ARTICLE: CONFLICTS OF INTEREST AND OFFICEHOLDERS**

> Where there is a relevant previous professional engagement, the Ethics Code requires an evaluation to be undertaken of whether or not the relationship creates a threat to the fundamental principles which include the principle of objectivity

or by itself give rise to any arguable allegations of conflict of interest. That is not to say that other types of engagement prior to the commencement of the insolvency might not give rise to an issue – obvious examples would be where the firm had acted as auditors[2] or was otherwise involved in advising on pre-insolvency transaction which might well need to be investigated subsequently by an officeholder. In relation to the latter, an analogy can be made with those cases where the court has removed administrators because of the need to investigate a previous transaction with which the administrators were involved – see Clydesdale Financial Services v Smailes [2009] BCC 810 and *Ve Vegas Investors IV LLC v Shinners* [2018] EWHC 186 (Ch). But, subject to this, the normal types of pre-appointment engagements undertaken by practitioners with a view to a possible subsequent appointment will not give rise to a conflict.

The other aspect of the effect of a pre-appointment engagement relates to compliance with the Ethics Code. This was also considered by Henry Carr J in *Zinc*. Where there is a relevant previous professional engagement, the Ethics Code requires an evaluation to be undertaken of whether or not the relationship creates a threat to the fundamental principles which include the principle of objectivity.[3] In undertaking that evaluation, the Ethics Code sets out a number of issues to be considered including *"whether the insolvency appointment being considered involves consideration of any work previously undertaken by the practice for that entity".*

The evidence of the administrators in the Zinc case was that they had undertaken that evaluation. The assessment which they had made was that the work which had not been done had not impacted on the financial state or stability of the Zinc companies, nor did the appointment as administrators involve considering any work previously done by their firm for the Zinc companies. The fees for the engagement and time spent (around 400 hours in total) were not abnormal for the type of engagement. In these circumstances, the Court was not prepared to accept that there had been any breach by the administrators of the Ethics Code in accepting the appointment as administrators.

The Ethics Code also provides that, where a practitioner was engaged by a secured creditor who then requests that the practitioner accept an appointment as administrator, then the practitioner should seek to satisfy himself that the company does not object to him taking the appointment[4]. However, as the Code makes clear, any objection will not be a bar to the appointment, if the practitioner is otherwise satisfied that there is no unacceptable threat to the fundamental principles. This issue did not arise in Zinc – since the secured lenders did not give prior warning to the company of the appointment of the administrators, then there was no obligation on the administrators to seek consent from the company to their appointment.

## Engagement of Lawyers

The other practical issue considered in both *Zinc Hotels* and *Davey v Money* related to the engagement by administrators of lawyers who had also acted, or were acting for, secured creditors. The Australian authorities suggest that an administrator should not engage lawyers who had been or were engaged by secured creditors, with the decision in the *Commonwealth Bank of Australia* case referred to above even going as far as suggesting that an administrator should not engage lawyers who are on the panel of banks who are secured creditors. However, it is clear that the English courts take a somewhat different approach.

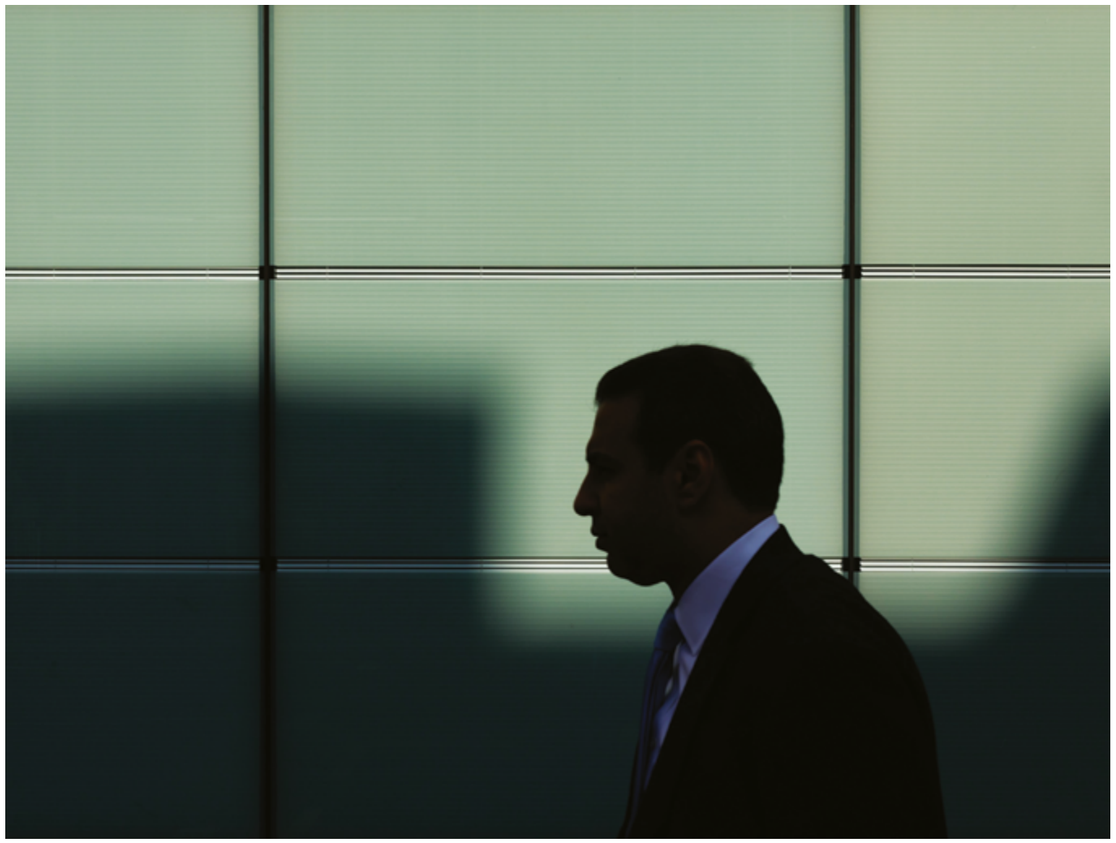
In *Davey v Money* (at [340]) Snowden J made the point that, if a pre-existing relationship with a secured creditor does not preclude an insolvency practitioner from accepting an appointment as administrators, then it is difficult to see why a pre-existing relationship between lawyers and a secured creditor would prohibit those lawyers from being engaged by the administrators:

> *"I do not think that Finkelstein J's views concerning the appointment of solicitors on the bank's panel can be taken to have been intended as prescribing some hard and fast legal rule as regards the appointment of agents by administrators. If, as the judge acknowledged, there is no prohibition on the appointment of administrators who have previously been engaged by the secured creditors, I fail to understand how he could have thought that such a rule could exist as regards the appointment of other professional agents."*

In fact, it is clear, as a matter of English law that, not only does the fact that lawyers may have been previously engaged by secured creditors not prohibit their subsequent engagement by the administrators, but also that there is no absolute bar on lawyers acting concurrently for both secured creditors and administrators. That was the point made by Arnold J in Avonwick v Shlosberg [2017] Ch 210 at [46]:*"There is nothing inherently objectionable about a solicitor acting for both a trustee in bankruptcy or liquidator and a major creditor of the bankrupt or insolvent company".* He referred to the earlier decision in *Re Schuppan* (No. 1) [1997] 1 BCLC 211 where Robert Walker J had pointed out that there might well be practical benefits to such an approach in terms of efficiency and cost savings, and that any conflicts of interest could be managed by practical measures put in place.

Against this context, in *Zinc Hotels* Henry Carr J dismissed the argument that it had been inappropriate for the administrators to have engaged the same lawyers who were also advising the secured lenders. He accepted that there were good practical reasons why such an approach was likely to have been helpful to the conduct of the administrations, and that appropriate measures had been put in place to deal with those aspects where there might be a conflict between the interests of the secured lenders and those of the companies, the unsecured creditors and/or shareholders.

The relevant factual circumstances in *Zinc* were that at the time the lawyers were engaged the evidence available to the administrators indicated that the value of the companies' assets was likely to break within the secured debt, and thus that the interests of the secured lenders and the companies were aligned in seeking to maximise the value of the companies' assets. As the administrations continued it, however, became apparent that there was in fact a real prospect of there being a return to shareholders, after discharge of the secured debt, the unsecured creditors and expenses. At this stage, the administrators took the decision

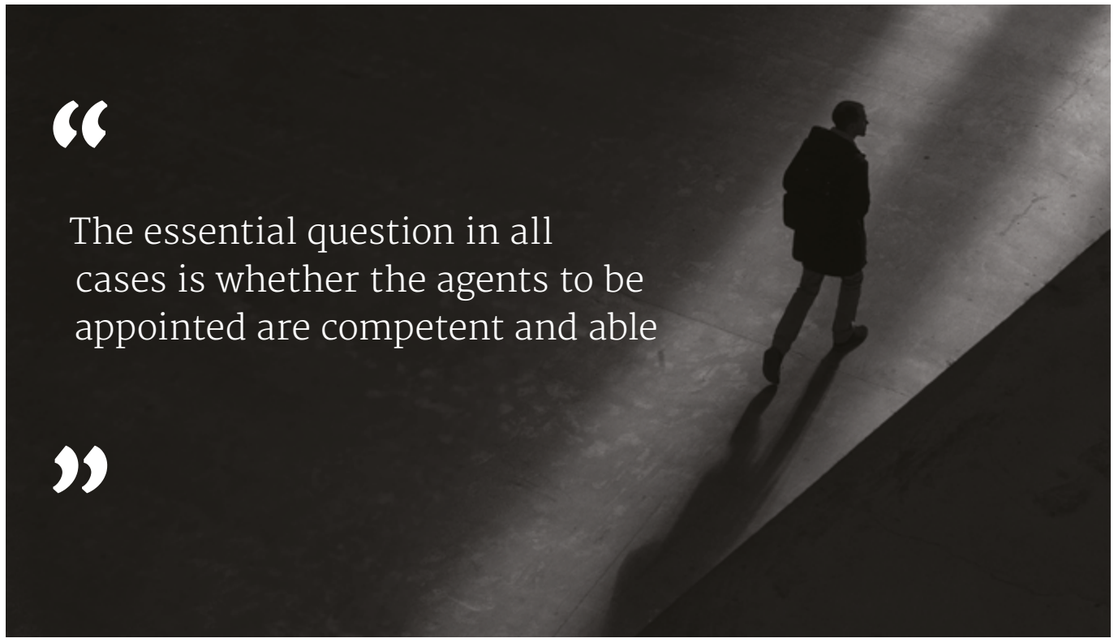


2 The Ethics Code makes clear that in this case it will be inappropriate for the appointment to be accepted if the audit work was carried out within the previous three years: see para. 79.

3 Ethics Code para.44.

4 Ethics Code para.80.

**FEATURE ARTICLE: CONFLICTS OF INTEREST AND OFFICEHOLDERS**




to change legal representation, to engage lawyers who were not also acting for the secured lenders. The court, therefore, did not have to consider the question of whether it would be appropriate for administrators to engage the same lawyers as also acted for secured creditors, in circumstances where the evidence indicated that the value of the companies' assets was likely to break in the unsecured debt or in the equity.

### Engagement of Other Agents

Finally, it is relevant to touch on the position of other agents engaged by administrators to assist with the conduct of administrations. The actual issue in *Davey v Money* concerned the appointment by administrators of property agents to manage the sale of a property in Canary Wharf which was intended to be redeveloped. The administrators appointed agents who were proposed by the bank which, as the secured creditor, had appointed the administrators. It was argued that the agents lacked the necessary independence and that the administrators should have held a *"beauty parade"* before appointing agents.

This argument was rejected by Snowden J. There is *"no hard and fast legal rule requiring a selection process to be held, or prohibiting the appointment by administrators of agents who have been recommended by the secured creditor(s)"*. Rather, the essential question in all cases is whether the agents to be appointed are competent and able to discharge their fiduciary duties to the company. This depends upon the precise nature of the duties in question and all the circumstances of the individual case. On the facts of *Davey v Money*, the agents, although not as well-known as some other firms, were competent and able to discharge their duties, and so it was not in appropriate for the administrators to have appointed them, notwithstanding that they had been nominated by the appointing bank.

### Conclusion

The English courts have historically taken a pragmatic approach to dealing with issues of conflict of interest in the context of insolvencies, recognising that the approach to dealing with conflicts has to be balanced with the practical requirements of conducting insolvencies in an efficient and cost effective way. Most practitioners would no doubt have found it surprising if the courts can consider that a previous engagement by secured creditors of practitioners to carry out a contingency planning exercise or similar would disable those practitioners from then being appointed as administrators, but it is helpful that this has been confirmed by the courts. The practical approach to the engagement of lawyers and other agents is also to be welcomed. Ultimately, the approach remains that the English court will not take an inflexible or dogmatic approach to conflict questions – and for the most part reliance will be placed on the relevant professionals to deal with conflicts as and when they arise in a sensible way. ■

**[Tom Smith QC acted for the Bank in *Dunbar v Davey*, and Tom Smith QC and Hannah Thornley acted for the Administrators in *Zinc Hotels*]**



# New Tenants at South Square

South Square is delighted to welcome Stefanie Wilkins and Lottie Pyper as new practising tenants following successful completion of their pupillages.

## STEFANIE WILKINS

Stefanie was first admitted to practice as a barrister and solicitor of the Supreme Court of South Australia in 2006. She has extensive experience in complex and large-scale commercial litigation and insolvency from her practice in Australia. Stefanie was called to the bar of England and Wales in 2017.

Before joining South Square, Stefanie practised for several years as a Senior Associate at Lipman Karas, a leading firm specialising in insolvency and commercial litigation, with offices in Australia, Hong Kong and London. Stefanie also worked for two years as Associate (judicial assistant) to the Honourable Justice Sulan in the Supreme Court of South Australia, and was an intern at the International Criminal Tribunal for the Former Yugoslavia.

During her time in practice and during pupillage, Stefanie has gained experience in a range of areas of practice, including domestic and cross-border insolvencies, claims against fiduciaries, banking and company law.

Stefanie graduated from the Bachelor of Civil Law with Distinction from University College, Oxford, during which she was jointly awarded the prize for Principles of Civil Procedure. She completed the BCL as a recipient of the Sir Robert Menzies Memorial Scholarship in Law. Stefanie holds undergraduate degrees in Law and Civil Engineering, both with first class honours, from the University of Adelaide.

Stefanie has published several academic works in the field of civil procedure, and most notably is one of the joint authors of *Zuckerman on Australian Civil Procedure* (published in July 2018).

## LOTTIE PYPER

Prior to coming to the Bar, Lottie graduated with a First Class degree in English Literature from Oxford University and a Distinction on the Graduate Diploma in Law from City, assisted by a scholarship from Gray's Inn. Lottie then studied the Bar Course with a Postgraduate Scholarship from City and a Bedingfield Award, Gray's Inn's most prestigious scholarship for that year.

Having completed an internship at J.P. Morgan as a credit risk analyst, Lottie is familiar with the regulatory framework underpinning commercial finance. She also has experience of financial analysis and modelling, in particular relating to mergers, hedging arrangements and loan maintenance covenants.

As a pupil, Lottie was exposed to all of chambers' core areas of practice, including both cross-border and domestic insolvency, restructuring, banking and finance, company law, commercial litigation, offshore and bankruptcy. She was supervised by Richard Fisher, Stephen Robins, Marcus Haywood, Adam Al-Attar, William Willson, Georgina Peters, Charlotte Cooke and Henry Phillips.

During pupillage Lottie assisted on a number of notable cases, including the attempted challenge to the BHS CVA *(Re SHB Realisations)*; the appeal in relation to the MF Global CVA *(Heis v Financial Services Compensation Scheme)*; disputes arising from the CBIR recognition of both the debt restructuring of the International Bank of Azerbaijan *(Re OJSC International Bank of Azerbaijan)* and the insolvency of Croatia's largest privately owned company *(Re Agrokor d.d.)*; preparations for the forthcoming Cayman-based appeal arising from the Madoff Ponzi scheme *(Primeo v HSBC)*; and the Lehman Brothers' scheme of arrangement.

Since accepting her offer of tenancy, Lottie has been instructed as a junior in a number of ongoing matters, including the restructuring of Noble Group.

# Michael Crystal QC receives the GRR 2018 Lifetime Achievement Award

On 26 June South Square's Michael Crystal QC was honoured with the Global Restructuring Review 2018 Lifetime Achievement Award in recognition of his contribution to the development of cross-border restructuring and insolvency sectors.

Michael (who together with Mark Phillips QC and Marcus Haywood), successfully appeared in the *AHAB v SICL & Ors* trial earlier this year (see pages 14-18 of this issue), has been involved as counsel, adviser or expert witness in most of the best known international insolvencies and restructurings in the UK and overseas in the last four-and-a-half decades, including BCCI, Maxwell Group Newspapers and Parmalat.

Michael was given the award at a dinner held by Global Restructuring Review in the Banking Hall. Mark Phillips QC, who gave an introductory speech to Michael's award said,

Michael on being made QC in 1984

*"When Michael started practice, bankruptcy was perceived to be an unglamorous end of the legal world. Fashionable barristers and solicitors would not get involved. Michael was at the forefront of developing solutions to cross-border insolvency problems where none had existed before. For example, before BCCI, in which he acted for the liquidators, cross-border pooling had never been attempted. Michael pulled it off."*

Accepting the award, Michael reflected on his experiences over 45 years at the bar, with photographs from the course of his career as prompts (some of which we publish here). The first, seen here to the far left, is of a young Michael as a junior barrister with the late Muir Hunter QC – one of the founders of the English insolvency bar – at the 1973-4 trial of British architect John Poulson, described at the time as *"the largest corruption of civil servants and politicians in the 20th century"*. The net result of that trial was the imprisonment for corruption of about 20 politicians and civil servants. *"For me, it was quite an interesting start,"* joked Michael.

He also recalled his time in Bermuda in the 1990s while he was working on the much-publicised family dispute between the Swiss baron Hans Heinrich Thyssen-Bornemisza and his eldest son, Georg, who had been accused of defaulting on payments from the family trust. The photo top right shows Michael and the Baron's legal team heading off to Court in Hamilton, Bermuda.

Running through a brief history of key moments in the insolvency sphere, Michael reviewed the "*raft of offshore failures*" that took place in Anglo-Saxon jurisdictions during the 1980s which gave rise – albeit quietly – to the development of international judicial cooperation "*so by the time we get to BCCI in 1991 there is already a background*" of cooperation to lean on. He also recalled the first instances of COMI-switching to the UK that took place in the early 2000s and the rise in so-called "bankruptcy tourism", leading up to the next phase when the financial world imploded in 2008.

Closing, Michael left the audience with three things that had struck a chord with him during his career.

Firstly, Michael emphasised the critical importance of respecting other jurisdictions' approaches to restructuring and financial failure. He noted there has been a sea-change in the recognition that different countries have different ways of doing things, and that the territorial approach has been replaced with universalism in the restructuring area, where there will inevitably be multiple jurisdictions involved in complex cases.

Secondly, *"beware of Gibbs"* – the 19th century precedent that remains in situ and prevents English law-governed debt being compromised outside of English proceedings – Michael warned. Michael described Gibbs as *"an unexploded mine field for us all to walk into over the next few years"* that would be all the more complicated because of Brexit.

Thirdly and finally, Michael predicted that lawyers and other restructuring professionals will have to start addressing what he called "*the valuation of litigation futures in restructuring cases*". At the heart of this is the extraction of value in restructuring cases, he said, taking into account aspects that are not being tackled and values that are being stripped. Some of these issues were also failing to be picked up in the US, which would explain why they're not being picked up in the UK either, Crystal noted. *"For me, that's something for the future."*

All at South Square are delighted that Michael's contributions have again be honoured in this way. ■

In Bermuda in the early 1990s

Michael with Mark Phillips QC (left) at the GRR awards

# Case Digest Editorial

Toby Brown

This edition of the Digest presents 30 summaries of a variety of English and offshore decisions, ranging from *Playboy Club* (pg 39) through to *Everton Football Club* (pg 54).

But the most interesting may be Marcus Haywood's detailed examination of the judgment in *Saad Investments v AHAB* (pg 14), following the largest trial ever to take place in the Cayman Islands, in which he appeared with Michael Crystal QC and Mark Phillips QC, assisted from London by Andrew Shaw. Their clients SICL and Singularis faced a claim for over US$4 billion arising from one of the largest, if not *the* largest ever, fraudulent Ponzi scheme. After a very substantial trial, which included one witness being cross-examined for 10 days, the Grand Court roundly rejected AHAB's claim. Marcus' article explains that the Chief Justice found that the partners of AHAB knew of and authorised the issuance of fraudulent financial statements, and knew of the fraud on AHAB's lending banks. Also of interest is that the Court would in any event have barred the claim on illegality grounds, since it would not enforce an illegal arrangement and/or because AHAB lacked clean hands.

The handing down of the Saad judgment in 2018 strengthens the impression that the Cayman Islands has in recent years hosted the biggest pieces of commercial litigation taking place across the Commonwealth. We can see further evidence of South Square's ongoing work in the Cayman Islands and the BVI in the digests of recent insolvency and fund disputes in which David Allison QC and Tom Smith QC have appeared (pp 49-52).

Moving back to England and Wales, since the last edition of the Digest we have seen a number of interesting insolvency decisions in the High Court and Court of Appeal involving a dozen members of South Square. For example, over the summer the Court of Appeal handed down a further judgment in *MF Global UK Ltd*, which has been in Special Administration since 2011 (pg 48). Mark Arnold QC, David Allison QC, Daniel Bayfield QC, Marcus Haywood and Adam Al-Attar appeared in this appeal which decided that the CVA approved in 2017 (which gave unsecured creditors an option to exit the administration in return for a final cash payment) was precluded from coming into operation due to a condition precedent.

Another notable insolvency decision was handed down the following month, in July 2018, in the long running administration of *Lehman Brothers International (Europe)* (pg 50). Hildyard J sanctioned a scheme to compromise complex legal proceedings in order to facilitate distribution of the substantial surplus to creditors. The notable issue concerned whether the majority creditors had an adverse special interest which meant that their vote had to be disregarded or discounted as not being representative of the class. Reflecting South Square's significant involvement in *Lehman Brothers* litigation, eight members of chambers were involved in this hearing (Robin Dicker QC, William Trower QC, David Allison QC, Daniel Bayfield QC, Richard Fisher, Adam Al-Attar, Henry Phillips and Ryan Perkins).

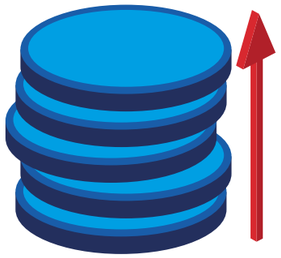
The summer also saw a number of contract law decisions from the appellate courts (pp 43-45). Of particular note is the Supreme Court's judgment in *Rock Advertising Limited v MWB Business Exchange Centres Limited* concerning "no oral modification" clauses, which are commonly used to prevent an attempt to vary a contract without written agreement. The Supreme Court reversed the Court of Appeal's decision and enforced the validity of the clause. Lord Sumption reasoned that there were legitimate reasons for such clauses, and that there was no conceptual inconsistency between the general rule allowing oral contracts and a specific rule that effect would be given to contracts requiring variations to be in writing.

Finally, the decision in August 2018 in *Fundo Soberano de Angola v Jose Filomeno dos Santos* is a salutatory reminder of the importance of giving full and frank disclosure when applying for freezing orders (pg 43). Popplewell J discharged a $3 billion worldwide freezing order, one of the largest ever granted, because there had been a serious and substantial breach of the duty to give full and frank disclosure of all material facts. Whilst there was no evidence that they had sought mislead the Court, it was incumbent on the claimant and its lawyers to make the fullest inquiry into the case given the size of the freezing order sought and the allegations of dishonesty.

That is but a brief digest of the digests, with many other interesting cases summarised for your reading over the following pages. ■



# Case Digests



## Banking and Finance

Digested by Toby Brown and Stefanie Wilkins

### Playboy Club London Ltd v Banca Nazionale del Lavoro Spa [2018]

**UKSC 43 (Lady Hale PSC, Lord Mance, Lord Sumption Lord Reed, Lord Briggs JJSC) 26 July 2018**

*Banker's reference – duty of care – undisclosed principal*

The Playboy Club London Ltd ("the Club") operates a casino in Mayfair, where an apparent "High Roller" requested a cheque cashing facility, for which the Club required a bankers' reference. To preserve confidentiality, the Club requested a refence from the Higher Roller's bank ("the Bank") through an associated company ("Burlington"). The Bank provided a favourable reference, saying that the High Roller was trustworthy up to £1.6m per week. The High Roller played roulette over 4 days using chips obtained on two cheques totalling £1.25m. However, the cheques were counterfeits and bounced, as the High Roller's account at the Bank never contained any funds. The Club was out of pocket for c. £800,000 and brought a negligence claim against the Bank which succeeded at first instance, subject to a deduction of 15% for contributory negligence. The Court of Appeal allowed the appeal, holding that the Bank only owed a duty of care to Burlington as addressee of the reference.

In the Supreme Court, Lord Sumption (with whom Lady Hale PSC, Lord Reed and Lord Briggs JJSC agreed) gave the lead judgment, and Lord Mance gave a concurring judgment containing additional reasons. Lord Sumption stated that the facts were to a certain extent similar to *Hedley Byrne & Co Ltd v Heller & Partners Ltd* [1964] AC 465 (though the critical difference was that here the reference was not relied upon by the addressee but by its undisclosed principal). It is fundamental to analysing the duty that the defendant is assuming a responsibility to an identifiable (if not necessarily identified) person. The Bank's knowledge of the transaction was relevant to identifying the persons to whom it can be said to have assumed a responsibility. The Club accepted there was no evidence that the Bank knew its reference would be communicated to or relied upon by anyone but Burlington, and conceded that ordinarily the representor owes no duty to a third party.

The Club argued that the case was different because the Club was Burlington's undisclosed principal, and therefore the relationship was "equivalent to contract" (to use Lord Devlin's phrase in *Hedley Byrne*) because in contract the Club would have been entitled to declare itself and assume the benefit of the contract. Lord Sumption described this as an ingenious but fallacious argument. The relationship of an undisclosed principal is not at all analogous to the kind of relationship which will give rise to a duty of care in tort. Whether a relationship is sufficiently proximate to give rise to a duty of care is essentially a question of fact, whereas the liability of a contracting party to an undisclosed principal is a purely legal construct. The whole point about the law relating to undisclosed principals is that a person may be brought into contractual relations with someone with whom he has no factual relationship at all. Such a relationship is by definition not proximate.

The Bank had no reason to suppose Burlington was acting for someone else and it knew nothing of the Club. In the circumstances, it was plain that the Bank did not voluntarily assume responsibility to the Club. The Supreme Court therefore dismissed the appeal. ■

CASE DIGESTS

# Banking and Finance

## Elite Property Holdings Limited v Barclays Bank PLC [2018]

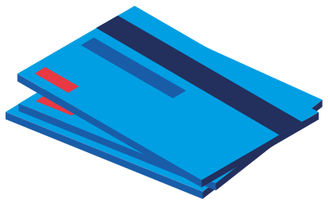
**EWCA Civ 1688 (Lindblom LJ and Flaux LJ) 17 July 2018**

*Mis-selling of IRHPs – no contractual duty to customer in respect of review agreed with FCA*

The Court of Appeal considered, for the first time, whether a bank owed a contractual duty to a customer in relation to its conduct of a review pursuant to an agreement with the Financial Conduct Authority ("the FCA") regarding interest rate hedging products ("IRHPs"). Although ultimately permission to appeal was refused, the Court gave permission for the judgment to be cited as a precedent.

The claimants had entered into three structured collars with the defendant ("the Bank") between 2006 and 2008 in connection with loan facilities totalling c. £7.5 million. They subsequently asserted that the products had been mis-sold to them. The Bank subsequently agreed with (what is now) the FCA to conduct a review of its sale of IRHPs. In 2014, the claimants agreed the terms of a "Revised Redress Offer" with the Bank, which provided (amongst other things) that the claimants would receive, in full and final settlement of any claims, an immediate lump sum payment, and also stated that the Bank would assess any claim made for consequential losses. Subsequently, under oversight of an independent reviewer, the Bank rejected the claims for consequential loss. The claimants then issued proceedings against the Bank. The judge dismissed the claims by way of strike out and/or summary judgment. The judge also refused the claimants permission to amend their claim to assert that, through their acceptance of the Revised Redress Offer, the Bank owed them a contractual duty to investigate their consequential loss claims.

Flaux LJ (with whom Lindblom LJ agreed) rejected the claimants' appeal. First, Flaux LJ observed that at the time that the Bank made the Revised Redress Offer, it was already under an obligation to the FCA to undertake a review. The Bank was always going to conduct the review, and was not assuming any fresh obligation to the claimants in carrying out the review, so it followed that there was no consideration for any suggested contractual promise concerning the review. Secondly, his Lordship relied on the earlier decision of the *Court of Appeal in CGL Group Ltd v Royal Bank of Scotland Plc* [2018] 1 WLR 2137, in which Beatson LJ had explained that there was no duty of care in tort owed by a bank to a customer when conducting a review of that customer's products and that the "overall regulatory regime" indicated that the FCA alone had power to compel a bank to comply with the terms on which it was obliged to conduct reviews. Flaux LJ considered that this analysis was "*inconsistent with there being any basis for a claim in contract*", absent some clear contractual term to the contrary, which was absent here. Accordingly, the Bank's only contract in relation to the review was with the FCA. ■



# Civil Procedure

Digested by Rose Lagram-Taylor

## Hertel v Saunders [2018]

**EWCA Civ 1831 (Lewison LJ, David Richards LJ, Coulson LJ) 31 July 2018**

*Part 36 Offers – costs orders – permission to amend*

This case concerned an offer of settlement, and whether it could be construed as a Part 36 Offer or not under CPR r. 36.5(1)(d). The claimants had initiated proceedings for a declaration that there was a partnership or joint venture between the parties. The claimant then applied for permission to amend, but prior to the amendment being made, the solicitor for the defendant wrote a letter of settlement to the claimant, stating that it was made under Part 36. The offer stated that the claim, as pleaded, was bound to fail against the claimant, but the offer also stated that it was made on the basis of the proposed amendments. The claimant accepted the offer.

The master held that the costs outcome for the case was governed by CPR r. 36.10(2) on the grounds that the offer related to part of the claim and the claimants had abandoned the balance of the claim. On appeal to the judge, the defendant argued that the offer was never a Part 36 offer, as such an offer could not extend to a case that had not yet been pleaded or formulated in an existing action. The judge accepted this and the order that the defendant pay the claimant's costs was largely overturned. This was because the claim in the proposed amendment to which the settlement related was not "*a claim or part of the claim or an issue which arose in the claim*" under CPR r.36.5(1)(d).

On appeal to the Court of Appeal, the claimants submitted that under CPR r. 36.7(1) a Part 36 offer could be made before the commencement of proceedings when the word "*claim*" could not be defined by reference to any pleadings, meaning a Part 36 offer generally should not be defined by reference to the pleadings after commencement either.

The appeal was dismissed. It was held that the position before proceedings commenced was different to that after commencement as there were pleadings with procedural rules that regulated them, meaning it would be wrong to ignore the clarity which pleadings provided by treating a Part 36 offer as though proceedings had not begun. It would also be wrong to introduce uncertainty by giving a wide definition to claims/parts/issues in circumstances where they could be properly defined by reference to the pleadings. Therefore, for the purposes of the offer, it did not matter that a new claim was subject to a proposed amendment, as it was not a claim until the amendment was allowed. Despite the fact that both parties had initially accepted that the offer was a Part 36 offer, the Court of Appeal ruled that this was irrelevant, as on analysis, it was clear it was not a Part 36 offer, and it could not become one merely because of its labelling as such. ■

## The National Guild of Removers & Storers Ltd v Bee Moved Ltd & Ors [2018]

**EWCA Civ 1302 (Kitchin LJ, Asplin LJ) 12 June 2018**

*Adducing fresh evidence*

The appellant trade association appealed against a decision that the respondent removals company and its directors were not responsible for a misrepresentation on a website which was relied upon for the purposes of its passing off claim. One of the issues for the Court of Appeal was whether the trial judge had erred in accepting evidence from one of the defendant's witness in relation to his knowledge of, and his ability to change, the webpage in question. As part of the appeal, the trade association sought to rely on fresh evidence which was said to undermine one of the respondent director's credibility.

On the issue of adducing fresh evidence, it was held that it was not appropriate to admit the fresh evidence, in accordance with the principals in *Ladd v Marshall* [1954] 1 WLR 1489. The finality of the litigation outweighed the relevance and necessity of the evidence. In addition, it was considered that the fresh evidence did not only become relevant at the trial itself, and was in fact of relevance before the trial began meaning it could have been obtained and relied upon at the trial if the trade association had chosen to do this. Further, it was concluded that whilst the fresh evidence could be used to contradict certain points raised in the trial, it was difficult to see that the evidence would have affected the judge's overall estimation of the witness in question, and the trial generally. Should the fresh evidence be admitted this would result in a retrial being necessary, and in the circumstances where this would cause further delay and costs this was viewed as an unnecessary and disproportionate result. ■

## Société Générale v Goldas Kuyumculuk Sanayi Ithalat Ihracat AS & Ors [2018]

**EWCA Civ 1093 (Longmore LJ, Macur LJ, Simon LJ) 15 May 2018**

*Service – legal advice – freezing injunctions*

The appellant bank appealed against a decision refusing to order deemed service of proceedings upon the defendants and the resultant dismissal of its claims and the discharge of certain freezing injunctions. The proceedings had originally been commenced following the failure of the defendant companies to pay for gold bullion supplied to them. Worldwide freezing orders were also obtained on the provision of an undertaking that proceedings would be served "as soon as practicable". Following ineffective service on the defendants (three of whom were based in Turkey, and one in Dubai), the defendants applied for the claims to be struck out and for the freezing orders to be discharged. The bank made a cross application for deemed service by an alternative method with retrospective effect pursuant to CPR r. 6.15, or in the alternative for service to be dispensed with under CPR r. 6.16, primarily on the basis that erroneous legal advice had been provided from a Turkish law firm which asserted service had been effected in Turkey, when it had not. This application was dismissed at first instance, and the claims were accordingly struck out and the freezing orders lifted. Popplewell J held that reliance upon negligent legal advice could never constitute a good reason for alternative service, and further that exceptional circumstances were required to justify alternative service under CPR r. 6.15 where an order might (i) deprive the defendants of an accrued limitation defence, or (ii) sanction a method of service not permitted by the Hague Convention on the Service Abroad of Judicial and Extrajudicial Documents in Civil or Commercial Matters 1965.

The Court of Appeal dismissed the appeal. In relation to erroneous legal advice, the court held that negligent or incompetent advice was always a bad reason for granting an extension of validity of a claim form. However, in the context of alternative service, it was not right to say that such advice was always "a bad reason" and instead whether there was "a good reason" depended on the facts of the case, in line with the decision in *Barton v Wright Hassall LLP* [2018] UKSC 2018, [2018] 1 WLR 1119 (as reviewed in the June 2018 edition of the *Digest*). On the requirements for exceptionality, the court held that a limitation defence had to be highly relevant to the exercise of the court's discretion, and CPR r. 6.15 required an inquiry into the reason for not achieving proper service before the expiry of a limitation period. As to the Hague Convention, service by an alternative method was to be permitted only "in special circumstances". Whilst the court considered that Popplewell J had made a limited error of principle in saying that negligence or incompetence must always be a bad reason for ordering alternative service, this was only a minor error and did not vitiate the judge's evaluation of the other factors in the case. ■

CASE DIGESTS

# Civil Procedure

## Director of the Serious Fraud Office v Eurasian Natural Resources Corporation Ltd [2018]

**EWCA Civ 2006 (Sir Brian Leveson P, Sir Geoffrey Vos C, McCombe LJ) 5 September 2018**

*Privilege*

The background from which this case stems concerned an allegation made by an apparent whistle-blower alleging corruption and financial wrongdoing within a wholly-owned subsidiary of the defendant company ("ENCR"). As a result of this allegation, ENCR engaged a law firm and forensic accountants to investigate, which resulted in certain documents being generated such as solicitors' notes (category 1), materials as part of the books and records review of the forensic accountants (category 2), and documents sent to the SFO (category 4). The SFO wrote to ENCR urging them to carefully consider their Self-Reporting Guidelines while undertaking internal investigations and later issued a series of notices under s.2(3) of the Criminal Justice Act 1987, requiring ENCR to disclose the production of specified documents. ENCR asserted legal professional privilege over these documents, leading to the SFO issuing proceedings seeking declarations that the documents were not the subject of legal professional privilege. At first instance, the declarations sought by the SFO were granted.

On the appeal of ENCR, there were four issues which the Court of Appeal had to decide.

Firstly, whether with respect to litigation privilege, the judge had been right to determine that, at no stage before all the documents had been created, criminal legal proceedings against ENRC, its subsidiaries or their employees had been reasonably in contemplation. As to this, it was considered that there was no general principle that litigation privilege could not attach until either a defendant knew the full details of what was likely to be unearthed or a decision to prosecute had been taken. The fact that a formal investigation had not commenced would be one part of the factual matrix, but would not necessarily be determinative. Accordingly, it was held that the judge at first instance had erred when concluding that a criminal prosecution had not reasonably been contemplated when the SFO wrote to ENCR about their Self-Reporting Guidelines. The documents in question demonstrated that litigation was a real likelihood if the self-reporting process did not result in a civil settlement. The Court of Appeal therefore upheld the appeal of ENCR on this ground, holding that criminal legal proceedings had been reasonably in the SFO's contemplation by the time the SFO sent its letter to ENCR.

Secondly, whether the judge had been right to determine that none of the documents had been brought into existence for the dominant purpose of resisting contemplated criminal proceedings against ENRC, its subsidiaries or their employees. It was considered that where there was a clear threat of a criminal investigation, whistle-blower allegations had to be brought into the zone where the dominant purpose might be to prevent or deal with litigation. It was also accepted that a criminal investigation and a potential prosecution had been reasonably in the contemplation of ENRC at the time that it had commissioned the solicitors' investigation. It was held that the judge at first instance had failed to take account that the category 1 documents had been brought into existence for the dominant purpose of resisting or avoiding proceedings. The same, it was held, could be said for categories 2 and 4. Accordingly, the category 1, 2 and 4 documents, with the exception of two emails, were covered by litigation privilege, contrary to the first judge's decision.

Thirdly, whether with respect to legal advice privilege, *Three Rivers District Council and others v Governor and Company of the Bank of England (No 7)* [2003] All ER D 59 had decided that communications with a client for legal advice privilege purposes were only those with an employee who was specifically tasked to seek and obtain legal advice. Three Rivers had decided that communications between an employee of a corporation and the corporation's lawyers could not attract legal advice privilege unless that employee had been tasked with seeking and receiving such advice on behalf of the client. It was held that whether or not *Three Rivers* had been wrong, was a question that could only be decided by the Supreme Court.

Finally, whether the judge had been right to conclude that none of the documents had been protected by legal advice privilege on the basis that (i) the information they contained had not been communicated to ENRC's solicitor by anyone authorised to give or receive legal advice on behalf of ENRC, (ii) the information they contained had not been communicated to ENRC's solicitor for the purpose of obtaining legal advice, and (iii) there had been overwhelming evidence that ENRC had always intended and/or agreed to share the information they contained with the SFO as part of a self-reporting process. As to this (i) if legal advice privilege had been all that could have been claimed, the judge would have been right to decide that the category 1 documents had not been protected by legal advice privilege as the documents had not contained information that had been communicated to ENCR's solicitor by anyone authorised to seek or receive legal advice on behalf of ENRC, (ii) the dominant purpose of the preparation of the interview notes and the documents review had been to resist or avoid contemplated criminal proceedings against ENRC and (iii) the documentation did not demonstrate that ENRC had ever intended or agreed to share the information it obtained with the SFO. Overall therefore, the appeal was allowed against the judge's declarations that the documents in categories 1, 2 and 4, save for the two emails, had not been covered by litigation privilege. ■

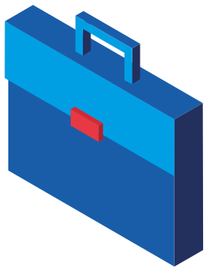
## Fundo Soberano de Angola v Jose Filomeno dos Santos [2018]

**EWHC 2199 (Popplewell J) 16 August 2018**

*Freezing injunctions - without notice - duty of disclosure*

The High Court discharged a $3 billion worldwide freezing order ("WFO"), believed to be one of the largest WFOs ever granted, on the grounds that there had been serious and substantial breaches in the duty to provide full and frank disclosure of all material facts. The claimants, the sovereign wealth fund of the Republic of Angola and several of its subsidiaries had applied for the continuation of the WFO. The underlying claim alleged a dishonest conspiracy between the claimant's former chairman and his business partner who owned a group of companies including the third to twentieth defendants. It was contended that the WFO should be discharged on the ground that, among others, there had been material non-disclosure by the claimants on the without-notice application.

In giving judgment, Popplewell J re-stated the principles surrounding the duty of full and frank disclosure (*Brink's Mat Ltd v Elcombe* [1998] 1 WLR 1350). The ultimate touchstone of whether there had been full and frank disclosure is whether the presentation of the application is fair in all material respects. Given the size of the freezing order sought and the allegations of dishonesty made, it was incumbent on the claimants and their legal advisers to make the fullest inquiry into the central elements of the case. Popplewell J found eight such counts of non-disclosure. In determining the effect of this, taking into account the interests of justice, the court had to consider the importance of the matters which were not disclosed, the nature and degree of culpability and the adverse consequences to the claimant of losing the protection against the risk of dissipation of assets, as well as the penal element of the sanction. The breaches were serious and that there was a high degree of culpability in the failures to disclose all relevant matters. Although there was no evidence that the claimant or its legal team had sought to mislead the court and abuse the court's process, this was irrelevant for the purposes of the finding that material breaches had occurred. There were no strong reasons for departing from the usual sanction for serious and culpable non-disclosure, and the breaches were sufficiently serious as to warrant discharging the freezing injunction and not granting fresh relief. The claimants had not established a real risk of unjustified dissipation. A good arguable case of dishonesty on the part of the defendants was not enough, and the alleged risk was merely an assertion unsupported by solid evidence. Accordingly, the WFO was discharged. ■



CASE DIGESTS

# Commercial Litigation

Digested by Madeleine Jones

## Rock Advertising Limited v MWB Business Exchange Centres Limited [2018]

**UKSC 24 (Lady Hale, Lord Wilson, Lord Sumption, Lord Lloyd-Jones, Lord Briggs) 16 May 2018**

*Contracts-no oral modification clauses*

The Supreme Court considered the validity of so-called "no oral modification" (or "NOM") clauses – contractual clauses which require modifications to the contract to be in signed writing by the parties.

Rock Advertising ("Rock") entered into a licence agreement with MWB Business Exchanges Centres Ltd ("MWB") to occupy office space for a fixed term of 12 months. The agreement contained a NOM clause. Rock went into arrears of the licence fees due under the agreement, and proposed a revised schedule of payments, which was a modification of the terms of the agreement. At first instance in the County Court it was found as a fact that MWB had agreed to this modification orally, but that as a matter of law, MWB was entitled to rely on the licence agreement's unmodified written terms, because the modification did not satisfy the NOM clause. However, this decision was reversed in the Court of Appeal, which held that the oral variation was also an agreement to dispense with the NOM clause, so that MWB was bound by the oral modification. MWB appealed to the Supreme Court.

The Supreme Court unanimously allowed the appeal. Lord Sumption, giving the leading judgment, noted that NOM clauses are common, because they prevent attempts to undermine written agreements by informal means, avoid disputes arising from oral discussions about whether a contractual variation was intended and what precisely was agreed, and

CASE DIGESTS

# Commercial Litigation

they make it easier for parties to police their own internal rules, restricting the authority to agree variations.

Those were all legitimate commercial reasons for NOM clauses. Contract law did not normally override such legitimate reasons. There was no conceptual inconsistency between a general rule allowing contracts to be made informally and a specific rule that effect would be given to contracts requiring writing for a variation. It did not follow that parties who agreed an oral variation in spite of a NOM clause must have intended to dispense with the clause. Parties to such a clause agreed not that oral variations were forbidden, but that they were invalid. The safeguard against injustice lay in the various doctrines of estoppel. That had not been made out in the current case. ■

## First Tower Trustees Ltd v CDS (Superstores International) Ltd [2018]

**EWCA Civ 1396 (Lewison LJ, Leggatt LJ and Sir Colin Rimer) 19 June 2018**

*Contracts – non-reliance clauses – misrepresentation*

The Court of Appeal considered the appeal of a landlord ("First Tower") against a decision that it was liable to a tenant ("CDS") for misrepresentation. CDS had entered a tenancy agreement with First Tower. The agreement contained a clause that it had not entered into the lease in reliance on any representation made by First Tower – a non-reliance clause ("NRC"). In pre-contractual discussions, First Tower had represented that it was unaware of any environmental problems relating to the property to be leased. This was untrue – it was aware of asbestos contamination. CDS had to lease alternative premises while remedial work was carried out. At trial, it was found that CDS had entered into the contract on the basis of a misrepresentation, and that the NRC was an attempt to exclude liability for misrepresentation which was invalid as it failed to satisfy the test of reasonableness under the Unfair Contract Terms Act 1977 (the "1977 Act").

The Court of Appeal dismissed First Tower's appeal. Section 3 of the Misrepresentation Act 1967 (the "1967 Act") provides that a contract that restricts or excludes liability for a pre-contractual misrepresentation is valid only insofar as it satisfies the reasonable test in s.11(1) of the 1977 Act. Where the clause does satisfy this test, the parties are bound to accept a particular state of affairs as true even if they know it not to be. The NRC in the tenancy agreement was an attempt to exclude liability for misrepresentation and therefore subject to s. 3 of the 1967 Act. It did not satisfy the reasonableness test in the 1977 Act and was therefore invalid. There might be circumstances where a clause precluding reliance on enquiries made before a contract was entered into would satisfy the reasonableness test, but it was hard to imagine what those circumstances would be. ■

## Bou-Simon v BGC Brokers LP [2018]

**EWCA Civ 1525 (Hickinbottom LJ, Singh LJ and Asplin LJ) 5 July 2018**

*Contracts – implied terms*

The Court of Appeal considered a loan agreement between a broker (Mr Bou-Simon) and his employer ("BGC"). Mr Bou-Simon borrowed £336,000 from BCG on terms that it would be repaid from partnership distributions made to him (on the assumption he would be made a partner), and if he ceased to be a partner any unpaid amounts would be written off if he had served at least four years. However, the loan agreement did not contain an express term that the loan would be repayable if Mr Bou-Simon did not serve a further four years at BGC. Mr Bou-Simon resigned within four years, and BGC relied on an implied term in the loan agreement that the full amount of the loan would be repaid unless four years had been completed.

Mr Bou-Simon appealed an order that the debt was repayable on the basis of this implied term. The Court of Appeal allowed the appeal.

The correct starting point for determining whether term is to be implied is for the court to determine what the parties have expressly agreed. The trial judge erred by starting by construing the agreement in order to fit the proposed implied term, rather than starting with the express terms themselves. The proposed implied term was not so obvious that it went without saying or to be necessary for business efficacy in the sense that the agreement would lack commercial or practical coherence without it. If the implied term had been included, the express terms would have had to be redrafted: this was an indicator that the implied term was not included. ■

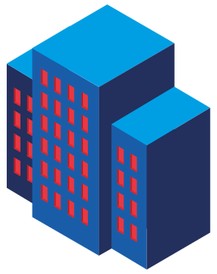
## Maurice MacNeill Iona Ltd (t/a Century 21 UK) v C21 London Estates Ltd [2018]

**EWCA Civ 1823 (Lewison LJ, Irwin LJ) 10 July 2018**

*Contracts – incorporation of terms*

The Court of Appeal considered whether the terms of a side letter between the master franchisor of an estate agency brand and a franchisee had been incorporated into a franchise agreement. Lord Justice Lewison, giving the judgment of the Court, found that it had not been.

The best way to establish that a contractual term is a condition of a contract is to say so in terms, although even that is not necessarily conclusive. That had not been done in this case. That the side letter said it was to be a "contractual component" of the franchise agreement was not sufficient. One party had given evidence that he understood the letter to be incorporated. This did not impact on the interpretation of the contract, which is an objective exercise. It was necessary to consider instead whether the side letter's terms formed part of the contract as a matter of necessary implication. On the facts, they did not. ■



CASE DIGESTS

# Company Law

Digested by Edoardo Lupi

## Re Nisa Retail Limited [2018]

**EWHC 1183 (Ch) (Morgan J) 4 May 2018**

*Solvent schemes of arrangement – objectors – shareholders*

The Court was asked to sanction a scheme of arrangement between Nisa Retail Limited ("Nisa") and its members, which involved the acquisition of the entire shareholding of Nisa by a purchaser. The application to sanction the scheme was oppose by one shareholder ("V&B") at the hearing.

At the convening hearing, Registrar Derrett had ordered a meeting of a single class of shareholders. At that meeting, shareholders representing 80.33% in number voted in favour of the scheme, representing 75.79% in terms of value.

V&B opposed the scheme at the sanction hearing on three principal grounds: (i) the consideration for the shares in Nisa was split into three elements, the split was irrational and its purpose could only be to manipulate the voting of the shareholders to achieve a favourable result; (ii) Nisa had sought to maximise the vote in favour of the scheme while taking no action in relation to the votes that might be cast, but which were not cast, against the scheme; and (iii) after the meeting, the Groceries Code Adjudicator had made public that she was investigating a senior company in the same group as the company acquiring Nisa: it was said that the investigation would have been a great concern to Nisa's shareholders, such that if the vote were taken again the outcome would likely have been different.

As to the first of the objector's grounds, the consideration was split into a fixed sum payable to each member, deferred payments of up to £1,654 per share, and an additional 1% rebate payable for four years based on and determined by the volume of continued trading by the member with Nisa post-scheme (albeit at a time when the members would, having sold its shares, have ceased to be a member). In circumstances where V&B was not in terms challenging the decision to convene a single class of shareholders, Mr Justice Morgan rejected the submission that the split consideration was irrational and, accordingly, rejected the analysis that the split must have been an attempt to manipulate the vote: each element of the split consideration could be rationally justified. As to the second ground, the Judge held that Nisa was not obliged to take any steps to get in the vote such that it was not appropriate to speculate what might have happened had more active steps been taken with regard to the 'no' voters. However, as regards the steps taken in respect of the 'yes' vote, the Judge noted that prior to the meeting Nisa had contacted a number of persons identified as potential 'yes' voters who had not yet voted. Of those, ten provided valid proxies supporting the scheme. Morgan J noted that even discounting these voters, there would still have been a statutory majority in excess of 75%. Accordingly, even if what had happened should not have happened (and Mr Justice Morgan declined to decide the point) the company's actions in this regard were immaterial and did not cause him to take a different view. As to the third ground, the objector's argument relied on authorities concerning the failure to disclose a material fact to the court meeting. However, there was no evidence to suggest that Nisa knew of any relevant fact in connection with the Groceries Code Adjudicator which it had failed to disclose to the court meeting. The judge noted that he had nothing like adequate material to form the view that the matter raised by V&B should require the voting process to be re-run. Accordingly, he proceeded to sanction the scheme. ■

CASE DIGESTS

# Company Law

## Interactive Technology Corporation Limited v Jonathan Ferster [2018]

**EWCA Civ 1594 (David Richards LJ, Newey LJ) 5 July 2018**

*Equitable compensation – directors – remedies*

The appeal concerned the meaning and effect of an order for the assessment of equitable compensation made by Morgan J following the trial of claims for breach of fiduciary duty against the respondent, Mr Jonathan Ferster. The underlying claims had been made by the appellant company ("ITC") against Mr Ferster, who was a former director.

Following the trial, Morgan J accepted that Mr Ferster had caused ITC to pay substantial unauthorised remuneration to him in excess of the salary of £120,000 per annum to which he was entitled. The exact amount of the unauthorised remuneration had yet to be established but Mr Ferster had accepted that it was not less than £4.48 million. A second hearing before Morgan J had taken place dealing with consequential matters, including the terms of the order. The relevant provision of the order provided: "*Judgment be entered for ITC for equitable compensation to be assessed in respect of the payment to Mr Jonathan Ferster of unauthorised "remuneration" from ITC that was in excess of Mr Jonathan Ferster's entitlement under Paragraph 6 above.*

The terms of the order were essentially common ground between the parties. ITC's skeleton argument made clear that it was electing the remedy of equitable compensation, as opposed to a repayment of the unauthorised remuneration, indicating that it regarded the former as greater than the latter. At the consequentials hearing, in the context of argument over interim payments, counsel for Mr Ferster submitted for the first time that on the evidence given at trial as to the market value of Mr Ferster's services, the remuneration received by him did not exceed that market value, with the result that ITC had suffered no loss. Nevertheless, despite these arguments, ITC maintained its election with regard to equitable compensation. In light of the dispute that had arisen, Morgan J made a number of declarations, which interpreted the provision of the order regarding equitable compensation. The declarations stated: (i) that the order "*provides for ITC to recover compensation for losses resulting from the payment to Jonathan Ferster of unauthorised remuneration*"; and (ii) that "*ITC had a right to elect between inconsistent remedies, namely (i) an order against Jonathan Ferster that he repay unauthorised remuneration received by him and (ii) an order against Jonathan Ferster that he pay equitable compensation for ITC's losses resulting from the payment by ITC of unauthorised remuneration. By no later than the point in time on 19 December 2016 when the Court pronounced the order, ITC made a binding election for (ii).*"

On appeal, ITC submitted that equitable compensation, both as a general proposition and in the context of the order, was not confined to compensation for losses (sometimes referred to as 'reparation claims') but included the recovery of compensation for money or assets disbursed without authority (sometimes called 'substitutive claims'). Richards LJ, with whom Newey LJ agreed, held that the Judge's approach involved a narrow reading of "equitable compensation" which was not in accordance with authority. In short, equitable compensation was apt to include a payment made to restore to a claimant the value of assets or funds removed without authority by a trustee or other fiduciary, such as a director. It could also include reparation for losses suffered by the claimant, such as in this case losses resulting from the payment of the unauthorised remuneration. But, equitable compensation was not restricted to reparation for losses, as the judge appeared to have held by adopting a binary distinction between loss-based and gains-based remedies. Accordingly, the appeal was allowed and the two declarations interpreting the order were deleted and replaced with a declaration sought by ITC, which made clear that it was entitled both to substitutive and reparative compensation. ■

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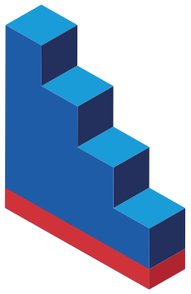


CASE DIGESTS

# Corporate Insolvency

Digested by Riz Mokal

## Granada UK Rental & Retail Ltd v The Pensions Regulator [2018]

**UKUT 0164 (TCC) (Rose J, Judge Herrington, Mr Abrams) 18 May 2018**

*Employer's pension scheme insufficiently resourced – Financial Support Direction – whether parent entities "connected with" or "associates of" employer – whether pension legislation could be applied in relation to events occurring before legislation came into force*

In 1999-2000, the five applicant companies ("the Targets") entered into a joint venture with a rival group ("Thorn") and set up the 'Box Clever' set of entities ("Box Clever"). The Targets and Thorn sold their respective TV rental businesses to Box Clever for £980m, which Box Clever funded in significant part by a £860m loan secured on its assets. In 2001, Box Clever set up an employee pension scheme ('the Scheme') and accepted liability for funding it. Box Clever thereafter became insolvent and entered administrative receivership in late 2003. The pension scheme was in deficit at that time which had since grown to £115m. In September 2011, the Pensions Regulator ('the Regulator') determined to issue a Financial Support Direction ('*FSD*') pursuant to section 43 of the Pensions Act 2004 upon the Targets to address the deficit. The Regulator contended that the Targets were "connected" with or "associates" of Box Clever for this purpose as of the "look-back" date of 31 December 2009, and that they had set up Box Clever in such a way as to bear the costs associated with the rental businesses without the right to share in future profits. The Targets denied that they were "connected" with or "associates" of Box Clever, and also contended that the Pensions Act was not retroactive and could not be applied in relation to events occurring before it came into force.

The Tribunal found in favour of the Regulator. (1) The issue of connexion and/or association turned, pursuant to section 435(1)(b) of the Insolvency Act 1986 on whether the Targets had control at the relevant date of Box Clever by virtue of being entitled to control at least a third of the voting power at any general meeting. The Tribunal found that voting rights had indeed remained vested in the Targets at the relevant time. (2) The Tribunal reasoned that the application of new legislation to existing circumstances involves a degree of retrospectivity, which creates the risk of unfairness or hardship. The answer to the question whether Parliament intended new legislation to have retrospective effect is a matter of degree, and the greater the likely unfairness of retrospective application, the less likely it is to have been intended by Parliament. Section 43 of the Pension Act does alter existing rights and duties but not retroactively, such as would be the case if it sought to alter or recharacterise the terms of already concluded transactions. Rather, the section is intended to provide a solution to an ongoing problem, viz, the underfunding of a pension scheme, and this intention would be frustrated if the Regulator were precluded from considering events occurring prior to the legislation's having come into force. The effect of the issuance of an FSD is analogous to that of the imposition of a new tax affecting assets held by the taxpayer at the time that the tax is imposed. ■

**[Gabriel Moss QC]**

CASE DIGESTS

# Corporate Insolvency

## Re MF Global UK Ltd (In Special Administration) [2018]

**EWCA Civ 1327 (McFarlane LJ, Asplin LJ and Sir Colin Rimer), 11 June 2018**

*Company voluntary arrangements – interpretation*

MF Global UK Limited (MFGUK) went into administration on 31 October 2011. By January 2014, 99.9% of client assets had been distributed and, following a distribution out of the administration estate in August 2016, almost all creditors had received 90p/£ on their claims. On 12 December 2017, a CVA was approved by creditors. The purpose of the CVA was to give unsecured creditors the option to exit the administration in exchange for a certain final cash payment shortly upon implementation of the CVA. Under the CVA, unsecured creditors could elect to be an "Exiting Creditor", a "Stay-in Creditor" or a "Participating Creditor". Upon implementation of the CVA, the Participating Creditors would fund a cash payment to the Exiting Creditors in exchange for a pro rata beneficial interest in the claims of the Exiting Creditors. Stay-in Creditors would retain their claim against the estate until the office holders made the Final Stay-in Creditors' Distribution.

Paragraph 3.1 of the CVA proposal imposed five conditions precedent to the coming into effect of the CVA. Of these, the condition set out in paragraph 3.1(e) remained to be met. That condition provided that "if there are any Disputed Claims after the Challenge Period has ended, the Administrators have confirmed that this should not preclude the CVA from becoming effective". The terms "Dispute Claims" and "Challenge Period" were separately defined. After approval of the CVA, and three days before the end of the Challenge Period, Deutsche Bank (DB) filed a contingent claim (the DB Claim) for an indemnity in the amount of EUR 126m in respect of potential liabilities which might arise if the German tax authorities were to bring claims relating to trades in German equities carried on by MFGUK. The administrators rejected the claim. However, an appeal against that rejection (and the rejection of the two other Disputed Claims) remained pending.

The administrators applied for directions as to whether, and if so how, to proceed to implementation of the CVA in the light the DB Claim. At first instance ([2018] EWHC 1372 (Ch)) , Hildyard J held that the condition precedent in para 3.1(e) should be construed as referring to circumstances which would preclude the CVA from coming into effect at all, rather than a circumstance which affected the economic balance or commercial objectives of the CVA.

Allowing the appeal in respect of that decision the Court of Appeal held that the function of the relevant condition precedent was to enable the administrators to assess whether the state of the Disputed Claims in existence following the Challenge Period presented any reason why the CVA should not become effective. It was focussing on a consideration by the administrators as to whether a material increase in Disputed Claims after the Challenge Period could be regarded as changing the basis on which creditors had voted in favour of the CVA. This meant that the administrators had to exercise a value judgment as to whether, in light of changed circumstances in the state of Disputed Claims, it would be fair for the CVA to come into effect. The emergence of the DB Claim had substantially falsified the commercial assumptions as to MFGUK's liabilities. Accordingly, the Court of Appeal directed that, in light of the emergence of the DB Claim, the administrators should confirm that the CVA was precluded from becoming effective. ■

**[Mark Arnold QC, David Allison QC, Daniel Bayfield QC, Marcus Haywood, Adam Al-Attar]**

## Stanford v Akers

**BVI Court of Appeal, 12 July 2018**

*Liquidators – challenge to powers of compromise*

The BVI Court of Appeal addressed standing in the context of applications under section 273 of the Insolvency Act 2003, the jurisdictional gateway whereby an aggrieved person can ask the court to reverse or vary a liquidator's decision.

Prior to its entry into liquidation, Chesterfield had purchased a series of complicated financial instruments from Deutsche Bank. The purchase of these instruments was ultimately funded by Kaupthing.

Chesterfield and Kaupthing both brought claims against Deutsche arising from the sale of the financial instruments. Chesterfield brought claims in England. Kaupthing brought claims in England and Iceland.

In 2016, the Joint Liquidators caused Chesterfield to enter into global settlement package involving linked settlements between (a) Chesterfield and Deutsche Bank; and (b) Chesterfield and Kaupthing. In addition, Kaupthing and Deutsche also entered into a linked settlement.

After learning of the settlement, Mr Stanford (who was neither a creditor nor a member of Chesterfield, and was at most a shareholder of one of the shareholders of Chesterfield) applied pursuant to section 273 of the BVI Insolvency Act 2003 to reverse the decision by the Joint Liquidators to enter into one element of the global settlement package, namely the settlement of claims between Kaupthing Iceland and Chesterfield. Mr Stanford contended that the Joint Liquidators ought to have settled with Deutsche Bank directly, without admitting Kaupthing's claim. In this event, it was said that Chesterfield would have retained the full benefit of the payment from Deutsche Bank (and from which Mr Sanford would have benefited as an ultimate beneficiary of Chesterfield).

Wallbank J dismissed the application on all grounds, finding that Mr Stanford did not have standing to bring the application (since he was neither a creditor nor a member of Chesterfield) and that there was no proper factual basis to challenge the Joint Liquidators' exercise of discretion in entering into the settlement.

Stanford appealed and sought to obtain disclosure on the appeal and simultaneously adduce it as fresh evidence under *Ladd v Marshall* principles. The Court of Appeal dismissed the application for disclosure as (i) having failed in his application at trial to obtain documents sealed on the court file, Mr Stanford should not be permitted disclosure on appeal when he had not appealed that case management decision of the judge; (ii) certain categories of documents sought were irrelevant to the issues as they post-dated the contested decision; (iii) certain documents should not be subject to an order for disclosure as they were privileged; (iv) in any event, the application for disclosure was bound to fail as the documents' existence was known by Mr Stanford at the time of the trial, when he did not seek to utilise them, thus offending L*add v Marshall* principles.

The Court of Appeal also dismissed the appeal agreeing with the trial judge on both grounds (i) as a shareholder of a shareholder of Chesterfield, Mr Stanford was an outsider to the liquidation with no legitimate interest entitling him to standing under section 273; and (ii) there was no proper factual basis to challenge the Joint Liquidators' exercise of discretion in entering into the settlement. In this regard, the Court of Appeal found that the failure of Mr Stanford to appeal the Judge's findings of fact was fatal to his appeal. ■

**[David Allison QC]**

## LF2 Ltd v Supperstone [2018]

**EWHC 1776 (Ch) (Morgan J) 11 July 2018**

*Assignment of claim by insolvency officeholder*

At first instance, the Deputy Insolvency and Companies Court Judge had held that insolvency officeholders are under a positive duty not to assign a cause of action that is without merit, and that the applicant seeking assignment has the burden of proving that the claim has a prospect of success. On appeal, the High Court disagreed, holding that the party objecting to the assignment bears the burden of showing that the claim has no prospect of success. If it is clear to the officeholder that the claim is hopeless and the party seeking the assignment has an improper purpose such as to harass the potential defendant in the claim, the officeholder should decline to make the assignment. In cases where the officeholder does not have such clear view, he should be prepared to obtain proper payment in return for the assignment. It is undesirable for the Court to conduct a lengthy hearing as to whether the claim is frivolous or vexatious. ■

**[Hilary Stonefrost]**

## Re Zinc Hotels (Holdings) Limited [2018]

**EWHC 1936 (Ch) (Henry Carr J) 20 July 2018**

*Administration – appointment out of court by qualifying floating charge holder – whether power to appoint "interim administrator" – power to appoint additional administrator by way of interim relief – whether previous work for appointor a bar to appointment – grounds for challenge to administrators' choice of statutory objective*

Administrators had been appointed over members of a corporate group which owned several hotels leased to the Hilton group, and which undertook a sales and marketing process for the sale of the hotels. The ultimate shareholder in the group applied for the removal of the administrators and for relief under para. 74 of Schedule B1 to the Insolvency Act 1986, and for interim relief including the appointment of an "interim administrator". The shareholder contended that the administrators lacked independence due to their previous engagement by the secured creditors. The application was dismissed. (1) The Court has no power to appoint a "provisional administrator" pending the appointment of a final administrator, but where an administration has been commenced it does have power to appointment a further additional administrator including by way of interim relief. (2) However, where administrators were appointed by a floating charge-holder, then an additional administrator can only be appointed by the floating charge-holder or by the court on the application of the existing administrators. The shareholder therefore lacked any standing to make the application. In any case, additional administrators can only be appointed with the consent of the existing administrators, and no such consent had been provided. (3) The prior engagement of the administrators' firm by the secured creditors did not bar the administrators from taking the appointment, nor was it contrary to the Insolvency Practitioner Code of Ethics. (4) The engagement by the

CASE DIGESTS

# Corporate Insolvency

administrators of the same solicitors who acted for the secured creditors until such time as it appeared that there was a real prospect of a return to shareholders was not inappropriate. (5) There was no serious issue to be tried in relation to the allegation that the administrators had wrongly failed to pursue the first objective of administrator (rescue as a going concern). The decision of administrators as to which objective to pursue would only be capable of challenge on grounds of lack of good faith or irrationality. (6) There was no serious issue to be tried in relation to the allegations that the administrators had wrongly failed to assess and pursue certain alleged valuable claims belonging to the companies in administration. (7) There was no basis for an injunction restraining payment of the sales proceeds since there was no serious issue to be tried, and no cross-undertaking had been offered. ■

**[Tom Smith QC, Hannah Thornley]**


## Re Lehman Brothers International (Europe) (in administration) [2018]

**EWHC 1980 (Ch) (Hildyard J) 27 July 2018**

*Scheme of arrangement – majority creditor had adverse special interest – test for disregarding or discounting vote*

The Court sanctioned a scheme whose purpose was to compromise certain complex legal proceedings in order to facilitate distribution of the substantial surplus in the company's estate. A key issue was whether the special interest arising from the relationship between majority creditors ('Wentworth') and certain subordinated creditors was so adverse to the class interests in which Wentworth were placed that their votes ought to be disregarded or discounted as not being representative of the class. The Court held that for this to be justified, there must be a strong and direct causative link between the adverse special interest and the creditor's decision to support the scheme. The existence of this link may usefully, though perhaps not necessarily, tested by asking whether the creditor would have supported the scheme but for the existence of the adverse special interest. Two important and inter-linked considerations are whether other creditors not affected by the adverse special interest have reasonably approved the scheme, and whether there is more to unite than to divide the adversely interested creditors with others in its class, taking account of the situation in the absence of the scheme. Applying these tests, the Court held that Wentworth's vote need not be disregarded or discounted. ■

**[Robin Dicker QC, William Trower QC, David Allison QC, Daniel Bayfield QC, Richard Fisher, Adam Al-Attar, Henry Phillips, Ryan Perkins]**

## Re GW Group Holdings

**Grand Court of the Cayman Islands (The Hon Justice Raj Parker) 7 August 2018**

*Cayman Islands - soft-touch provisional liquidators*

The Grand Court considered competing applications for the appointment of provisional liquidators over the Cayman holding company of a group which provides one-stop precision engineering solutions. The company is listed on the Hong Kong Stock Exchange and the operations of the group are headquartered in Singapore.

The first application was filed by Bank of China ("BOC") under s104(2) Companies Law for the appointment of members of PwC as provisional liquidators on the grounds that there was a real risk of dissipation of assets and real questions as to the integrity of the management. It was supported by the majority of the creditors of the company.

The second application was filed by the company under s104(3) Companies Law for the appointment of members of Kalo in Cayman and RSM in Hong Kong on the grounds that the company intended to present a compromise or arrangement to its creditors. It was supported by a minority of the creditors of the company.

It was common ground that the company was unable to pay its debts within s93 Companies Law.

The Grand Court appointed provisional liquidators on the application of the company, finding that a company's directors may apply for "light touch" provisional liquidators without a shareholders' resolution; rejecting the contention of BOC that there had to be a formulated restructuring plan for the Court to appoint "light touch" provisional liquidators; and rejecting the contention of BOC that the company's chosen officeholders were not independent. The Grand Court dismissed BOC's application, finding that it had failed to discharge the heavy burden faced by a creditor of providing clear or strong evidence to prove that provisional liquidators were necessary to prevent the dissipation or misuse of assets and misstatement by the directors. ■

**[David Allison QC]**

## Officeserve Technologies Ltd v Annabel's Ltd [2018]

**EWHC 2168 (Ch) (HHJ Paul Matthews sitting as a High Court Judge) 15 August 2018**

*Post-petition dispositions – relevance of good faith and of absence of knowledge of petition – change of position defence – estoppel by representation*

Payments in excess of £1.7m were made by a company between the date of presentation of a petition to wind it up and the making of the order. Of these, nearly £206,000 were made to the respondents to an application under section 127 of the Insolvency Act 1986 by the joint liquidators. No validation application was made, and there was no proper engagement on the respondents' behalf with the litigation. The Court characterised the liquidators' claim as in principle one for restitution for unjust enrichment, albeit that, by virtue of arising under the statutory insolvency regime, it need not possess all the characteristics of a comparable claim under the general law. In particular, the defence of receipt of money in good faith and for valuable consideration is not available. The defence of change of position is available, but on the facts, was not applicable. The Court further held that estoppel by representation remains a distinct defence and one in principle available in response to section 127 claims. Payment of money does not, however, itself amount to a representation that the money is owed, and on the facts, there was no representation on the basis of which an estoppel might arise. ■

## In re Videology Limited [2018]

**EWHC 2186 (Ch) (Snowden J) 16 August 2018**

*Cross-border Insolvency Regulations 2006 – US Bankruptcy Code Chapter 11 proceedings – whether debtor's COMI located in US – whether extended moratorium available in aid of non-main proceedings*

The company was the English subsidiary of a US parent, was licensed by the parent to use intellectual property critical to its business, and was the vehicle by which the corporate group of which it was part undertook business in the UK, Europe, the Middle East and Africa. The company together with the parent and others in the group voluntarily entered Chapter 11 proceedings to obtain protection against creditor claims while the group's financing was restructured and a coordinated sale of its business undertaken. At that time, the company had significant trade and tax liabilities in the UK and secured liabilities to lenders acting through a US-based agent. Entities in the group, including the company, had also obtained debtor-in-possession finance in the US. The parent applied for and was granted recognition in England of its Chapter 11 proceedings as foreign main proceedings, together with the equivalent of the moratorium applicable in English administration proceedings but including a restriction on the making of an administration order. In relation to the company, the Court had recognised the Chapter 11 proceedings as foreign proceedings and, in view of several proceedings then underway in England against the company, ordered a moratorium by way of interim relief of essentially the same form as for the parent. The Court held, however, that the presumption that the location of the company's registered office coincided with its centre of main interests ('COMI'). It found that the reference in the Recast European Insolvency Regulation to "conducts the administration of its interests" was broader than just to the place of strategic decision-making by the board or senior management, which in any case was not as easily ascertainable by third parties as factors such as employment of staff, the placing of orders, the sending of invoices, the making and collection of payments, and the operation of the corporate bank account. The UK remained the location of the company's trading premises and staff, was the place where its customer and creditor relationship were established, where its day-to-day dealings with trade creditors occurred, and where its receivables and cash at bank (its main assets) were based. These factors were also readily ascertainable by customers and particularly trade creditors, and there had been no general communication to the contrary with the creditors. These factors outweighed the pro forma and somewhat confused evidence from the company's US-based secured creditors. The Court therefore characterised the US proceedings as non-main on the basis that it had an establishment at the corporate group headquarter. It did, however, continue the extended moratorium on the basis that to do so was in the interests of the company's creditors as a whole, including those based in the UK. ■

**[Robert Amey]**

CASE DIGESTS

# Corporate Insolvency

## Re Ardon Maroon Asia Master Fund, unreported

**Grand Court of the Cayman Islands (McMillan J) 27 August 2018**

*Feeder fund – whether redemption of shares effective without notice*

The Ardon investment funds operated under a master-feeder fund structure, under which investors invested in a feeder fund which in turn invested in a master fund. Prior to the master fund and the feeder fund going into liquidation, an investor had redeemed its shares in the feeder fund. The liquidators of the master fund however contended that the feeder fund had not in turn effectively redeemed its shares in the master fund, as the feeder fund had not served a separate redemption notice on the master fund. The feeder fund's proof of debt claiming the allegedly unpaid redemption proceeds was therefore rejected. On appeal, the feeder fund argued that it was not necessary for the feeder fund to have served a second redemption notice on the master fund, in addition to the redemption notice served by the investor on the feeder fund. The appeal was however rejected. On their proper construction, the articles of association of the master fund did not empower the directors of the master fund to issue shares on terms that they could be redeemed without service of a written redemption notice. Further, on the facts, there had been no relevant determination by the directors of the master fund issuing the shares on this basis. Accordingly, it had been necessary for the feeder fund to serve a second redemption notice on the master fund and since no such notice had been served there had been no valid redemption. ■

**[Tom Smith QC]**

## Re Herald Fund SPC, unreported,

**Grand Court of the Cayman Islands (Kawaley J) 27 August 2018**

*'Feeder fund' – provable subordinated claims – whether statutory interest payable*

Herald Fund was a Cayman incorporated investment fund, which had acted as a "feeder fund" to the Madoff investment business, and which had gone into liquidation following the uncovering of the Madoff fraud. Certain investors in Herald had redeemed their shares in the fund prior to the suspension of redemptions and the placing of Herald into liquidation. The Privy Council had previously held, upholding the courts below, that such investors (*'the Redemption Creditors'*) had provable claims to the unpaid redemption proceeds. These claims were subordinated to the claims of third-party creditors by section 49(g) of the Companies Law (the equivalent of section 74(2)(f) of the Insolvency Act 1986), but ranked ahead of the rights of shareholders to distribution of surplus assets. Following payment of the principal amounts owing to the Redemption Creditors, the question then arose as to whether or not statutory interest was payable on such subordinated claims. The Grand Court held that statutory interest was payable on the claims. The claims of the Redemption Creditors were "debts proved" in the winding up and therefore prima face entitled to statutory interest. The scheme of the companies legislation envisaged and provided for proofs to be lodged at different times. Further, although the statutory provision governing statutory interest provided that "all interest under this section ranks equally", that did not exclude the application of statutory interest to debts which were deferred or postponed by other statutory provisions (such as section 49(g)) or by contract. ■

**[Tom Smith QC]**

CASE DIGESTS

# Personal Insolvency

Digested by Matthew Abraham and Lottie Pyper

## Deutsche Apotheker- und Arztebank EG v Leitzbach [2018]

**EWHC 1544 (Ch) (HHJ Hodge QC) 30 May 2018**

*Annulment - centre of main interests - discretion under section 282 of the Insolvency Act 1986*

The Court was faced with a creditor's application to annul a bankruptcy order made on the debtor's petition presented by the debtor at a time when he claimed to have been residing in England. The Court, in determining whether to annul the bankruptcy order, considered the issue of whether it had a discretion to annul in circumstances where it has found, as a matter of fact, that the debtor did not have its COMI in England and Wales.

The Court followed the decision of Nugee *J in Raiffeisenlandesbank Oberosterreich AG v Meyden* [2016] EWHC 414 (Ch) and held that if a bankruptcy order is made without jurisdiction, then it should be set aside, without consideration of discretionary matters. In response to a challenge that this approach would give rise to unjust results in circumstances where there is no limitation period for an application for an annulment the Court held that a person who was a creditor at the time the bankruptcy order was made, but whose debt has since become statute-barred, would not have the necessary standing to apply for an annulment of the bankruptcy order, and that that was a sufficient answer to the concern that a bankruptcy order could be annulled very many years after it had been made. Therefore the judge granted the application. ■

## Barker v Baxendale-Walker [2018]

**EWHC 1681 (Ch) (ICC Judge Briggs) 10 July 2018**

*Bankruptcy Petitions - pending appeals - r. 10.24 of the Insolvency Rules 2016*

The debtor was a solicitor who had provided tax advice to the petitioner concerning an employee benefit trust. The petitioner asserted that he had suffered substantial financial losses as a result of the debtor's negligent advice. At first instance his negligence claim was rejected, but the Court of Appeal overturned that decision, finding that the debtor was negligent and entering judgment against him for over £16 million. The Court of Appeal refused permission to appeal and the debtor applied to the Supreme Court for permission. That application was still outstanding at the time of the instant hearing. Further, the Court of Appeal had not granted a stay of execution. HMRC was also a creditor to the sum of £565,000 and supported the petition.

The debtor opposed the petition on the grounds that he had a genuine and substantial cross-claim that equalled the judgment debt, and the judgment debt was subject to an outstanding application for permission to appeal. The petitioner asserted that the cross-claim was an abuse of process, and an application for permission to appeal was not the same as a "pending appeal" under r. 10.24(2) of the Insolvency Rules 2016.

Having reviewed the relevant case law, the Chief Registrar held that the language of rule 10.24(2) was focussed on providing the court with a discretion to stay if an appeal is pending; an ordinary reading of the language favours the meaning "to await"; awaiting an appeal not awaiting permission to appeal; the language used in rule 10.24(2) refers to the existence of an appeal; and an application for permission is not an appeal and as such no appeal is waiting to be heard. The Chief Registrar noted that in respect of sub rule (2), the Insolvency Rules Committee had had many opportunities to alter, vary or add to the words of sub rule (2) since 1986 and have not done so. As a result, he inferred from this that the word "pending" reflects public policy and is deliberately limited to its meaning. The petition was therefore granted. ■

CASE DIGESTS

# Personal Insolvency

## Re Maud [2018]

**EWHC 1414 (Ch) (Snowden) 11 June 2018**

*Abuse of process – adjournment – bankruptcy petitions – foreign proceedings – joint creditors*

The petitioning creditors, Aabar Block S.a.r.l. ("Aabar") and Edgeworth Capital (Luxembourg) S.a.r.l. ("Edgeworth") were joint creditors in respect of a personal loan originally made to the Debtor by RBS. The debtor was a shareholder of the parent company of a group of Spanish and Dutch companies known as the Marme Group. The personal loan was one of a number of loans made by RBS for the purpose of enabling the Marme Group to purchase a valuable Spanish real estate asset (the "Santander Asset"). In November 2010 the petitioning creditors had purchased the RBS Loans with a view to acquiring the Santander Asset. In February 2014 the companies in the Marme Group entered insolvency proceedings in Spain (the 'Spanish Insolvency Proceedings').

The petitioning creditors presented a bankruptcy petition against the Debtor in June 2015 ("the Petition").

The Petition was repeatedly adjourned and then stayed until the instant hearing before Snowden J in November 2016. By this time Aabar no longer supported the making of a bankruptcy order and instead sought an adjournment so that the debtor could maintain his involvement in the Spanish Insolvency Proceedings as a shareholder. Two other creditors also appeared to oppose the making of a bankruptcy order. Edgeworth maintained that a bankruptcy order should be made.

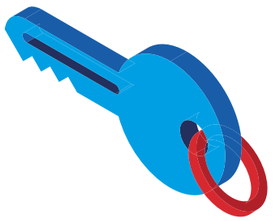
The debtor submitted that the Petition was an abuse of process since the petitioning creditors' real aim was to acquire the Santander Asset. Snowden J rejected this submission, holding that a petition was not an abuse of process if the purposes of the Petitioning Creditors included recovering money owed to them.

The Court then considered whether it was possible to make a bankruptcy order on the basis of a petition where one of the co-petitioners was now seeking an adjournment. Since there was no relevant authority on this point in the bankruptcy context, Snowden J approached the matter from first principles. Where two creditors jointly own a debt, they are joint trustees in respect of that interest. Joint trustees are required to exercise their powers unanimously. Obtaining a bankruptcy order is part of the bundle of class rights attaching to a debt and could no more be separately asserted than the debt could be pursued in an action of one joint creditor. Accordingly the Court could not simply accept Edgeworth's submissions unless Aabar's stance was irrational or a breach of its duty as a joint trustee. Snowden J was not satisfied that this was the case. As a result there was in fact no creditor before the Court entitled to ask for immediate bankruptcy.

The Petition was adjourned. It was exceptional for a bankruptcy petition to have been pending for so long, but this was a wholly exceptional case. ■

**[Antony Zacaroli QC (as he then was); David Allison QC; Ryan Perkins]**





# Property and Trusts

Digested by Andrew Shaw

## Baker v Craggs [2018]

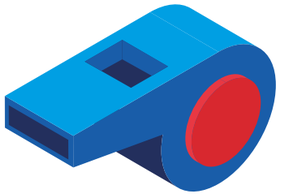
**EWCA Civ 1126; [2018] 3 WLR 401 (Patten LJ, Henderson LJ and Flaux LJ) 16 May 2018**

*Overriding interest – easement*

The owners of a farm sold fields, barns and a yard to Mr Craggs and also granted him a right of way over a drive leading to the yard. However, the transfer which was subsequently executed did not reserve any right of way over the drive to the owners. Mr Craggs' application for registration as proprietor was subject to delay and he was not registered as such until 16 May 2012. In the intervening period, the owners sold a farmhouse and a barn to Mr and Mrs Baker and purported to grant the Bakers a right of way over the drive leading to the yard sold to Mr Craggs and over the yard itself. The Bakers were registered as proprietors of this property on 14 March 2012.

The Bakers subsequently brought proceedings to determine whether the grant to them of a right of way over the drive and the yard were effective. At first instance, Newey J held that the grant of an easement to the Bakers before Mr Craggs's title to his land had been registered was a "conveyance to a purchaser of a legal estate of land" within the meaning of s.2(1) of the Law of Property Act 1925 ("LPA 1925"); Mr Craggs had not had the benefit of an "estate contract" within the meaning of s.2(3)(iv) of LPA 1925 when the easement was granted to the Bakers and, consequently, the exemption to overreaching at s.2(3) of LPA 1925 did not apply and the grant of the easement to the Bakers was effective, Mr Craggs' interest in the land having been overreached.

Henderson LJ, with whom Patten and Flaux LJJ agreed, rejected Newey J's reasoning. He held that the grant of an easement was not "a legal estate in land" because it was not within the definition at s. 1(1) of LPA 1925. Accordingly, the doctrine of overreaching had no application. The correct analysis was to treat the issue as a question of priority to be answered in accordance with the Land Registration Act 2002 ("LRA 2002"). The bare trust that arose on the completion of the sale of property to Mr Craggs was protected by his actual occupation of that property and was therefore an overriding interest under s.29 of, and paragraph 2 of Schedule 3 to LRA 2002. This overriding interest could not be defeated by the subsequent purported grant of an easement by the owners to the Bakers. ■



CASE DIGESTS

# Sport

Digested by Robert Amey

## Mercato Sports (UK) Ltd v Everton Football Club Co Ltd [2018]

**EWHC 1567 (Ch) (HHJ Eyre QC) 12 July 2018**

*Football agent allegedly introducing player to football club – agent commencing litigation to recover its fee from club – whether FA Rule K applicable*

In 2017, a professional footballer ("AB") entered into a contract with Everton FC. The claimant agents claimed a fee from Everton FC for introducing AB to them, and when Everton FC refused to pay, the claimants commenced litigation in the High Court.

Everton FC sought a stay of the proceedings pursuant to Section 9 of the Arbitration Act 1996, arguing that Rule K of the Rules of the Football Association Ltd 2017 – 2018 operated as an arbitration agreement between the parties. Mercato Sports (UK) Ltd denied that it was bound by Rule K.

There was no suggestion that Mercato Sports (UK) Ltd and Everton FC had ever entered into a contract with each other directly that would apply the FA Rules (and in particular Rule K). Rather, it was argued that, since both parties had contracted with the FA to comply with the FA Rules, there was an implied contractual relationship between them (following *Clarke v Dunraven (The Satanita)* [1897] AC 59). Mercato Sports (UK) Ltd denied that it had such a contract with the FA, and argued that in any event, there was no basis for implying a contract between it and Everton FC.

The court held that Mercato Sports (UK) Ltd had a 'vertical' contract with the FA by virtue of having acceded to the FA Rules, as did Everton FC, and that in the circumstances, it was right to imply a 'horizontal' contract between Mercato Sports (UK) Ltd and Everton FC. The invoice rendered by Mercato Sports (UK) Ltd and Everton FC bore the former's registration number as an FA-registered intermediary: a strong indication that the relationship was intended to be governed by the FA Rules. Accordingly, the substantive dispute was subject to the FA Rules, and must be determined in a Rule K arbitration. ■

# The Corporate Insolvency Framework Review: A New UK Rescue Culture?

MARK PHILLIPS QC LOTTIE PYPER

## Introduction

In 1982 the Cork Report drew attention to the recently enacted Chapter 11 of the US Bankruptcy Code 1978 as a paradigm example of a flexible rescue procedure. As is now well known, Chapter 11 proceedings can be initiated without the involvement of the Court and enable the debtor to remain in possession of the Company. The company can have the benefit of debtor-in-possession financing and in a Chapter 11 plan it is possible to cram-down dissenting classes of creditor. Almost forty years on from the introduction of Chapter 11 in the US, the UK government has announced plans to reform the UK's insolvency and restructuring framework. It appears that the Government's intention is to create a more debtor-friendly environment. It is not possible to examine every proposal in one article, but we examine the potential the Government's proposals have to effect a shift in the dynamic of the UK rescue culture. On one view, the latest plans mark the end of a journey to a rescue culture that started with the Cork Report and took the UK through the Acts of 1986 and 2002. On another view, we have gone back to the future of 1986.

The proposals are set out in Section 5 of 'Insolvency and Corporate Governance, Government Response' published on 26 August 2018.[1] They arise from a consultation titled *"A Review of the Corporate Insolvency Framework (2016)."* The proposed reforms are to be introduced as soon as Parliamentary time allows, and include the following:

1. A moratorium to enable distressed but viable companies to consider their options (which for convenience we will call the 'restructuring moratorium').
2. A new restructuring plan that, amongst other things, will enable cross-class cram downs;
3. Legislation preventing suppliers from relying on 'ipso facto' clauses when a company enters formal insolvency proceedings.

We anticipate that these reforms, in particular the restructuring moratorium and the new restructuring plan, will ultimately mark a turning point for the UK rescue culture. However, the teething problems that followed the introduction of the CVA and administration procedures in the Insolvency Act 1986 should not be forgotten. It is important that Parliament is alive not just to the present statutory possibilities in the UK insolvency and restructuring framework, but also to the history, particularly of what were purposes (b) and (c) of the administration procedure between 1986 and 2002.

## The restructuring moratorium

The purpose of introducing a restructuring moratorium is to give financially distressed but viable companies time to consider their options, including restructuring existing debt or seeking new investment. This represents a significant shift in power in a restructuring. The company is able to discuss and negotiate the terms without the fear that one creditor could hold out for a better deal under the threat that if that creditor does not get what it wants it will enforce its debt and bring the whole deal crashing down. It should enable companies to achieve structures that give the company a better chance of surviving.

The automatic moratorium has always been an integral aspect of the administration procedure. A stay, albeit not a moratorium, has been used to support schemes of arrangement. In *Bluecrest Mercantile NV v Vietnam Shipbuilding Industry Group*[2] the Court exercised its discretion to stay proceedings of dissenting creditors, thereby effectively imposing a moratorium in circumstances where a scheme of arrangement had a *"reasonable prospect of going ahead"*.[3] However, the moratoriums currently available in the UK have different, but significant limitations: the moratorium in Schedule A1 is limited to small and medium sized companies, the administration moratorium can only be obtained by the directors relinquishing control to an insolvency practitioner, and the Bluecrest moratorium can only be obtained following an application to the court if there are relatively advanced proposals for a scheme of arrangement and will only apply to specific creditors.

The restructuring moratorium will allow companies of all sizes to obtain a moratorium quickly and cheaply. The directors do not need to relinquish control to an insolvency practitioner and no court application will be necessary. The Report also emphasises that the restructuring moratorium is intended to be a stand-alone tool and not a necessary pre-requisite seeking creditors' consent to a restructuring plan. This might be a mistake. If a moratorium was a required step it would not be open to companies to take ever more elaborate and expensive steps to avoid going into a moratorium in order to keep creditors on side, and there is a risk we will end up back where we are now. It would also avoid the protection to all creditors that will result from the restructuring moratorium supervisor (known as the 'Monitor'), which is discussed in more detail below. The restructuring moratorium will be modelled on the administration moratorium.[4] Certain companies will be excluded from being able to benefit from the restructuring moratorium.[5] As a result of the

1. https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/736163/ICG_-_Government_response_doc_-_24_Aug_clean_version__with_Minister_s_photo_and_signature__AC.pdf. Unless otherwise indicated, references in this article are to this document. The paper states that in some areas the Government will legislate for reform; in others further consultation will be needed, particularly where the consultation paper put forward open questions rather than specific proposals. Section 5 contains specific proposals.

2. [2013] EWHC 1146 (Comm).

3. At [39].

4. See paragraphs 42 and 43 of Schedule B1 to the Insolvency Act 1986, and page 43, [5.9].

5. Page 48, [5.35].

6. See paragraph 15 of

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restructuring moratorium the moratorium in Schedule A1 Insolvency Act 1986 will be repealed. There will also be no need to have a separate moratorium available only to small and medium sized companies.

### Entering into the restructuring moratorium

The restructuring moratorium will be triggered by filing the necessary papers at court. This will be similar to the procedure for an out-of-court appointment of an administrator.[6] This should be a cheap and efficient process. The Monitor will be required to[7] file their consent to act and confirm that they are satisfied that the eligibility tests and qualifying conditions are met' send notice to all known creditors of the company and register the company's entry into the moratorium at Companies House. This gives protection to all creditors against abuse of the process. There are two significant advantages to the company. First, monitoring is carried out by the Monitor and not, at least in the first instance, by the court. Second, the Monitor does not take over the management of the company. In the context of a restructuring, there is no need to take the management of the company away from the directors, one of the reasons why the moratorium through administration that was in place between 1986 and 2002 was underused.

A restructuring moratorium will be challengeable by applying to the Court.[8] Grounds of challenge will include the qualifying conditions not being met and the restructuring moratorium causing unfair prejudice to creditors. The same principles as those established in the case law regarding applications to have administration moratoriums lifted will be applicable.[9] This is a sensible protection. The first ground will only apply in the rare cases where a moratorium has been sought when it should not have been. The second is more nuanced. It has long been established that unfair prejudice does not mean that a creditor's rights have been infringed.[10] Infringement of rights will occur in every case as soon as a creditor is not entitled to enforce those rights as by his contract it had been agreed he could. Unfair prejudice (which harks back to section 27 of the Insolvency Act 1986) is a holistic question: there must be prejudice and it must be unfair, in other words something affecting that creditor in a particular and unfair way.

### Eligibility criteria and qualifying conditions

In order to be eligible for the restructuring moratorium, the company must not have entered into another restructuring moratorium, a CVA or administration within the previous 12 months, or be the subject of a winding-up order or petition.[11] If a winding-up petition is pending, a company will be precluded from triggering a restructuring moratorium by filing papers at court. However, it may be able to obtain a restructuring moratorium if the court grants permission.[12] This is very similar to the position in an administration. Since the 1980s this has led to some creditors presenting protective petitions (and in earlier times to take qualifying floating charges) in order to give themselves a platform to be heard on the application for a moratorium. The difficulty with such a strategy is that the conditions will almost always be fulfilled, and unfair prejudice to the particular creditor is difficult to show. Consequently, while the petitioning creditor will be heard, there might not be much that he can say.

The company must be in a state of *"prospective insolvency"* such that it will become insolvent if action is not taken. If a company is already insolvent it is not eligible for the restructuring moratorium.[13] It is not clear from the Report what the test for *"prospective insolvency"* will be in the new legislation, and in particular whether or not it will mirror the requirement that *"the company is or is likely to become unable to pay its debts"* in order for the Court to make an administration order.[14] However, there is no need for a different test, and it is difficult to conceive of a test that would better fit the concept of *"prospective insolvency"* than the current test.

The Monitor must be satisfied, on a balance of probabilities, that if the restructuring moratorium is triggered, the prospect of rescue is more likely than not.[15] At first blush this appears to be different to that required by paragraph 11(b) of Schedule B1 Insolvency Act 1986, which is that an administration order must be *"reasonably likely to achieve the purpose of administration"*. However, that test resulted from extensive caselaw that considered the test *"is likely to achieve"* which is similar to the language used in the consultation.[16] The Courts have interpreted the current provision to mean that there must be a *"real prospect"* of achieving the purpose of administration, rather than it being likely: Hammonds (A Firm) v Pro-Fit USA Ltd.[17] The Monitor must also be satisfied that company has sufficient funds to carry on its business and meet its obligations as they fall due during the duration of the moratorium. In practice this is likely to be an important question, which we consider below.

Sanctions will be introduced to deter abuse of the restructuring moratorium by directors.[19] The Government has stated that it is considering

whether similar sanctions to those in the existing moratorium available to small and medium sized businesses for the purpose of entering into CVAs will be required for the restructuring moratorium.[20]

### Length of the Restructuring Moratorium

The initial period of a restructuring moratorium will be 28 days.[21] This can be extended by up to 28 days by the company.[22] Further extensions can be obtained by approval of more than 50% of secured creditors by value and more than 50% of unsecured creditors by value. Alternatively, the company will be able to make an application to the court for an extension of time.[23] The initial period and the extensions might be too short. The danger is that the risk of a moratorium running out, or having to explain to the court why there should be a longer period[24], is likely to incentivise companies to pre-package their deals. Once companies start to pre-package a deal they are unlikely to need a moratorium and again, we will end up where we are now.

### The role of and qualification requirements for Monitors

Monitors will be required to be insolvency practitioners. The legislation will, however, have a mechanism allowing the government to permit other classes of professional to act as supervisors in future years, subject to developing regulatory frameworks.[25] We question whether expanding those who can be Monitors beyond insolvency practitioners is sensible. Licensing was introduced in 1986 to deal with abuses that had been endemic for some time, and it has proved relatively successful. Widening the group who might be Monitors is unnecessary and increases the risk that the current controls will not catch new less regulated groups. The role of the Monitor will be to assess the company's eligibility for entry into the restructuring moratorium and whether it continues to meet the necessary criteria for the duration of the moratorium period. The Monitor will also be required to sanction any asset disposals outside the normal course of business and the granting of any new security over company assets.[26] These protections are sensible and support the arguments in favour of the role being limited to licensed insolvency practitioners.

Monitors who have acted for a company in a restructuring moratorium will be prohibited from being appointed as an insolvency officer of that company if the company enters administration or liquidation within 12 months of that restructuring moratorium. This prohibition will not apply if the company decides to enter into a CVA.[27]

Schedule B1, and page 45, [5.19].

7. Page 45, [5.19].

8. Page 45, [5.20], page 49, [5.38].

9. Page 49, [5.40].

10. See *Re Charnley Davies Ltd* [1990] BCC 605 per Millett J at 625.

11. Page 46, [5.22].

12. Page 46, [5.23].

13. Page 47, [5.29].

14. Paragraph 11(a), Schedule B1 Insolvency Act 1986.

15. Page 48, [5.31].

16. *Re Harris Simons Construction Ltd* [1989] 1 WLR 368; *Re Primlaks (UK) Ltd* [1989] BCLC 734; *Re SCL Builders Ltd* [1990] BCLC 98; *Re Rowbotham Baxter Ltd* [1990] BCLC 397; *Re Chelmsford City Football Club* (1980) Ltd [1991] BCC 133.

17. *[2008] 2 BCLC 159 at [20].*

18. Page 48, [5.33].

19. Page 50, [5.44].

20. See for example paragraphs 16(3), 17(3), 18(3), 19(3), 20(9), 22(2) and 23(1) of Schedule A1 of the Insolvency Act 1986.

21. Page 51, [5.49].

22. Page 52, [5.52].

23. Page 52, [5.55].

24. A court hearing gives dissenting creditors an opportunity to set out what they see as the difficulties with the proposed restructuring. It gives them a point of leverage.

25. Page 54, [5.63].

26. Page 54, [5.65].

27. Page 56, [5.76]. This addresses one of the concerns that has arisen in the context of pre-packs.

28. Page 57, [5.79].

**FEATURE ARTICLE: THE CORPORATE INSOLVENCY FRAMEWORK REVIEW**

> The introduction of cram down into schemes of arrangement is a significant development

### Costs of the Restructuring Moratorium

Costs incurred during the restructuring moratorium will be treated in the same way as expenses in an administration. The Report states that[28]:

*"Where a company exits a moratorium and subsequently enters administration or liquidation, any unpaid moratorium costs will enjoy super-priority over any costs or claims in the administration or liquidation, including the expenses of such procedures. Highest priority would be afforded to any suppliers prevented from relying on contractual termination clauses... Any other costs would rank next, followed lastly by any unpaid fees due to the monitor."*

The present rules regarding expenses of an administration are set out in Schedule B1 to the Insolvency Act 1986 and the Insolvency Rules 2016. In particular, paragraph 99(4) of Schedule B1 provides that any debts or liabilities incurred in respect of contracts entered into during administration will be afforded super priority in the payment waterfall. Transposing these provisions into the restructuring moratorium has the effect of enabling UK companies to access financing whilst the company directors remain in office. This is comparable to what is known in the US as 'debtor-in-possession financing' or 'DIP financing.' Companies will be able to enter into the process knowing that they can borrow and that the costs of the process will be paid. The fact that it breaks covenants in other financing agreements does not matter at this stage, because entering the moratorium will itself probably have the same effect. It will however be interesting to see how insolvency practitioners approach the restructuring moratorium, since whilst their expenses will be given the priority given to other expenses, they will not be afforded the super-priority status that they would ordinarily enjoy in an administration. That reflects their different role. They will be monitoring the process, not managing the company.

### The new restructuring plan

The restructuring plan will be based upon the current UK Scheme of Arrangement[29], but will enable companies to implement the cross-class cram down of a company's restructuring proposals onto secured and unsecured creditors. There will be no financial entry limitations for the cram down to apply; both solvent and insolvent companies will be able to propose restructuring plans.[30]

### Similarities to schemes of arrangement

One aspect of Chapter 11 that is not present in schemes of arrangement is the ability to cram down dissenting creditors in some circumstances. In schemes of arrangement, it is only a majority of creditors in the same class who are able to 'cram down' in the loose sense of that term, the dissenting minority in the same class. The most significant introduction in the consultation is the introduction of cram down in other circumstances. As the new procedure will be modelled on schemes of arrangement, there will be many shared features. The proposals for a cram down will be sent to creditors and shareholders and filed at court. Creditors will be divided into classes on the same principles as in a scheme of arrangement.[31] The court will consider class composition at the equivalent of a convening hearing, after which the creditors and shareholders will vote on the proposal. Subject to voting thresholds and other requirements being met, the procedure will be confirmed by the court at a second hearing equivalent to a sanction hearing.[32] The test for class composition will be the same as at present, namely whether or not it would be impossible for creditors to consult together with regard to their common interest. This involves considering the creditors' rights prior to the scheme, their rights in the relevant comparator to the scheme, and their rights as a result of the scheme. In testing the fairness of the plan for dissenting creditors, the valuation basis will be the 'next best alternative' to the restructuring plan.[33] This appears to be similar to the need to compare creditors' rights under a scheme of arrangement to their rights under the appropriate comparator, which will vary depending on the individual circumstances of the company. There will be no prescribed requirement for the restructuring plan to be overseen by a scheme 'supervisor', although in some cases appointing a supervisor may be appropriate.[34] If a supervisor is appointed, they will not be subject to any specific qualification requirements.

### Unique features of the cram down procedure

The voting thresholds will be 75% in value of the creditors in each class. Unlike for schemes of arrangement, there will be no separate requirement that 50% in number of the creditors in each class approve the proposals.[35] There are also proposals for cross-class cram down. The cross-class cram down proposal is that at least one class of impaired creditors must vote in favour of the scheme in order for a cross-class cram down to be confirmed.[36] If a dissenting class of creditors is to be bound by the scheme, no creditors with more junior interests can receive any distribution or retain any benefit under the restructuring plan until the dissenting class has been paid in full. The Report states that:[37]

*"Where a cross-class cram down is to be applied, a requirement is needed to safeguard creditor interests that respects and applies the ordinary order of priority in liquidation and administration. The restructuring plan legislation will provide that a dissenting class of creditors must be satisfied in full before a more junior class may receive any distribution or keep any interest under the restructuring plan."*


The starting point is that for cross-class cram down a junior class of creditors cannot receive any distribution until the dissenting class of creditors has been satisfied in full. To that extent creditors being crammed down retain an element of control in that, whilst they can be forced to be bound by the scheme, they cannot be forced to take a 'hair cut' for the benefit of creditors junior to them. However, the Government says that it also wants the court to be able to confirm a restructuring plan even if it does not comply with the rule that more junior creditors cannot receive a benefit unless more senior creditors are satisfied in full. The court will be able to confirm a restructuring if it is satisfied that it is necessary to achieve the aims of the restructuring; and it is just and equitable in the circumstances to sanction the cram down. This is intended to be a high threshold.[38] For the first time, the court will be able to sanction a scheme (or in this case confirm a restructuring) if, amongst other things, it is necessary to achieve the aims of the restructuring and it is just and equitable to do so. This represents a significant alteration in the balance of power between companies and the holders of 'fulcrum' debt. A creditor will not be able to hold out for a better deal safe in the knowledge that if he does not agree there can be no scheme. We expect there to be quite significant litigation about the circumstances in which a scheme that includes a cram down can be approved, particularly if there is a benefit to more junior creditors. It is likely to become an area of significant court development.[39] The Report gives some guidance by drawing comparisons between a cram down and the US 'Absolute Priority Rule'.[40] This is doubtless because the cram down procedure was designed with Chapter 11 in mind. When a company that has filed for Chapter 11 protection wishes to exit those proceedings, it must obtain confirmation of its exit plan with the court. The US court may only confirm the plan if, among other things, it conforms to the Absolute Priority Rule.[41]

The introduction of cram down into schemes of arrangement is a significant development. Whilst companies will want to achieve agreement across all classes where possible, where it is not possible, cram down can cut through it. It will, in some circumstances, be possible to cram down a more senior class and leave some benefit to a more junior class. The availability of cram down will make it easier to achieve agreement because the creditor can no longer simply hold out for the deal he wants in all circumstances. The dissenting creditor will know that if the company is able to show that it is necessary to achieve the restructuring and just and equitable, he can be

29. Part 26 of the Companies Act 2006.
30. Page 66, [5.130].
31. Page 69, [5.150].
32. Page 66-7, [5.135-8], page 69, [5.149].
33. Page 74, [5.174].
34. Page 67, 5.139].
35. Page 70. [5.153].
36. Page 73, [5.167].
37. Page 72, [5.163].
38. Page 72, [5.164].
39. Given that this is a new concept in the UK, we anticipate that the English courts will have regard, at least in the early days, to how the issue is dealt with in jurisdictions that have a developed system of cram down, such as the US.
40. Page 72, [5.164].
41. Section 1129(b) of the U.S. Bankruptcy Code. The Absolute Priority Rule requires that more senior stakeholders are satisfied in full before any junior stakeholder can receive or retain an interest in the Company.
42. Page 60, [5.97].

**FEATURE ARTICLE: THE CORPORATE INSOLVENCY FRAMEWORK REVIEW**

> There is scope for these proposals to overhaul the UK rescue culture


bound by a restructuring agreement he does not agree to. Whilst the dissenting creditor will not welcome this loss of control, this may prove less time consuming and less expensive than the sorts of negotiations companies presently have to go through to deal with recalcitrant creditors, even for the dissenting creditor.

### Ipso facto clauses

Suppliers under contracts for the supply of goods and services will be precluded from relying on so-called 'ipso facto' clauses. These clauses typically enable a creditor to terminate the contract when the company enters formal insolvency proceedings.[42] Suppliers will still be able to terminate the contract on any other contractual ground.[43] There will also be a carve-out enabling a supplier to apply to the court for permission to terminate the contract on the grounds of 'undue financial hardship.' In this case it will be for the court to decide whether, if the supplier were compelled to continue to fulfil the contract, it would be more likely than not to enter an insolvency procedure as a consequence. The court will also consider if it would be reasonable in all the circumstances to exempt the supplier from its obligation to fulfil the contract, having regard to the effect of non-supply on the debtor company and its prospects of rescue.[44] There are numerous decisions in jurisdictions that already prohibit ipso facto clauses that demonstrate the utility of precluding their operation, particularly in a rescue context.[45] If a supplier is required to continue supplying the company, the quid pro quo is that the suppliers prevented from relying on ipso facto clauses will be afforded first priority in administration or liquidation. This may incentivise the inclusion of ipso facto clauses in supply contracts, because the supplier will either be entitled to terminate or will receive priority payment for his supplies. For the company it is paying for continued supply.

### Conclusion

The Report evinces an intention to enact proposals designed to create flexibility for distressed companies. The moratorium for companies seeking to put in place a restructuring agreement goes back to what was intended in 1986. The absence of the requirement that the directors hand over control, balanced with the role of the Monitor is a positive one. The time for the moratorium is too short and should be lengthened to avoid companies continuing to rely on pre-packs. The introduction of the cram down is long overdue. In the context of Brexit, it is noteworthy that the reforms are in line with the terms of the draft EU directive on Insolvency and Restructuring published in 2016[46], which contains proposals for a restructuring moratorium and cross-class cram downs. The EU Directive is anticipated to be enacted in May 2019, and the UK needs to remain competitive.

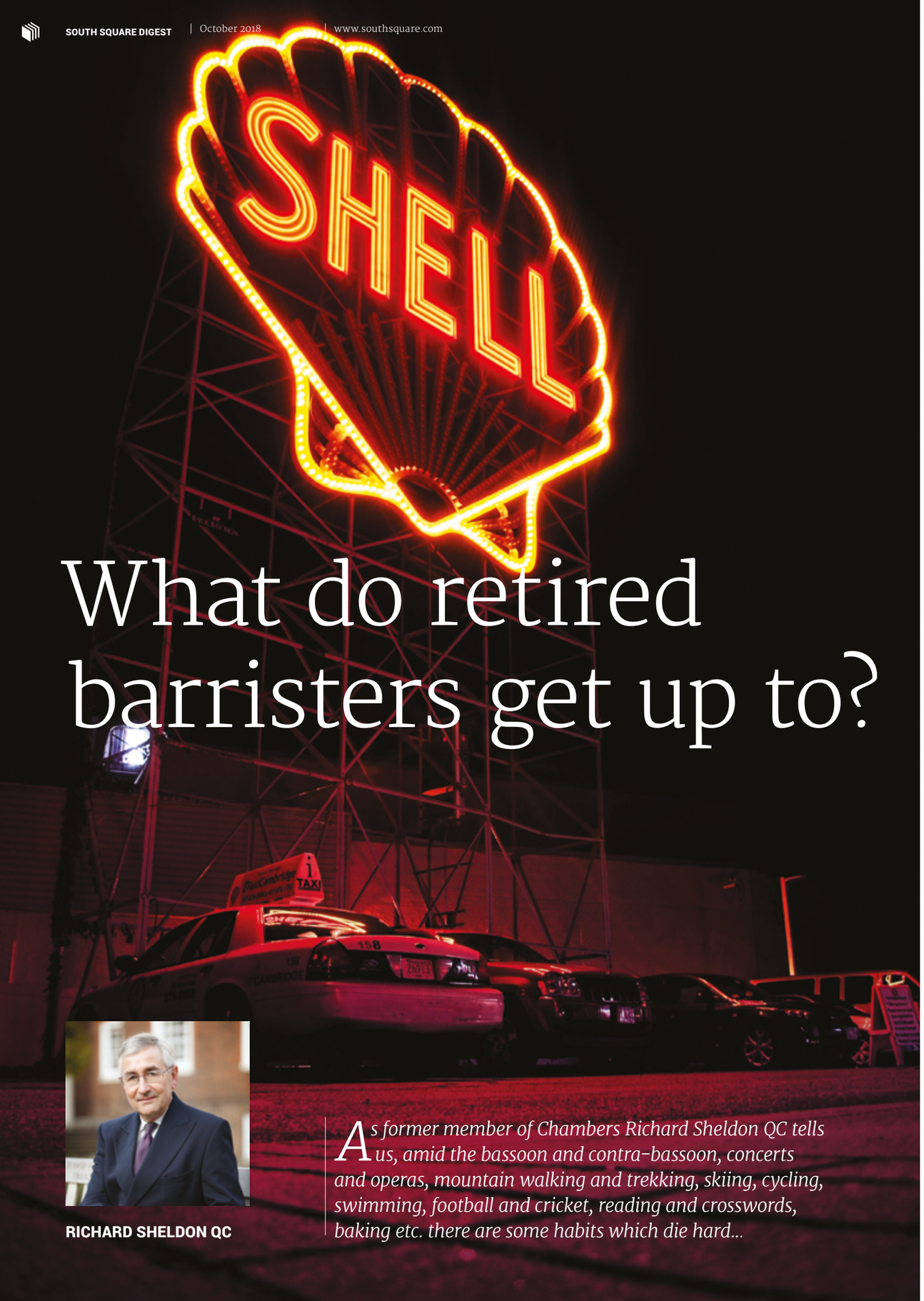
There is scope for these proposals to overhaul the UK rescue culture. We anticipate a shift away from convoluted restructurings and pre-packs, often aimed, at least in part, at overcoming the current restrictions and difficulties in the legislation towards a simpler, cheaper and more overtly debtor-friendly environment. However, that will depend upon practitioners embracing the terms and spirit of what could become a new rescue culture. Whether in the long term this will be regarded as a brave new world or another false dawn, only time will tell. ■

43. Page 60, [5.99].

44. Page 62, [5.107-8]. Certain financial products and services will be exempted from the new provisions, see: page 61, [5.102].

45. *Pan Ocean Co Ltd v Fibria Celulose S/A [2014]* Bus. L.R. 1041; *In re Lehman Bros Holdings Inc* (2010) 422 BR 407 (in the US); *AWB (Geneva) SA v North American Steamships Ltd* [2007] 1 CLC 749 and [2007] 2 Lloyd's Rep 315, CA (considering the Canadian position); *Norcen Energy Resources Ltd v Oakwood Petroleums Ltd* (1988) 72 CBR (2d) 1; *In re T Eaton Co* (1997) 46 CBR (3d) 293; *In re Playdium Entertainment Corpn* (2001) 31 CBR (4th) 302 and *In re Doman Industries (2003) BCSC* 376 (in Canada).

46. 2016/0359 (COD).




# What do retired barristers get up to?



RICHARD SHELDON QC

*As former member of Chambers Richard Sheldon QC tells us, amid the bassoon and contra-bassoon, concerts and operas, mountain walking and trekking, skiing, cycling, swimming, football and cricket, reading and crosswords, baking etc. there are some habits which die hard...*

"That's me" I said to the usher pointing to my name under "Richard Michael Sheldon v Shell UK Ltd" on the court list. "Are you represented?" she asked. "No" I replied. "Taking on the big fish then, are you? Good luck!".

Three years into retirement I was a world away from my former stomping ground in the Rolls Building and RCJ. Clerkenwell and Shoreditch County Court may not quite have the same cachet but a part of me was quite looking forward to the trial.

It had all started one Sunday last June when I filled up my car with diesel at the Shell Service Station in Upper Street, Islington with a view to going to Garsington Opera to hear Pelleas and Mellisande later that day. Having picked up my elderly parents en route, the car suddenly lost power on the M40 about a mile before the Stokenchurch junction. I was able to crawl along the motorway and down the drive to the Wormsley Estate. The AA identified a faulty fuel injector and the car had to be towed back home. The AA were very accommodating, ordering a taxi to take my parents home and arranging for the car (and me and my wife) to be towed back after the opera had finished. As the AA mechanic pointed out, every cloud has a silver lining and I was able to enjoy rather more nicely matured Chateau La Mission Haut Brion than I had anticipated.

The following morning I took the car to my local garage. After a week the garage, having replaced the faulty fuel injector as identified by the car's computer, were unable to discover why the engine would not start. With much embarrassment they said they would have to refer the car to Renault West to see if they could identify the problem. Renault West worked on the car for the best part of a week before they reported that the problem was contaminated fuel. The fuel tank had to be drained and all the fuel injectors replaced. I asked for a sample of the fuel to be retained. After 3 weeks I got the car back and a hefty bill of some £1600. That's when the fun and games began.

I went to Shell Upper Street armed with a sample of what had been identified as contaminated fuel. The first visit was abortive as nobody was around to deal with the problem. On the second visit I was given a telephone number to call and told to register a complaint that way. I duly rang the number which was clearly inappropriate (it was aimed at Shell retailers) and ended up talking to someone in Poland with little connection with Shell. I went onto the Shell website and obtained a number for the helpline. I spoke to a woman who assured me that I had come through to the right number to deal with my type of complaint and then was asked a series of standard questions. I offered to send the invoices which identified the fuel as contaminated and showed the work carried out and I also offered the sample. I was told that was unnecessary - Shell would carry out its own "detailed" investigations and would report back in 2-4 weeks.

Needless to say, I had not heard anything after 4 weeks and had to send a chaser. A series of emails ensued in which Shell, having come up with the usual flannel about how seriously they take customer complaints, said that they had sold 5600 litres of diesel that day, no other customer had complained and that the sensors indicated that there had been no water contamination. All liability was denied. I repeatedly offered to supply them with the sample of contaminated fuel – no interest was shown. I despatched a letter before action with accompanying documents.

I had decided to bring proceedings because I thought that I had more than a 50/50 chance of winning. The cost of issuing proceedings was £105 – and there would be a trial fee of £170 to pay. Pretty good odds against a claim for £1700 (ie the garage bills plus the cost of the fuel and of towing the car from the local garage to Renault West). As the proceedings would fall under the small claims jurisdiction there was no risk of my having to pay Shell's costs unless I acted unreasonably, something I was not worried about. I was also genuinely interested in seeing how the system worked from the user's point of view.

Issuing the claim online was relatively straightforward even to a computer illiterate like myself – no more difficult than buying a pair of trousers. The online claim form required me to summarise my claim in 120 words which in the circumstances was not difficult. The most problematic part was working out the daily rate of interest – to make the calculation easier I upped my claim to £2000 (!?), the balance being a claim for damages for inconvenience.

Solicitors appeared on the scene for Shell. They filed a 3 page defence to my 120 word claim. The first 2 paragraphs give the flavour. I quote:

1. The claimant has sued the wrong defendant... The claim against the named defendant must fail. In light of this, the defendant contends that the claim should be struck out...
2. The claimant has failed to particularise his claim at all. In addition, the claimant has failed to particularise any allegations of negligence or breach of duty against the defendant. The defendant contends that the claim should be struck out as having no prospect of success.

I burst out laughing when I read these paragraphs. As to the first, in my letter before action, I had asked in the concluding paragraph whether the Shell entity with which I had been dealing was the correct entity to sue: correspondence continued with that entity (and with the solicitors representing them who had given no inkling that the entity was not correct). So I knew that would not be a problem. As to the second, in my 120 word summary of my online claim form I had specifically referred to my detailed letter before action (with relevant documents enclosed): so that was water off a duck's back too. More seriously, this smacked to me of intimidatory tactics: a litigant in person without relevant experience could well have been put off by these pleas. And the general tenor of the defence struck me as more appropriate for the complex fraud claims with which I had dealt in the Chancery Division rather than the small claims court. In the defence nothing was admitted and I was put to proof of everything.

## FEATURE ARTICLE: WHAT DO RETIRED BARRISTERS GET UP TO?


> Do you have any reason to disagree with the statement that contamination of biodiesel can occur not just by water but also by solid particulates – which can be one-off occurrences?
>
> I have no reason to disagree. I don't know – I just sell the stuff.

> My background told me that I should prepare a witness statement

Since the proceedings were contested they were transferred to my local county court (also nearest Upper Street) and directions for trial were given. I ticked the box for mediation; Shell declined. The directions included those for service of witness statements. I was aware that the small claims procedure was intended to be informal and so was not sure whether I needed to serve a witness statement – the only part of the procedure which was unclear. My background told me that I should prepare a witness statement in order to marshal my arguments. In preparing my witness statement I also had a bit of fun – Shell had suggested that the fuel in the tank might have been contaminated before I filled up at Upper Street. This caused me to check my credit card statements to discover that I had filled up the car on the previous occasion at… Shell Upper Street!

Shell served a witness statement too – from the manager of Upper Street service station. It did not add anything of substance to what had been said before but exhibited a series of tables showing the amount of fuel sold and "nil" on the sensors to detect water contamination. When the witness statement was served, so was a "without prejudice" letter from Shell's solicitors offering to "settle" the claim by not seeking Shell's costs if I were to withdraw the claim. I have to confess to a feeling a certain fluster when I received the letter and had to check the rule about costs in small claims proceedings before concluding that the letter was not an offer at all and just another attempt to bully. I should add that, at the stage this letter was sent, Shell's solicitors were unlikely to have known of my background. I first included it in my witness statement – after quite a lot of soul searching as to whether I should. As it turned out at trial, it was in retrospect clearly the right thing to do because the deputy district judge started by saying that so far as he was aware he had never instructed me or appeared before me when I sat as a High Court judge!

To the trial. Shell were represented by junior counsel – 100% professional and impeccably behaved. I was relieved to find that the hearing would take place in a proper court, familiar surroundings, rather than a dingy office which the outward appearance of the building in Gee Street had threatened.

The deputy district judge started by asking Shell's counsel why my repeated offers of providing the sample (made on at least 5 occasions) had been refused. I knew I was on to a winner! There was no satisfactory explanation (which is why I had repeated the offers in the first place!). There were more old dogs' tricks to come.

I was cross examined on my witness statement – a rather more gentle process than depositions in New York on experts' reports I had provided! To my surprise, the manager of Shell Upper Street turned up for cross examination (the pre-trial questionnaire had been filled by Shell as indicating no witnesses would appear at trial). First, Shell's junior counsel asked the manager some questions to explain his statement. She referred to the attached table showing the volume of diesel sold on the day in question. The relevant figure on the copy of the table which she, the witness and the judge had was obscured by highlighting. My copy was as clear as a bell. I was just about to intervene to be "helpful" (which I would probably have done as counsel) when a voice inside me said "Stop! – it's Shell, let them stew": and I did, and they did, with the deputy district judge becoming more and more irritated at Shell's inability to identify the relevant figure.

It was then my turn to cross-examine the manager. I was completely unprepared but I had with me a print out which I had picked up from the internet which gave details of the causes of diesel contamination. I had provided Shell's counsel with a copy in case I wanted to rely on it in court but I was aware that it was in some respects double edged. Cross examination gave me the perfect opportunity to introduce (without reference to the print out itself) the matters on which I intended to rely – thereby preventing Shell's counsel from relying on the print out. I was well aware that such a line of cross examination was not technically permissible – but we were in the informal process of the small claims court! The cross examination of the manager was not without its funny side.

*Do you agree that the diesel which is sold in pumps across the UK is required by EU law to contain a minimum of 7% biodiesel?*

*I don't know*

*Do you have any reason to disagree?*

*No*

*Do you have any reason to disagree with the statement that contamination of biodiesel can occur not just by water but also by solid particulates – which can be one-off occurrences?*

*I have no reason to disagree. I don't know – I just sell the stuff.*

The deputy district judge asked questions of his own about Shell's complaints' procedure which led to the answer that the woman I had spoken to on the phone on the customer helpline was in Manila in the Philippines! There was no register of complaints at the service station itself.

I knew I had won! The deputy district judge laid into Shell in his judgment, saying that Shell's attitude had been "you prove it – I am not interested in customers' complaints"; there had been no attempt to investigate the complaint seriously as any properly run large organisation would have done; and no proper complaints procedure: trading standards would be very interested. He found that Shell had acted unreasonably (the failure to analyse the samples being cited as a principal reason).

The judge turned to me and said that his finding that Shell had acted unreasonably opened up the opportunity for me to claim costs over and above the court fees. He was obviously mad at Shell's behaviour. I decided to lay it on a little by referring to Shell's litigation tactics, including the "offer" of settlement. By the time I had finished, the deputy district judge had become positively incandescent:

"So, what costs would you like to claim?" he asked. "I don't have any", I replied, "I've retired so there is no loss of earnings." "What about travel expenses?" he asked. "I don't have any – I walked to court this morning". The judge raised his eyebrows and looked to the ceiling. "Well, how much time did it take you to prepare the case?" I replied: "No more than a day, plus the half day in court for trial." "I'm going to recompense you for that time at the rate of £500 per day - a total of £750."

In the proceedings, I claimed £2000. Judgment was awarded in my favour for £2956 (which included court fees). I am somewhat ashamed to confess that I don't think that I ever achieved for a client a judgment for 50% over and above the amount claimed. I have split the £750 between the Personal Support Unit and Amnesty International – the latter specifically to support the victims of the Shell oil spill in the Nigerian delta.

Afternote: my garage later told me that they had quite often had to repair cars allegedly damaged by contaminated fuel but that this was the first time that they were aware of a successful claim having been brought, earlier attempts at recovering compensation having been fobbed off by the petrol companies. Perhaps others will be encouraged! ■

# Insolvency Set-Off and Secured Debts

MADELEINE JONES

Image: Justinian I, Detail of a contemporary portrait mosaic in the Basilica of San Vitale, Ravenna.

During his reign, Justinian sought to revive the empire's greatness and reconquer the lost western half of the historical Roman Empire. His reign is marked by the ambitious but only partly realized renovatio imperii, or "restoration of the Empire". A still more resonant aspect of his legacy was the uniform rewriting of Roman law, the Corpus Juris Civilis, which is still the basis of civil law in many modern states.

The setting off of mutual debts is an ancient feature of the law. The Digest of Justinian (compiled in the sixth century AD from earlier Roman legal sources) contains the following definition, which still serves:

*"Set-off is a contribution made between a debt and a credit."*

[Dig. 16.1.1. Translation by S P Scott, *The Civil Law*, IV, Cincinnati, 1932.]

Solvent set-off is available under statute (currently s.49(2) of the Senior Courts Act 1981 and CPR r.16.6), in equity and under contract; special rules govern banks' right to combine accounts. These species of solvent set-off are cousins of insolvency set-off, but should not be confused with it. Insolvency set-off raises a distinct set of issues.

Insolvency set-off was first enshrined in English statute in the Bankrupts Act 1705 (3 Anne, c.17), although it was already present in the common law before this date: *Anonymous* (1676) 1 Modern 215, 86 E.R. 837; *Chapman v Derby* (1689) 2 Vernon's Cases in Chancery 117. The doctrine has survived in each of the succeeding revisions of English insolvency statute law (except that there was no such provision under the original administration regime: see further *Isovel Contracts Ltd v ABB Building Technologies Ltd* [2002] 1 B.C.L.C. 390). Its current place is as follows: for administrations, r. 14.24 of the Insolvency Rules 2016 (the "2016 Rules"), for windings up, r. 14.25 of the 2016 Rules, and for bankruptcies, s. 323 of the Insolvency Act 1986 (the "1986 Act").

## Insolvency set-off

In *Stein v Blake* [1996] 1 AC 243 at 251, Lord Hoffmann described bankruptcy set-off (the doctrine operates in the same way in all compulsory insolvency proceedings) as follows:

*"Bankruptcy set-off ... affects the substantive rights of the parties by enabling the bankrupt's creditor to use his indebtedness to the bankrupt as a form of security. Instead of having to prove with other creditors for the whole of his debt in the bankruptcy, he can set off pound for pound what he owes the bankrupt and prove for or pay only the balance. So in Forster v. Wilson (1843) 12 M. & W. 191, 204, Parke B. said that the purpose of insolvency set-off was 'to do substantial justice between the parties.' Although it is often said that the justice of the rule is obvious, it is worth noticing that it is by no means universal."*

As to the *"substantial justice"* done by insolvency set-off, it has been said that:

*"Where one party has no prospect of paying its debts, it would usually run counter to common notions of good sense and justice to require the other party to pay, as opposed to set off, its debt."*

[*Revenue and Customs Commissioners v Xicom Systems Ltd* [2008] EWHC 1945 (Ch) at [18], David Richards J]

Under English law, insolvency set-off has the following features (see *MS Fashions Ltd v Bank of Credit and Commerce International SA* [1993] Ch 425 at 432-3, *Stein v Blake* at 254-5):

a. It is mandatory, so that its operation cannot be excluded by prior agreement nor by judicial discretion: *Stein v Blake* at 254; *Halesowen Presswork & Assemblies Ltd. v. National Westminster Bank Ltd* [1972] AC 785;

b. It is automatic, so that it occurs at the moment of liquidation with no further procedural step needing to be taken for set-off to take place: *Stein v Blake*, at 254;

c. It extinguishes the prior causes of action, which it replaces with a net balance taken as at the date of the winding up order: *Stein v Blake* at 255; *MS Fashions* at 432

d. In taking the account the court has regard to events which have occurred since the date of the winding up: *MS Fashions* at 432.

The creditor who benefits from insolvency set-off bypasses the *pari passu* principle: she receives 100p in the £1 in respect of the amount of her debt that may be set-off, and need only prove for the balance.

## Availability of Insolvency Set-Off

Set-off is expressly stated in the relevant provisions of the 1986 Act and the 2016 Rules to apply to mutual dealings. It has also been said that the claim against the company or bankrupt must be provable. The question of whether secured liabilities may be set off has been unsettled in English law for some time. The questions of both mutuality and provability impact on whether set-off is available in respect of such debts.

## Provability

In *Re Norman Holding Co Ltd* [1991] 1 WLR 10 at 15-16, Mervyn Davies J found that a secured debt was not susceptible to set-off, on the basis that the secured debt had not been brought within the liquidation by means of a proof:

*"As a secured creditor he does not (unless he so elects) prove or claim to prove for his debt in the liquidation. He relies on and realises his security. But as an unsecured creditor he proves in the liquidation and so is caught by set-off as to the unsecured debt. I read Rule 4.90 [the predecessor to r. 14.25] as affecting debts proved in the liquidation and not as affecting debts that are elected not to be proved therein. The position is that a creditor with two debts, one secured and the other unsecured, is obliged to submit to set-off in respect of his unsecured debt but is not obliged so to submit as to his second debt, because for that purpose he is not proving in the liquidation.*

*"Having regard to the considerations set out above I take the view, with some hesitation, that while rule 4.90 set-off applies to an unsecured creditor who proves in the liquidation, that creditor is not obliged to bring into account any secured debt owing*

## FEATURE ARTICLE: INSOLVENCY SET-OFF AND SECURED DEBTS

> Proof is a voluntary procedure... set-off operates automatically

*to him by the insolvent company if the secured debt is not proved in the liquidation. As I have said, rule 4.90 affects debts proved in the liquidation but does not affect debts that are elected not to be proved."*

It is not controversial that a secured creditor may elect to abandon her security and prove as an unsecured creditor, in which case set-off would certainly operate. Mervyn Davies J deals with the situation where the creditor does not so elect. On this view, by choosing to rely on her security, the secured creditor in effect takes her debt outside the insolvency proceeding, which is concerned with the division of distributable assets among creditors in accordance with their provable liabilities.

This analysis was given support by Rose LJ in an obiter comment in *Bank of Credit and Commerce International SA (In Liquidation)* (No.8) [1996] Ch 245, at 256:

*"It has been said many times that the right of set-off in bankruptcy is a rule as to debts and liabilities provable. It was on this basis that section 39 of the Bankruptcy Act 1869 and its successors were made applicable in companies winding up: see Mersey Steel and Iron Co. Ltd. v. Naylor, Benzon & Co. (1884) 9 App.Cas. 434, 437-438. In In re Charge Card Services Ltd. [1987] Ch. 150, following an extensive review of the authorities, Millett J. held that any claim which is admissible to proof is capable of set-off if the other requirements of set-off are satisfied. The converse is equally true: a claim is not capable of set-off unless it is admissible to proof. This is plain from the terms of rule 4.90 itself, which applies only where a creditor proves or claims to prove in the liquidation. To qualify for set-off, therefore, the creditor's claim must be capable of proof.[ ...]*

*"Insolvency is concerned with the distribution of the debtor's uncharged assets among his unsecured creditors. Trust property and security stand outside the scheme of distribution and the scope of insolvency set-off. Set-off ought not to prejudice the right of a secured creditor to enforce his securities in any order he chooses and at a time of his choice."*

However, the analysis is not without its problems. Proof is a voluntary procedure which happens at some point after the date of the bankruptcy or winding up order. Set-off, on the other hand, operates automatically at the point of the making of the order. The inapplicability of set-off to secured debts thus seems at odds with the analysis in *Stein v Blake*.

In *Scottish Widows Plc v Stewart* [2005] EWHC 1831 (QB) HHJ Eccles QC considered a submission that *Stein v Blake* had impliedly overruled *Re Norman Holdings* for this very reason. He was *"not convinced that it was overruled at all by the reasoning in Stein v Blake"* (at [185]; his remarks on the subject are obiter). He continued ([185]-[186]):

*"The reason, it seems to me, why In re Norman Holdings survives Stein v. Blake is that the latter case was concerned to decide whether the original chose in action survived the process of automatic set-off rather than to create a new principle in deciding the circumstances in which such a set-off should be held to occur. The reason why a secured debt falls outside the liquidation when the creditor realises the security seems to me as valid as before. It remains for another court to decide on another day what the position might be if a secured creditor takes advantage of his right to prove, in the event that he surrenders his security or finds it to be insufficient."*

The view expressed by Rose LJ, that a non-provable debt is incapable of being set-off, has now been overruled. In *In re Lehman Bros International (Europe) (in administration) (No 4)* [2017] 2 WLR. 1497 Lord Neuberger (the other four Justices agreeing) held, citing Lord Hoffmann's doubts in the appeal of *BCCI (No. 8)*, [1998] AC 214, at 228, and a decision of the High Court of Australia, *Gye v McIntyre* (1991) 171 CLR 609, as follows:

*"I can see no good reason why a debt owing by the creditor to the company which is or would be non-provable in the creditor's insolvency should thereby be disqualified from being set off under rule 2.85 [the predecessor of r.14.24] against a proof lodged by the creditor in the company's administration.[...]*

*"There is nothing in rule 2.85 which, at least expressly, stipulates that the set-off liability has to be provable, and it is inappropriate to imply limitations into a legislative provision unless it is strictly necessary. In any event, the general purpose of insolvency set-off appears to me to point against implying any such restriction. As Parke B explained in Forster v Wilson (1843) 12 M & W 191, 204, the purpose of insolvency set-off is "to do substantial justice between the parties," which is reflected in the more recent analysis of Lord Hoffmann in Stein v Blake [1996] AC 243, 252–255. Gye v McIntyre was a clearly reasoned judgment of a powerful court, which included the observations at (1991) 178 CLR 609, 628–629 that there was "nothing at all" in the relevant legislation which required the set-off claim to be provable, that there was no "reason in fairness or common sense why such an additional test should be imposed," and "considerations of justice and fair dealing which underlie" the set-off provisions "require that a set-off be allowed in such circumstances".*

As it is now clear that non-provable debts are capable of being set-off, the reasoning in *Re Norman Holdings* on the inapplicability of set-off to secured debts is no longer to the point.

> As it is now clear that non-provable debts are capable of being set-off, the reasoning in *Re Norman Holdings* on the inapplicability of set-off to secured debts is no longer to the point

### Mutuality

A recent decision of Tottle J, sitting in the Supreme Court of Western Australia, *Hamersley Iron Pty Ltd v Forge Group Power Pty Ltd (In Liquidation)* [2017] WASC 152, affirmed the non-application of set-off to secured debts in an insolvency for a different reason, namely that an attached security interest is a proprietary right, and the proprietary nature of this right, as against the unsecured debt of the insolvent company, a merely personal right, destroys the mutuality of interest between creditor and debtor which is necessary for the cross-debts to be set off.

This is a novel argument, though the learned Australian judge found support for it in a venerable authority: *Jones v Mossop* (1844) 67 ER 506, 509 per Sir James Wigram (cited at [292] in *Hamersley Iron* as *"the principle underlying the requirement for mutuality"*):

*"[N]o rule is better understood than that you cannot set off demands due in different rights; the principle being that one man's money shall not be applied to pay another man's debt."*

However, here Sir James Wigram was not referring to a claim under a personal right and a claim under a proprietary right, but a claim against a man in his capacity as Administrator of an estate and a claim against a man in his capacity as assignee of a debt. Furthermore, the judge in *Jones* rejected the argument that the fact that the claims were in this sense *"owed in different rights"* meant that set-off did not apply. The finding was unsurprising, as despite a rather complicated fact

pattern involving the passing of an estate through death and then the bankruptcy of the administrator, the claim involved cross-debts (what is remarkable about the case is that the judge found the right to set-off in equity rather than in statute, raising the issue – beyond the scope of this article and of primarily academic interest – of whether there exists a non-statutory doctrine of insolvency set-off).

With respect to the learned Australian judge, the argument that the security destroys mutuality does not overcome the objection of the editors of *Totty, Moss & Segal: Insolvency* (Sweet and Maxwell, 2018), H6-04.1 to the idea that security stands outside a liquidation:

*"[T]he fact that secured assets stand outside the scheme of insolvency distribution is neither here nor there because the set-off is not against any secured assets, but against the debt secured. A secured debt is a debt all the same."*

A secured debt is a debt which gives rise to a property right, but it does not for this reason lose its character of debt.

It is well established that mutuality is destroyed where the beneficial interest of a cross-claim is held by someone other than the creditor:

*"My view is this, that, the account standing in the names of the brother and sister, the case could not have been brought within the rules of equitable set-off or mutual credit, unless the brother was so much the person solely beneficially interested that a Court of Equity, without any terms or any further enquiry, would have obliged the sister to transfer the account into her brother's name alone."*

[Re *Willis, Percival & Co, ex parte Morier* (1879) 12 ChD 491 at 502 per Brett LJ]

This decision was not overruled by *Stein v Blake: Bank of Credit and Commerce International SA (in liq.) v Prince Fahd Bin Salman Abdul Aziz Al-Saud* [1997] B.C.C. 63 at 70. However, *Re Morier* deals with cross claims between a debtor and a creditor where C held the benefit of the claim on trust for A. It does not dispose of a situation where there is a cross-claim with a secured debt, that is, where C's claim against D is the assertion of a real right in D's property.

## Conclusion

With respect to the learned Australian Judge, it is therefore submitted that the better view (and the one which, following the judgment of Lord Neuberger in *Lehman (No 4)*, should prevail in English law) is that of Dillon LJ in *MS Fashions* at 446:

*"It is common ground that where there are such mutual credits, mutual debts or other mutual dealings the set-off is mandatory and cannot be excluded by any contract between the parties: see Halesowen Presswork & Assemblies Ltd. V. National Westminster Bank Ltd. [1972] A.C. 785. If there are indeed mutual credits or mutual debts or mutual dealings between a company, or a bankrupt, and a creditor, then the set-off applies notwithstanding that one or other of the debts or credits may be secured. See, for instance, the judgment of Lord Selborne L.C. in Ex parte Barnett; In re Deveze (1874) L.R. 9 Ch. App. 293 and the judgment of Dixon J. in Hiley v. Peoples Prudential Assurance Co. Ltd. (1938) 60 C.L.R. 468, 498. Dixon J. added: "To the extent that the secured debt is answered by set-off the security is freed."* ■

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> "It is common ground that where there are such mutual credits, mutual debts or other mutual dealings the set-off is mandatory and cannot be excluded by any contract between the parties"



# EUROLAND: European Union (Withdrawal) Act 2018

GABRIEL MOSS QC

*Since the last edition of the Digest, the European Union (Withdrawal) Bill has received the Royal Assent and has become the European Union (Withdrawal) Act 2018.*

## FEATURE ARTICLE: EUROLAND: EUROPEAN UNION (WITHDRAWAL) ACT 2018

The Act has some key provisions affecting insolvency and restructuring law which are due to take effect on and after "*exit day*", defined in Section 20 of the Act as "*29 March 2019 at 11.00 pm…*".

As expected, Section 1 repeals the European Communities Act 1972 "on exit day".

Section 2 preserves, subject to what follows below, "*EU-derived domestic legislation*", defined so as to include the UK implementation[1] of reorganisation and winding-up Directives relating to banks and direct insurers[2].

Section 3 of the Act preserves as part of domestic law on and after exit day *"direct EU legislation"* including *"any EU Regulation"*. Accordingly the Recast Regulation on Insolvency Proceedings 2015/848 of 20 May 2015 will remain in force, subject to what follows below.

In the case of direct EU legislation such as the Recast Regulation, it is only the English language version that is to be brought into English domestic law: Section 3(4). But other language versions can be used for the purposes of interpreting the Regulation. This is an oddity, since under EU law all language versions are equally authoritative and to that extent EU law is not being preserved by Section 3.

The principle of the supremacy of EU law over domestic law continues to apply after exit day in relation to EU law as it stands prior to exit day, but the principle of supremacy of EU law does not apply to any enactment or rule of law passed on or after exit day: Section 5, save that pursuant to Section 5(3) the supremacy of EU law is preserved in relation to a modification made after exit day of an enactment or rule of law passed or made before exit day *"… if the application of the principle is consistent with the intention of the modification"*.

The Act preserves EU law as at exit day, so that if there were a Regulation amending the Recast Insolvency Regulation, that would have no effect in English law unless the change is also made by UK legislation: see Section 7.

In interpreting retained EU law, UK courts will not be bound by any principles laid down or any decisions made on or after exit day by the Court of Justice of the European Union (CJEU): Section 6(1)(a). Moreover, references to the CJEU are cut off on or after exit day: Section 6(1)(b).

One oddity in relation to Sections 5 and 6 is the use of the expression *"on or after exit day"*. Since *"exit day"* is defined in Section 20 not merely as a "day" but as *"29 March 2019 at 11.00 pm"* it is not entirely clear what "*on*" exit day means in relation to 29 March 2019. Thus if the EU passes some legislation modifying the Recast Insolvency Regulation on 29 March 2019 itself, but prior to 11.00 p.m. UK time (midnight in Brussels), it is not at all clear whether such a modification or decision is made *"on"* exit day. It would actually be more logical to read the phrase *"on or after exit day"* as being at or after 11.00 pm on 29 March 2019.

Recast Regulation 2015/848 on Insolvency Proceedings, as well as the UK implementation of the banking and insurance reorganisation and winding up directives, will continue to have effect after 11 pm on 29 March 2019, subject to what follows below.

The interpretation of, for example, the Recast Regulation and the implementation of the Directives is to be decided "*in accordance with any retained case law and any retained general principles of EU law …*": Section 6(3) of the Act. However, pursuant to Section 6(4) the Supreme Court is not bound by any retained EU case law, although in deciding whether to depart from it, the Supreme Court must apply the same test as it would in deciding whether to depart from its own case law. To that extent again the principle of retaining EU law in the same state as before the exit from the EU has been breached.

Incidentally, *"retained EU case law"* is defined in Section 6 sub-section (7) as referring to *"any principles laid down by, and any decisions of …"* the CJEU *"… as they effect in EU law immediately before the exit day …"*. Likewise, by Section 6(7) *"retain general principles of EU law"* refers to general principles of EU law as they had effect *"… immediately before exit day …"*.

The above is however only a *prima facie* situation as at the time of leaving the EU. The real position will be decided, not by Parliament but by Ministers in the light of the outcome of the negotiations both for the so-called *"implementation period"* (the transition phase to the end of 2020) and what the Act in Section 13 refers to as the *"negotiated withdrawal agreement"* and the *"framework for the future relationship"*.

Thus for example in a *"no deal"* scenario where no agreement has been reached, there would be a breach of reciprocity at the time of exit. The recast Regulation on Insolvency Proceedings and the Banking and Insurance Reorganisation and Winding-up Directives would apply to the UK but not the EU 27[3]. The UK would be bound for example to recognise and give effect to a German main insolvency proceeding pursuant to the Recast Regulation but German courts would not have any obligation under the Regulation to recognise, for example, a secondary proceeding in respect of the same debtor in the UK.

1. Insurers (Reorganisation and Winding-Up) Regulations 2003, Credit Institutions (Reorganisation and Winding Up) Regulations 2004. See *Moss, Wessels and Haentjens, EU Banking and Insurance Insolvency (2nd ed, 2017)*.

2. Title IV of Directive 2009/138/EC of the European Parliament and of the Council of 25 November 2009 on the taking-up and pursuit of the business of insurance and reinsurance (Solvency II) and Directive 2001/24/EC of the European Parliament and of the Council of 4 April 2001 on the reorganisation and winding-up of credit institutions, as amended by Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms (ERRD). See *Moss, Wessels and Haentjens, EU Banking and Insurance Insolvency (2nd ed, 2017)*.

3. In the case of Denmark, the recast Regulation on Insolvency Proceedings does not apply in any event. References to the EU27 in this article should be interpreted accordingly.

As a result of this lack of reciprocity, under Section 8 of the Act the relevant Minister can simply change the legal position in the UK in relation to the Regulation or the Directives by using the notorious *"Henry VIII powers"*, described in this context, oddly, as being to *"… prevent, remedy or mitigate … any other deficiency in retained EU law, arising from the withdrawal of the United Kingdom from the EU"*. The so-called *"deficiency"* is defined as including a situation where reciprocal arrangements have ceased to exist: Section 8(2)(c).

In the absence of any deal or a treaty concerning the Recast Regulation and/or the Directives concerning insolvency, reciprocity will undoubtedly cease to exist, apart from during the proposed implementation period to the end of 2020. Thus, it seems likely that either immediately upon exit (in a *"no deal"* scenario) or subsequently at the end of the implementation/transitional period the Recast Regulation and/or the UK implementation of the Directives will cease to be part of English law.

## FEATURE ARTICLE: EUROLAND: EUROPEAN UNION (WITHDRAWAL) ACT 2018

> The aim of the UK government is to do some kind of deal, both in relation to the implementation/transitional phase to the end of 2020 and thereafter

WILLIAM WILLSON

Thus, in the worst-case scenario where there is no deal, even as to an implementation period, we need to be ready for a potential situation where reciprocity is lost on 29 March 2019 at 11.00 pm which, at a minimum, would mean that (unless the EU 27 made transitional arrangements) the UK would cease to be able to rely on the Recast Regulation or the Directives in EU 27 countries and may well lose the Recast Regulation and/or implementation of the Directives by the Government using its Henry VIII powers.

Of course, the aim of the UK Government is to do some kind of a deal both in relation to the implementation/transitional phase to the end of 2020 and thereafter, and it is confident of achieving this. Even in that event, it is currently unclear whether and to what extent the Recast Regulation or the UK implementation of the Directives will survive beyond the implementation/transition stage. Since *"nothing is agreed until everything is agreed"*, the fundamental uncertainty continues and the only certainty is what would happen in a *"no deal"* scenario, which cannot be wholly discounted.

To sum up, if we were to ask the question: *"What will happen on exit day?"*, the answer remains *"we don't know"*. This will remain the case while the status of the negotiations is that nothing is agreed (since not everything is agreed) and therefore nothing is known for certain. The effect of the Withdrawal Act 2018, despite its quirks and oddities, is to leave things mainly as they are, but entirely subject to change, depending on the outcome of the negotiations. We are hurtling towards a date, only a few months away, when either the EU law relating to insolvency will continue as before or not, entirely depending on the wholly unknown and unforeseeable outcome of the present negotiations.

This brings us back to Parliament trying to have a *"meaningful say"* in these matters, for which alleged purpose there are now specific provisions in the Act. If there is no deal and the Prime Minister makes a statement before the end of 21 January 2019 that no agreement in principle can be reached on the arrangements for withdrawal and the framework for a future relationship, a Minister must make a statement as to how the Government proposes to proceed and put a motion in neutral terms before the House of Commons as well as a motion for the House of Lords to take note of the statement. If no such Prime Ministerial statement is made but at the end of 21 January 2019 there is in fact no agreement in principle a Minister must within five days of the end of 21 January 2019 make a statement setting out how the Government proposes to proceed and make arrangements for a motion in neutral terms for the Commons and a motion for the Lords to take note of the statement.

It is not at all clear what would happen next.

If a deal is reached on the negotiated withdrawal agreement and the framework for a future relationship, then prior to ratification they must be approved by a resolution of the House of Commons and there must be a motion for the House of Lords to take note of the agreement and framework for which the Lords can have up to five sitting days. An Act of Parliament will have to be passed which contains provision for the implementation of the withdrawal agreement. It is not at all clear from the Act what would happen if the Commons or Parliament as a whole rejected the agreement reached by the Government and/or refused to pass the necessary Act of Parliament.

As far as the Withdrawal Act 2018 is concerned, we are definitely exiting the EU on 29 March 2019 at 11.00 p.m. UK time, i.e. midnight in Brussels. This seems to be intended as "red meat" for Brexiteers. However, even that date is in reality uncertain. If need be, it can be amended by a subsequent (and perhaps very short) Act of Parliament for which there is likely to be a majority in both Houses if the exit under Article 50 is delayed with the agreement of the EU 27. The implementation period has the provisional end date of the end of December 2020, but that can also be moved by agreement with the EU 27.

Truly it can be said that nothing will be clear until everything is clear!

### Amendment to Annexes A and B of the Recast Insolvency Regulation

On 6 July 2018, EU Regulation 2018/946 of the European Parliament and of the European Council was published in the Official Journal. This replaces Annexes A and B to EU Regulation (EU) 2015/848 on insolvency proceedings ("the Recast Regulation").

The amended Annexes A and B address recent changes in insolvency laws/procedures in Croatia, Bulgaria, Latvia, Portugal and Belgium.

Of note, the amended Annex A includes, in relation to the Republic of Croatia, the "Act on the Extraordinary Administration Proceeding in Companies of Systemic Importance for the Republic of Croatia" (also known as "the Extraordinary Administration Law"). This will now become an "insolvency proceeding" for the purposes of Article 2(a), and will be subject to automatic recognition.

The Extraordinary Administration Law has recently been the subject of a contested recognition application in the High Court, where a dissenting creditor, Sberbank, sought to argue (unsuccessfully) that the Extraordinary Administration of Croatia's largest privately owned company, Agrokor, was not a "foreign main proceeding" for the purposes of the CBIR 2006. With the amendments to Annex A, that dispute (in relation to which permission to the Court of Appeal had been granted) is now academic.

William Willson of South Square assisted the Government of the Republic of Croatia with their submission to the European Council. ■

LEGAL EYE: NEW SERIES

# "The first thing we do, let's kill all the lawyers": Shakespeare and the legal world

ROSE LAGRAM-TAYLOR

In this new regular feature of the Digest, Madeleine Jones and Rose Lagram-Taylor cast their Legal Eye over matters of legal interest, both ancient and modern.

In this edition of the column, Rose explores Shakespeare's involvement with the law, and the law's involvement with him.

The temple gardens scene from Henry VI Part 1



LEGAL EYE: NEW SERIES

The title quote is perhaps a strange sentiment for this first article of the new Legal Eye column. But, as with most things in law, things are not necessarily as straightforward as they seem.

One might suppose by the malicious message in this rallying cry, that Shakespeare was not such a fan of us lawyer types. You would not be wrong to take this stance. However, according to a 1990 New York Times article, this line has been misinterpreted as the literal message it seems to be. Instead, the article suggests, this command (delivered by Dick the Butcher in Henry VI, Part II, Act IV, Scene II) should in fact be taken as a compliment to the attorneys and judges of the world who instil a sense of justice in society. A stretch? Maybe. But the reasoning behind this view focuses on who Dick the Butcher actually was - a follower of the rebel leader Jack Cade, who thought that if he disturbed law and order, he could become King. So, killing all the lawyers was seen to be the only way in which society and the monarchy could be brought down.

What was Shakespeare's relationship with the law? For those avid theatre-goers out there, you may already know that several of Shakespeare's plays feature a legal theme. Let us not forget Shylock's demand for a pound of flesh in the trial scene of a Merchant of Venice. Shylock did in fact have a penal bond with conditional defeasance, granting him a pound of Antonio's flesh upon non-payment by a date which had passed. As Shylock himself submits when putting forward his case:

> *"The pound of flesh which I demand of him/*
> *Is dearly bought, tis mine and I will have it./*
> *If you deny me, fie upon your Law."*

And in Measure for Measure, each character faces judgment and his own punishment in the true sense (from which the play takes its name). See Matthew 7. 1-2 (Geneva Bible):

> *"Judge that ye be not judged. For with what judgement ye judge, ye shall be judged, and with that measure ye mete, it shall be measured unto you again."*

Shylock, The Merchant of Venice

Even in Henry VI, Part I, a play not typically remembered as having a legal theme, Shakespeare uses the Temple Gardens (which, tucked off Fleet Street in London, can still be enjoyed today) as a setting for one of the most pivotal scenes. Richard Plantagenet picks a white rose from a bush growing in the gardens, coaxing his followers to do the same, whilst Somerset counters by plucking a red rose and calls his supporters to follow. Warwick, in choosing a white rose laments in Act II, Scene IV:

> *"And here I prophesy: this brawl to-day/*
> *Grown to this faction in the Temple-garden/*
> *Shall send, between the red rose and the white/A thousand souls to death and deadly night."*

Given the prevalence of the law in his plays, some in fact have theorised that Shakespeare himself was a student of the Inns of Court. We know he used at least two of them to stage his shows. The Comedy of Errors was performed in Gray's Inn in 1594 and Twelfth Night in the Middle Temple in 1602.

Whether or not he was, Shakespeare certainly had his own run-ins with the law, and may have narrowly escaped its clutches when he failed to pay his taxes in Bishopsgate in 1597, perhaps explaining why he moved to Southwark the following year. Shakespeare also used the justice of the law to his own advantage, bringing law suits against pirate publishers. However, it is as a witness in a trial at the Court of Requests in 1612 where we see a true glimpse of the real Shakespeare. The case itself involved the family with whom the Bard lodged. They wanted their apprentice to marry their daughter, Mary, which duly took place in 1604. But, in 1612, the then-former apprentice took out an action testifying that he had not been paid Mary's promised dowry. Shakespeare was called to testify as to his involvement in the saga in which he assisted Mary's mother in bringing about the match. In the only record of Shakespeare's own words, he affirmed:

> *"The said defendant's wife did solicit and entreat this deponent to move and persuade the said Complainant to effect the said Marriage, and accordingly this deponent did move and persuade the complainant thereunto."*

> "Shakespeare certainly had his own run-ins with the law"

**LEGAL EYE: NEW SERIES**

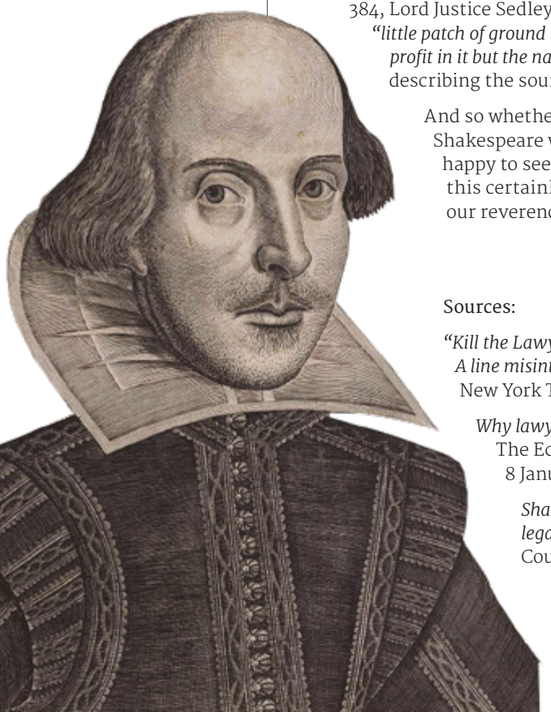
> A 2015 study found that Shakespeare was the most quoted writer by the then-current justices of the US Supreme Court

The continuing fascination of Shakespeare and the law has not gone amiss. Numerous books on the topic exist, ranging from 19th century tomes such as J Campbell's *Shakespeare's legal acquirements considered* (1859) to the more modern-day studies like R Strier's *Shakespeare and the Law* (2013). In fact, interested undergraduates can now take modules on this subject at the likes of King's College London, Warwick University, and even Harvard.

We lawyers are still in awe of the majesty of Shakespeare's word, the eloquence of which we can only hope to achieve. In 2015, Scott and Ami Dodson published a study which found that Shakespeare was the most quoted of all writers by the then-current Justices of the US Supreme Court, with Antonin Scalia coming out on top as the *"most prolific citer and the widest read"*. In fact, as pointed out in Robert Peterson's *The Bard and the Bench* all 37 of Shakespeare's plays have been quoted at least once in over 800 judicial opinions in the American courts.

However, the reach of Shakespeare in the law today extends beyond the boundaries of just America. When Oscar Pistorius was convicted of murder, the presiding judge described the case as a *"human tragedy of Shakespearean proportion"*. Closer to home, during the 'Twitter Joke Trial' of *Paul Chambers v DPP* in 2012, the Lord Chief Justice quoted King Lear in asserting that "social media users are *"free to speak not what they ought to say, but what they feel."* And, in the boundary dispute of *Strachey v Ramage* [2008] EWCA Civ 384, Lord Justice Sedley recited Hamlet's *"little patch of ground that hath no profit in it but the name"* when describing the source of contention.

And so whether or not Shakespeare would be happy to see all lawyers dead, this certainly won't kill our reverence for him. ■



Sources:

*"Kill the Lawyers", A line misinterpreted,* New York Times, 1990

*Why lawyers love Shakespeare,* The Economist, 8 January 2016

*Shakespeare and the legal world,* Counsel, June 2016

## Did you know?

All beached whales and sturgeons must be offered to the Reigning Monarch pursuant to the Prerogativa Regis 1322 as initiated by Edward II. This was tested in 2004 when Robert Davies, a Welsh fisherman, caught a sturgeon off the coast of Wales and offered it to the Queen. He received a notice back saying the Queen was happy for him to dispose of the sturgeon as he saw fit.

However, this then led to a criminal investigation into the fisherman on the basis that sturgeons are a protected species meaning it is an offence to deliberately catch or kill them. The case was dropped and the sturgeon, named Stanley, now resides in the Natural History Museum in London. ■

Past Events

# South Square & Mourant Litigation Forum 2018

On 20 September we held our annual joint litigation forum with Mourant, at Landing Forty Two of the Leadenhall Building.

South Square's David Allison QC and Peter Hayden, Partner, of Mourant were co-chairs of the well-attended event, with speakers from South Square, Mourant, Allen & Overy, Clifford Chance, Deutsche Bank, Freshfields, Lipman Karas and Macfarlanes LLP.

The afternoon was rounded off by an entertaining keynote address from Lord Daniel Finkelstein OBE, columnist and Associate Editor of the Times, followed by networking drinks. The next edition of the Digest will carry a full summary of the forum. ■

Image courtesy of Leadenhall Building Gallery

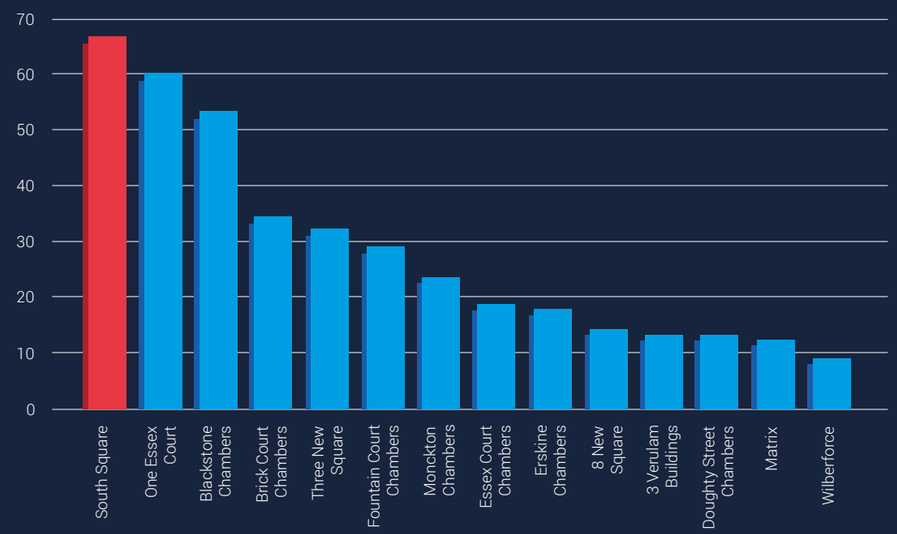
# International Insolvency Institute 18th Annual Conference, New York

Members of the International Insolvency Institute ("III") convened at New York University School of Law over 23 – 25 September 2018 for a packed schedule of talks and events. Michael Crystal QC, Mark Phillips QC and Georgina Peters of South Square all attended, with Michael also acting as a panellist on the session on Legal Civilizations. Other sessions included a judicial panel (including former Member of Chambers the Hon. Justice Antony Zacaroli) on recent cross-border cases, and a discussion entitled "Will it be different: are we prepared for the next financial crisis?" A full write-up will be included in the next edition of the Digest. ■

# News In Brief – October 2018

## South Square: the magic circle's chambers of choice

**WILLIAM MACKINLAY**
*Chambers Director*




We were delighted to be crowned *'the magic circle's barristers chambers of choice'* by The Lawyer this August, based on the number of instructions we were reported to have received over the last 3 years.

The statistic comes from The Lawyer Litigation Tracker which, if you haven't seen it, provides some interesting insights about which sets work for which firms in which practice areas. The data is drawn from publicly available sources only, predominantly BAILLI and firms' submissions, and while it doesn't present a complete picture, it does reveal that 64 matters, 28% of the 228 recorded cases which came to South Square, came from the magic circle firms.

It is, of course, wonderful to see our name in lights on an occasion such as this but we were equally pleased, and reassured, to see that a significant element of our work continues to come from a very broad range of clients. Long may that remain so. ■

## Judicial Appointments

**Hon Mr Justice Zacaroli**

South Square is delighted that former Member of Chambers, the Hon Mr Justice Zacaroli, was appointed President of the Upper Tribunal (Tax and Chancery Chamber), with effect from July 16 2018. He succeeds the Hon Mrs. Justice Rose.

The Upper Tribunal (Tax and Chancery Chamber) is one of 4 chambers of the Upper Tribunal, and is responsible for handling appeals for certain decisions made by the First-tier Tribunal (Tax) for cases about tax and the General Regulatory Chamber for cases relating to charities. It also handles appeals against certain decisions made by the Financial Conduct Authority, Prudential Regulation Authority, Pensions Regulator, Bank of England, HM Treasury and Ofgem. ■

> "The Hon Mr Justice Zacaroli has been appointed President of the Upper Tribunal (Tax and Chancery Chamber)"

## Carillion update

On 6 August 2018 agreements were completed to transition the last of the 278 contracts previously provided by the Carillion group to new service providers. This signalled the end of the trading phase of the liquidation, which commenced on 15 January, and which ensured the continued provision of essential public-sector services across hospitals, schools, transport and other key infrastructure with minimal service disruption.

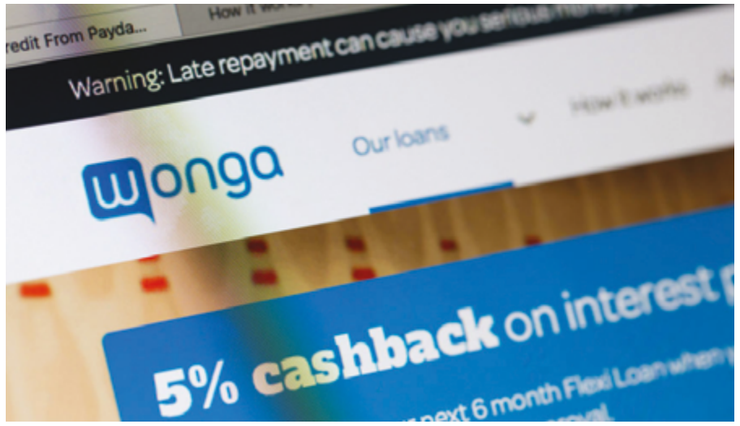
The Official Receiver continues to investigate the causes of failure of the company. However, at the TUC Congress in Manchester in September Unite, Britain's biggest labour union, called for a criminal investigation into key individuals involved in the collapse, with Gail Cartmail, Unite's assistant general secretary, stating that *"If no laws were broken, then we need better, stronger laws."* Unite did not name which individuals it


## Dark Days for Debenhams

Hot on the heels of the August collapse of House of Fraser (eventually bought by Mike Ashley's Sports Direct) come reports that Debenhams is considering restructuring options with experts at KPMG. These reports follow a long-term slide in Debenhams' share prices, with its stock falling almost two thirds to below 13p, and with hedge-fund short-selling making it the most heavily shorted stock on the London stock market (according to the Financial Conduct Authority).

On 11 September, however, Chairman Sir Ian Cheshire told BBC Radio 4's *Today* programme that news that the retail chain may be looking into an insolvency process was "simply not true".

Debenhams was founded as a drapers in 1778 by William Clark, who opened the first store selling quality fabrics, bonnets and gloves at 44 Wigmore Street in London's West End. ■




## Wonga no Longer - What went wronga?

Former payday lender Wonga collapsed into administration on 30 August. Founded in 2006 and offering loans to consumers for 30 days without the need for a formal, lengthy application process the company was one of the first to offer an instant lending application on Apple mobile phones. Wonga claimed to be offering a debt solution that was speedy and convenient for what they declared were tech-savvy consumers who acted in their own best interests. However, the catch was the astronomical, and now infamous, annual interest rates of up to 5,853%, which could soon substantially increase the cost of even a small loan taken out for a few days.

Wonga began to attract criticism in 2012 after running adverts that encouraged students with jobs to borrow money for activities such as overseas holidays and festival tickets. However, the reversal of its fortunes began in earnest in 2014 when the Financial Conduct Authority (FCA) ruled that its debt collection practices, which included the sending of threatening letters from fake law firms to its debtors, were unfair and ordered the company to pay £2.6m in compensation to 45,000 customers. That same year Occupy London highlighted Wonga's sky-high interest rates at a May Day protest. Subsequent FCA decisions to impose new affordability checks on payday loans, to cap the daily interest payable at 0.8% of the amount borrowed, and to limit default charges to £15 effectively ruined Wonga's business model.

Wonga claimed its business practices were being misrepresented and that 99% of its one million UK customers were satisfied but the company began to spiral into the red, reporting an annual loss of more than £37m for 2014 - a huge reversal of fortune considering it made an £84m profit just two years earlier. Its losses in 2015 doubled to just over £80m and in 2016, despite a move to focus on slightly longer-term loans with more flexible repayment rules, Wonga still lost £65m.

In recent months Wonga was hit by a wave of compensation claims (many through claims management companies), each of which cost the company £550 per claim to process whether or not the borrower's claim is upheld or not. In early August, Wonga raised an emergency £10m from shareholders, but the cash injection appeared only to accelerate the flow of compensation claims. Anyone who made a claim but has not received compensation is now unlikely to receive a payout - due to the nature of the business, there is no protection offered to consumers under the Financial Services Compensation Scheme.

In a statement delivered at the end of August, Wonga said its board had assessed "all options" and concluded that administration was the only option, with accountancy group Grant Thornton called in as administrators. ■

News in brief

# Trial of 'Basil the ghost' adjourned

In what may be a legal first, the trial of Michael Seed – allegedly 'Basil the ghost' and the mastermind behind the 2015 Hatton Garden heist – has been adjourned to allow his defence more time to construct their arguments because of problems that may arise from the recent release of British crime film "King of Thieves". The other 5 of the gang of 6 have already been jailed for a combined 34 years.

Joining luminaries such as Michael Caine, Jim Broadbent and Ray Winstone on screen, the character of 'Basil' is portrayed by Charlie Cox. The film purports to be the "unbelievable true story" of a gang of retired crooks (all, save 'Basil' in their 60s and 70s) employing old-school thieving skills to

## Former partners, Dwight and Katie, face bankruptcy

Former football Dwight Yorke, and his erstwhile partner, TV personality Katie Price, are both at risk of bankruptcy.

Once worth an estimated £45 million, Price has been given until the end of this month to reach an agreement with her creditors to pay back more than £120,000 in personal debt, and a greater amount owed by her companies.

Yorke, who separated from Price in 2002, had his bankruptcy hearing, adjourned until October 15 following the dwindling of his company's assets to £2. This is not the first time that Yorke has faced bankruptcy. The petition raised against him in 2017, however, was dropped when the amount he owed fell below £5,000. ■

## 'Lord Harley of Counsel' bankrupt

The career of solicitor-advocate Alan Blacker, the self-styled 'Lord Harley of Counsel' who first came to public attention in 2014 when criticised by a judge for looking like *"something out of Harry Potter"* and for wearing medals and ceremonial ribbons on his gown, has concluded with his personal bankruptcy.

Struck from the roll of solicitors by the Solicitors Disciplinary Tribunal (SDT) in 2016 for, among other things, a variety of inaccurate and misleading statements regarding his professional memberships and academic qualifications, the Solicitors Regulation Authority filed a petition to bankrupt Blacker at Manchester County Court in March 2018.

Blacker had been ordered to pay an initial £86,000 costs by the SDT and, following an unsuccessful bid for a fresh hearing into the case, he was also ordered to pay a further £7,500 to cover further regulatory costs. ■

## Lawcatz

A new TV chat show is to be piloted on Sky this month: LawCatz. The aim of the show, apparently, is to demystify the legal profession by providing viewers with an easy-to-understand analysis of common legal problems and questions (with the pilot episode dealing, inter alia, with the vexed question of "who gets to wear the wig?") together with expert guidance from solicitors and barristers on how the law works. Should the show prove as successful as other law-themed TV shows (such as ITV's "Judge Rinder", Channel 4's "The Trial: A Murder in the Family" and Dave's comedy "Judge Romesh") then subjects including Brexit, employment, divorce and medical negligence will be up for discussion later in the series. ■

# Katie Hopkins enters an IVA

Katie Hopkins, the self-styled "most controversial columnist" in Britain has agreed an individual voluntary arrangement (IVA) with her creditors in a bid to avoid bankruptcy.

In 2017, Hopkins lost a libel case against food blogger and poverty campaigner Jack Monroe after sending two tweets in which she implied that Monroe supported the defacement of a war memorial. Hopkins had confused Monroe with the columnist Laurie Penny, and Monroe originally asked Hopkins to apologise and donate £5,000 to a migrants' charity. Hopkins, however, refused to back down. The High Court found Hopkins' tweets were defamatory and ordered her to pay £24,000 in damages and £107,000 in legal costs within 28 days.

Hopkins' Daily Mail column and LBC show both ended this year by "mutual consent" and she put her Devon home on the market in February this year, selling it for £950,000 within three weeks.

Ms Hopkins has not commented publicly on the IVA. She had previously tweeted *"The only thing people in debt have in common other than bad money management, is an ability to blame anyone but themselves."* ■

> "The only thing people in debt have in common other than bad money management, is an ability to blame anyone but themselves."
>
> **Katie Hopkins**

## Primera Air Collapses

Danish leisure airline Primera Air filed for bankruptcy on Monday 1 October.

The airline specialised in ultra-cheap flights, such as the £99 starting price for tickets on its route from London Stansted to Boston launched in March this year. On 18 September Primera invited passengers to fly in "our most spacious Premium Economy seats" in the brand new Airbus A321neo. However, less than two weeks later Primera's Twitter account tweeted a brief note to say that the airline's operations had been suspended. Stranded passengers predictably responded with surprise and not-a-little outrage.

Primera claims that aeroplane maker Airbus is partly to blame for its collapse for failing to deliver the new Airbus A321 on time this summer, ready for flights to the US. The company then had to lease other, older, planes from National Airlines at the last minute, a move that cost it £17.78 million. These older aircraft were unable to make the journey non-stop as advertised but had to stop in Iceland to refuel. Some of the leased planes also had to be grounded because of engine trouble.

Airlines are risky business. Last year, out of 79 new airlines, 25 failed. And even long-established companies like Monarch in the UK are not immune; the company went into administration in 2017, leaving nearly 100,000 passengers stranded. ■

SET BY
Madeleine Jones

# SOUTH SQUARE CHALLENGE

Enter the October 2018 South Square Challenge and you could win a magnum of champagne!

Welcome to the October 2018 South Square Challenge. Your task for this seasonal challenge is to identify the subjects in the pairs of images and what unites them, and the common theme which unites all eight pairs! As ever, the prize for the winner (drawn from the wig tin if we have more than one correct entry) is a magnum of champagne and a much-coveted South Square umbrella.

## ENTRY DETAILS

Please send your answers by e-mail to kirstendent@southsquare.com or by post to Kirsten at the address on the back cover. Entries to be in by 10 December please. Best of luck!

01

Credit: Ghostbusters ECTO-1 by Flickr user relux.

02

Credit: Derby Magistrates Court, Saint Marys Gate, Derby by Eamon Curry

04

03

05

Credit: The artist Michael Jackson performing his song "Jam" as part of his Dangerous world tour in Europe in 1992 by Wikipedia user Casta03

06

07


08

Credit: The Ghost of Clytemnestra Awakening the Furies, John Downman

## MARCH CHALLENGE

The answers to the March 2018 challenge were:

1. I – George Savile, 1st Marquess of Halifax
2. K – Jeremy Bentham
3. A – Dr Allan Woodcourt in Bleak House (played by Richard Harrington)
4. J – William Pitt (although the quote was originally attributed to John Locke)
5. F – Louis XIV
6. B – Sir William Blackstone
7. G – Cicero
8. E – Theodore Roosevelt
9. C – Franz Kafka
10. D – Aristotle
11. H – Oscar Wilde

The winner, drawn this time from a bulging wig tin, is Leah Alpren-Waterman of Watson Farley & Williams LLP, to whom we send our congratulations, a magnum of champagne and a South Square umbrella.

# Diary dates

South Square members will be attending, speaking and/or chairing the following events

## 2018

25 October 2018
**Chambers Bar Awards**
Hilton Park Lane, London

7 November 2018
**INSOL International Hong Kong One Day Seminar**
Four Seasons, Hong Kong

19 November 2018
**RISA Conference 2018 in association with South Square**
Ritz Carlton, Grand Cayman

## 2019

30 March 2019
**ILA 2019 Academic Forum and Conference**
London

2-4 April 2019
**INSOL Singapore**
Sands Expo and Convention Centre, Singapore

South Square also runs a programme of in-house talks and seminars – both in Chambers and on-site at our client premises – covering important recent decisions in our specialist areas of practice, as well as topics specifically requested by clients.

For more information contact events@southsquare.com, or visit our website www.southsquare.com

SOUTH SQUARE | *Commercial barristers*

‘The set is highly regarded internationally, with barristers regularly appearing in courts around the world.’

CHAMBERS UK

*Company/Insolvency set of the year, winner 2017*
CHAMBERS BAR AWARDS

*Insolvency set of the year, shortlisted 2017*
LEGAL 500 BAR AWARDS

## Practice areas

- Insolvency & Restructuring
- Banking & Finance Litigation
- Offshore
- Commercial Litigation & Arbitration
- Company Law
- Civil Fraud
- Sport
- Insurance
- Trusts & Property

**Mediation**
Members of Chambers have frequent experience of mediation and other forms of alternative dispute resolution, and a number have been trained as mediators and accept appointments.

## Sectors

- Financial Services
- Banking
- Energy
- Government/ Regulation
- Insurance
- Manufacturing
- Professional Services
- Retail
- Shipping
- Sport
- Aviation
- Technology & Communication

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SOUTH SQUARE

"South Square has endless expertise and there is pretty much nothing the barristers there haven't been involved in." **CHAMBERS AND PARTNERS**

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Christopher Brougham QC
Gabriel Moss QC
Richard Hacker QC
Mark Phillips QC
Robin Dicker QC
William Trower QC
Martin Pascoe QC
Fidelis Oditah QC
David Alexander QC
Glen Davis QC
Barry Isaacs QC
Felicity Toube QC
Mark Arnold QC
Jeremy Goldring QC

David Allison QC
Tom Smith QC
Daniel Bayfield QC
John Briggs
Adam Goodison
Hilary Stonefrost
Lloyd Tamlyn
Richard Fisher
Stephen Robins
Marcus Haywood
Hannah Thornley
William Willson
Georgina Peters
Adam Al-Attar
Henry Phillips

Charlotte Cooke
Alexander Riddiford
Matthew Abraham
Toby Brown
Robert Amey
Andrew Shaw
Ryan Perkins
Riz Mokal
Madeleine Jones
Edoardo Lupi
Rose Lagram-Taylor
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