SOUTH SQUARE

Digest

FamilyMart v Ting Chuan:

The Privy Council determines that matters underlying a just and equitable winding up petition are arbitrable

A team from Ogier Cayman Islands and Hong Kong, together with South Square's Hilary Stonefrost, review the recent Privy Council decision

A New Era of Corporate Insolvency in Jersey: A team from Fried Frank, Appleby Jersey and South Square consider the important decision of the Jersey Court of Appeal in *Re Redox PLC S.A*

Case Note - Primeo Fund v Bank of Bermuda: Toby Brown summarises this long-anticipated Privy Council judgment

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In this issue

***FamilyMart v Ting Chuan*:**
A team from Ogier Cayman Islands and Hong Kong, together with South Square's Hilary Stonefrost, review the recent Privy Council decision

***Brake v Chedington*:**
New member of Chambers, Jon Colclough, asks 'When does a bankrupt have standing to complain?' in the light of the Supreme Court's recent decision.

A New Era of Corporate Insolvency in Jersey:
A team from Fried Frank, Appleby Jersey and South Square consider the important decision of the Jersey Court of Appeal in *Re Redox PLC S.A*

Articles

Regulars

Case Digests

SOUTH SQUARE

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From the Editors

Marcus Haywood and William Willson

Welcome to our final edition of the South Square Digest for 2023.

As we go to press we are delighted to announce that South Square was named Insolvency and Restructuring Chambers of the Year at the annual Turnaround, Restructuring and Insolvency Awards. We thank all our clients and friends for their continued support which is much appreciated by Members and staff alike.

South Square is also delighted to have welcomed four new members of Chambers since our previous edition: Jon Colclough, Oliver Hyams, Philip Judd and Imogen Beltrami. Jon, Oliver and Philip are well known and experienced practitioners in Chambers' core areas of practice. Imogen has recently successfully completed her pupillage. Biographies of each feature in this edition.

This edition of the Digest comes shortly after the Chancellor's Autumn Statement. UK economic growth has been weak since early 2022. High inflation and rising interest rates have constricted household budgets and consumer and business spending. The OBR forecasts that the economy will grow more slowly than it had forecast previously in March 2023. Inflation is now forecast to be more persistent and domestically driven. Against that backdrop, the number of company insolvencies in October 2023 was 18% higher than in the same month in the previous year (1,954 in October 2022).

The Chancellor, Jeremy Hunt sought to blunt the impact of the highest levels of taxation since the second world war with, amongst other things, a cut in employees' national insurance contributions, fuelling speculation about a snap spring general election.

So, as we approach the end of the year, like Father Christmas on 24 December this edition of the Digest takes us around the globe as we present (pun intended) you with a range of topical articles.

First, a team from Ogier Cayman Islands and Hong Kong, together with our own Hilary Stonefrost, review the recent Privy Council decision in *FamilyMart v Ting Chuan*, which determined that matters underlying a just and equitable winding up petition are arbitrable.

We then travel back to the UK where new Member of Chambers, Jon Colclough, asks '*When does a bankrupt have standing to complain?*' following the decision of the Supreme Court in *Brake v Chedington* (in which Jon appeared).

A hop across the channel to Jersey, and a team from Fried, Frank, Harris, Shriver & Jacobson (London), Appleby

(Jersey) and South Square consider the decision of the Jersey Court of Appeal in *Re Redox PLC S.A.* in relation to Jersey's new creditor winding up procedure.

Continuing our global tour Associate Member, the Hon. Paul Heath KC reviews the New Zealand Supreme Court decision in *Yan v Mainzeal* to give us the NZ perspective on director responsibility.

As well as our usual case digests (headed up in this edition by Daniel Bayfield KC) we have two important case notes: Toby Brown summarises one of the most anticipated recent judgments – the Privy Council judgment in the long-running *Primeo Fund* litigation, which raises a number of issues of importance for litigators. Peter Burgess presents us with a two-for-one offer in his review of *Cithara v Haiman*, in which the decision of the Grand Court of the Cayman Islands in *Shinsun* was considered.

A very welcome return to Associate Member Professor Christoph G. Paulus with his erudite and amusing insights on insolvency-related happenings at the CJEU. And for those unable to attend our annual Litigation Forum, held in conjunction with Mourant, Chambers' current pupils Angus Groom and Charlotte Ward provide a summary of the sessions.

Finally, in News in Brief we celebrate Mark Phillips KC being named the Legal 500 Chancery Silk of the Year, along with other vaguely law-related news and, of course, our South Square Challenge.

Many thanks to all our authors for their contributions. As always, views expressed by individuals and contributors are theirs alone.

If you find yourself reading someone else's copy, or indeed have come across the Digest for the first time and wish to be added to the circulation list, please send an e-mail to kirstendent@southsquare.com and we will do our best to make sure you get the next and future editions.

We wish all our readers a Happy Christmas and a peaceful New Year.

Marcus Haywood and William Willson

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FamilyMart v Ting Chuan

The Privy Council determines that matters underlying a just and equitable winding up petition are arbitrable

Introduction

In the recent decision of *FamilyMart China Holding Co v Ting Chuan (Cayman Islands) Holding Corporation* [2023] UKPC 33 (**FamilyMart**),[1] the Judicial Committee of the Privy Council (the **Board**) found that, although an arbitral tribunal does not have the power to determine whether it is just and equitable to wind up a company nor to make a winding up order, it may determine matters underlying a winding up petition. The Board heard this case and two other cases[2] in the week of 15 to 18 November 2022 in the historic first ever sitting of the Board to occur in the Cayman Islands.

The Board's decision in *FamilyMart* is a landmark decision on the issue of arbitrability and provides useful guidance for shareholders, directors and other stakeholders of Cayman companies on the interaction between arbitration clauses and the just and equitable jurisdiction.

Facts

China CVS (Cayman Islands) Holding Corp (the **Company**) is a Cayman Islands holding company which operates a convenience store business in the People's Republic of China under the "FamilyMart" brand. The Company is a joint venture between the majority shareholder, Ting Chuan (Cayman Islands) Holding Corporation (**Ting Chuan**) and the minority shareholder, FamilyMart China Holding Co. Ltd (**FMCH**). The relationship between the two shareholders is governed by a shareholders agreement which contains an arbitration clause.

The Petitioner presented a petition to wind up the Company on the just and equitable ground (the **Petition**) and sought alternative relief in the form of buyout orders pursuant to section 95(3) of the Companies Act. The Petition is, in part, based on allegations that the majority directors, nominated by Ting Chuan, had caused the Company to engage

1. Ogier (Cayman) LLP together with Tom Lowe KC of Wilberforce Chambers and Hilary Stonefrost of South Square Chambers, acted on behalf of the Respondents. This article first appeared on Ogier's website at https://www.ogier.com/news-and-insights/insight/the-privy-council-makes-landmark-decision-on-the-arbitrability-of-winding-up-petitions/.

2. The other two cases were a property dispute and a claim relating to the Bill of Rights of the Cayman Islands: *HEB Enterprises Ltd v Richards* [2023] UKPC 7; *Ramoon v Governor of the Cayman Islands* [2023] UKPC 9.

in extensive related party dealings which were not disclosed to the minority directors appointed by FMCH or to FMCH itself in its capacity as minority shareholder. FMCH alleged this, among other things, had given rise to a loss of trust and confidence which justified a finding that it would be just and equitable to wind up the Company.

At first instance, Kawaley J ordered that the Petition be stayed pursuant to section 4 of the Foreign Arbitral Awards Enforcement Act (1997 Revision) (the **FAAEA**) until the complaints therein had been arbitrated. On appeal, the Cayman Islands Court of Appeal (**CICA**) found that no part of the Petition was arbitrable and overturned Kawaley J's decision. Ting Chuan was granted leave to appeal to the Board.

Before the Board, Ting Chuan contended that the questions in issue in the proceedings were divisible into five separate "matters" as follows:

(1) *Whether FMCH has lost trust and confidence in Ting Chuan and in the conduct and management of the Company's affairs.*

(2) *Whether the fundamental relationship between FMCH and Ting Chuan has irretrievably broken down.*

(3) *Whether it is just and equitable that the Company should be wound up.*

(4) *Whether FMCH should be granted the alternative relief, which it prefers, under section 95(3)(d) of the Companies Act, namely an order requiring Ting Chuan to sell its shares in the Company to FMCH, and, if so, what is the value of those shares.*

(5) *Whether, if such alternative relief is not appropriate, an order winding up the Company should be made and whether the persons identified by FMCH should be appointed as joint official liquidators.*

While both parties agreed that matter (5) was not arbitrable as only the Court could make a winding up order, Ting Chuan contended that matters (1) to (4) were arbitrable or, in the alternative, only mattes (1) and (2) were arbitrable. FMCH's position was that none of the matters were arbitrable.

Section 4 of the FAAEA

In forming its decision, the Board focused on the proper construction of section 4 of the FAAEA, including by reference to similar provisions throughout the common law world. Section 4 provides:

"*If any party to an arbitration agreement, or any person claiming through or under him, commences any legal proceedings in any court against any other party to the agreement, or any person claiming through or under him, in respect of any matter agreed to be referred, any party to the proceedings may at any time after appearance, and before delivering any pleadings or taking any other steps in the proceedings, apply to the court to stay the proceedings; and the court, unless satisfied that the arbitration agreement is null and void, inoperative or incapable of being performed or that there is not in fact any dispute between the parties with regard to the matter agreed to be referred, shall make an order staying the proceedings.*" (emphasis added)

The two key legal issues before the Board which arise from section 4 of the FAAEA were:

1. What is a matter agreed to be referred?
2. When is an arbitration agreement inoperative?

What is a "matter"?

A number of recent authorities from common law jurisdictions have construed "matter" in a broad and expansive manner.[3] The decision in *FamilyMart* was handed down on the same day as and determined in parallel with the UK Supreme Court decision in *Republic of Mozambique (acting through its Attorney General) v Privinvest Shipbuilding SAL* [2023] UKSC 32 (***Mozambique***) which also considered the meaning of the term "matter". Although both *FamilyMart* and *Mozambique* represent a retreat from some of the most expansive language of the recent cases, they nevertheless give a broad definition to the term "matter" as follows:

"*a substantial issue that is legally relevant to a claim or a defence, or foreseeable defence, in the legal proceedings, and is susceptible to be determined by an arbitrator as a discrete dispute. If the "matter" is not an essential element of the claim or of a relevant defence, it is not a matter in respect of which the legal proceedings are brought……a "matter" requiring a stay does not extend to an issue that is peripheral or tangential to the subject matter of the legal proceedings……a "matter" is something more than a mere issue or question that might fall for decision in the court proceedings or in the arbitral proceedings.*"[4] (emphasis added)

The Board further held that:

1. The definition of a "matter" does not cover "*all issues which may be the subject of the arbitration agreement*" and the matters must be of "*reasonable substance*".[5]

2. No judicial formula encapsulating the meaning of "matter" should be treated as if it were a statutory test and the Court should approach the question in a practical and common-sense way.[6]

3. The complexity and practical futility of a stay is not an irrelevant consideration, but such fragmentation could be resolved by effective case management and was not necessarily a basis on which to conclude that a "matter" was not arbitrable.[7]

Arbitrability

The Board then considered the meaning of the phrase "*the arbitration agreement is….inoperative*" in section 4 of the FAAEA, which relates to the question of arbitrability. The Board referred to two types of non-arbitrability: (i) *subject matter non-arbitrability*: where certain disputes are excluded by statute or public policy from determination by arbitration; and (ii) *remedial non-arbitrability*: where the award of certain remedies is beyond the jurisdiction which the parties can confer.[8]

As to remedial non-arbitrability, which was relevant to the appeal, the Board pointed out that there was strong authority for the proposition that the power to wind up a company lies within the exclusive jurisdiction of the Court.[9] However, the Board noted that:

1. there was general consensus from the cases that an arbitral tribunal has the power to grant *inter partes* remedies such as buy out orders, notwithstanding the fact that the power to make such orders are provided by statute;[10] and

2. there was "*substantial agreement amongst common law jurisdictions*" that in an application to wind up a company on just and equitable grounds there may be matters in dispute between the parties, such as breaches of a shareholders' agreement, which can be referred to an arbitral tribunal for determination, notwithstanding that only a court can make a winding up order.[11] The Board concluded that:

"*Matters, such as whether one party has breached its obligations under a shareholders' agreement or whether equitable rights arising out of the relationship between the parties have been flouted, are arbitrable in the context of an application to wind up a company on the just and equitable ground and the arbitration agreement is not inoperative because the arbitral tribunal cannot make a winding up order.*"[12] (emphasis added)

Were matters (3) and (4) arbitrable?

On the question of whether the arbitral tribunal could make a finding as to whether it was just and equitable that the Company be wound up and the appropriate form of remedy, the Board agreed with the interpretation of the Companies Act provided by Moses JA in the judgment of the CICA, and said:

3. This included the Singapore Court of Appeal Decision of *Tomolugen Holdings Ltd v Silica Investors Ltd* [2015] SGCA 57 (*Tomolugen*), and the English decisions of Popplewall J in *Sodzawiczny v Ruhan* [2018] EWHC 1908 (Comm) (*Sodzawiczny*) and the English Court of Appeal in *Republic of Mozambique (acting through its Attorney General) v Credit Suisse International* [2021] EWCA Civ 329.

4. *FamilyMart* at [61] citing Tomolugen at [113]; *WDR Delaware Corporation v Hydrox Holdings Pty Ltd* [2016] FCA 1164 at [110]; *Mozambique* at [75].

5. *FamilyMart* at [63] citing Tomolugen at [113] and disagreeing with *Sodzawiczny* at [63].

6. *FamilyMart* at [64].

7. *FamilyMart* at [66].

8. *FamilyMart* at [69].

9. *FamilyMart* at [75].

10. *FamilyMart* at [76] citing *Fulham* at [77]-[78], [96] and [99]; *Tomolugen* at [88]-[89] and [103] and *WDR Delaware* at [147].

11. *FamilyMart* at [77] citing *Fulham* at [76]; *Quiksilver Greater China Ltd v Quiksilver Glorious Sun JV Ltd* [2014] 4 HKLRD 759 at [14]; *Tomolugen* at [96]-[103]; *WDR Delaware* at [161]-[164].

12. *FamilyMart* at [78].

13. *FamilyMart* at [80].

14. *FamilyMart* at [81] citing *Lau v Chu* [2020] UKPC 24 at [43].

15. [2011] EWCA Civ 855.

16. *FamilyMart* at [81] citing *Fulham* at [83]; *Tomolugen* at [100].

17. See *Fulham* at [46]; *In re Neath Rugby Ltd* [2009] EWCA Civ 291, [2010] BCC 597 at [84]; *In re Asia Television Ltd* [2015] 1 HKLRD 607 at [55]-[58].

18. *FamilyMart* at [89].

19. *FamilyMart* at [90].

20. *FamilyMart* at [92].

21. In relation to an arbitration between FMCH and Ting Chuan, such a finding would be binding under Article 35(6) the ICC Rules of Arbitration: *FamilyMart* at [93].

22. *FamilyMart* at [96].

23. *FamilyMart* at [97].

1. The Court's consideration under section 92 of the Companies Act as to whether it is just and equitable that a company should be wound up is a threshold question which must be answered before a petitioner can gain access to any of the remedies available under section 95;[13]

2. When considering whether to make a winding up order, the Court must make a wide ranging enquiry into and evaluation of the facts and the relevant circumstances which exist at the date of the hearing;[14]

3. An arbitrator's decision that a winding up order should be made based on circumstances which existed at an earlier date could not determine the issue which the Court has to consider, and the obiter suggestion by Patten LJ in *Fulham Football Club (1987) Ltd v Richards*[15] that an arbitrator could make a ruling on whether it would be appropriate for a complainant to initiate winding up proceedings or be limited to some other remedy was incorrect;[16]

4. A ruling by a tribunal that it was of the view that it is just and equitable that a company be wound up would be ineffective and it could not bind the parties in a hearing before the Court and, given the interests of third parties in a possible winding up of the company which must be taken into account under section 95 of the Companies Act,[17] it could also not bind the court.

Accordingly, the Board agreed with FMCH's position that matters (3) and (4) were not arbitrable and that a tribunal does not have the power to decide whether it is just and equitable that the company should be wound up or the alternative remedy to be granted.

Were matters (1) and (2) arbitrable?

As to whether the factual matters underlying the petition were arbitrable (the loss of trust and confidence and relationship breakdown) the Board found:

1. Although a fragmented process (involving both an arbitration and court proceedings) may frustrate the expectations of reasonable businesspeople, this was a policy question which may be relevant to consider when considering the interpretation of the arbitration agreement.[18] However, it was not a relevant factor in the arbitrability of matters (1) and (2) and the Board was not satisfied that the risk of delay excluded those matters from arbitration, particularly in light of the parties' contractual obligations.[19]

2. There was nothing stopping the parties from presenting the Court with a statement of agreed facts following arbitration and such a statement could include, in principle, an agreement on matters (1) and (2).[20] Since the Court would be bound by any such statement, there is no reason why it would not be bound that way in respect of a question determined by an arbitral tribunal.[21]

3. The fact that all that the arbitral tribunal would be able to render at the close of an arbitration on matters (1) and (2) was a declaration did not change the fact that they were arbitrable.[22]

The Board thus concluded that findings as to loss of trust and confidence and irretrievable breakdown of a corporate relationship are "matters" under section 4 of the FAAEA for which a stay of the winding up proceedings was mandated.[23]

Conclusion

Ultimately, the appeal was allowed as, although the Board agreed with FMCH that the question of winding up and remedy were not arbitrable, it agreed with Ting Chuan that the existence of a loss of trust and confidence and irretrievable breakdown were arbitrable, giving rise to a mandatory arbitration stay under section 4 of the FAAEA.

FamilyMart is a groundbreaking decision on the interplay between arbitration and the winding up jurisdiction of common law courts. Although the Board confirmed that an arbitral tribunal has no jurisdiction to make a winding up order nor any jurisdiction to decide whether it is just and equitable to wind up a company, it found that certain matters which underlie a winding up petition (i.e. allegations of wrongdoing) are arbitrable. Therefore, in cases where there is an arbitration agreement, those underlying allegations may need to be resolved and determined through arbitration before the Grand Court will consider whether it is just and equitable to wind up the company.

It will be interesting to see how the Court will case manage winding up petitions stayed due to an arbitration clause, however, the bifurcated approach adopted by the Board may lead to procedural difficulties. For instance, there may be cases where, between the date of the arbitral award and the date of the hearing before the Court, there are allegations of further oppressive conduct

which could constitute grounds for winding up. Given the need for a Court to form an opinion as to whether it is just and equitable to wind up a company as at the date of the hearing,[24] this could result in the Court being compelled to order that the parties return to arbitration to determine whether such conduct occurred and, if so, whether it supports a finding that trust and confidence has broken down. In cases where oppressive conduct is ongoing, such an approach could lead to an unmanageable, potentially never-ending merry-go-round of arbitration and Court hearings. While this argument was raised before the Board, it was ultimately not addressed in the judgment.

In the meantime, given the prevalence of just and equitable winding up petitions in the Cayman Islands (and the absence of a statutory remedy for unfair prejudice or oppression), shareholders of Cayman companies should carefully review their shareholders' agreements before presenting a winding up petition. If those agreements contain arbitration clauses, although the clause will not, of itself, prevent them from presenting a winding up petition, they might be obliged to have the underlying disputes of fact resolved via arbitration before seeking relief from the Grand Court. ■

24. *Lau v Chu* [2020] 1 WLR 4656 at [43] per Lord Briggs JSC.

JON COLCLOUGH
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Brake & Anor v The Chedington Court Estate Ltd [2023] UKSC 29

Introduction

Section 303(1) of the Insolvency Act 1986 ("**IA 1986**") provides that:

"*If a bankrupt or any of his creditors or any other person is dissatisfied by any act, omission or decision of a trustee of the bankrupt's estate, he may apply to the court; and on such an application the court may confirm, reverse or modify any act or decision of the trustee, may give him directions or may make such other order as it thinks fit.*"

On a literal reading of section 303, the only limit on a bankrupt's ability to apply to court is that he or she must be "*dissatisfied by any act, omission or decision of a trustee*".

However, the courts have held since, probably, 1880 (*Re Sidebotham* (1880) 14 Ch. D. 458) and certainly since 1949 (*Debtor v Dodwell* [1949] Ch 236) that section 303 (or its predecessors) is not to be read literally. The right of a bankrupt to apply to court is not untrammelled.

The question for the Supreme Court, on the rather involved facts of *Brake v Chedington*, was: when does a bankrupt have standing to complain?

Factual Background

It is unfortunately necessary to set out the factual background in some detail to understand the issues that were before the Supreme Court. The bankrupts were a married couple.

As well as being bankrupt, they were partners in an insolvent partnership that was itself in liquidation. They lived in a large house in rural Dorset ("**the House**"). The House was partnership property but had been sold by receivers appointed by the mortgagee. A company owned by a friend of the bankrupts purchased the House and allowed them to continue living there.

Next to the House was a much smaller cottage ("**the Cottage**"). It was partnership property but was outside the scope of the mortgagee's security. It therefore vested in the partnership liquidators subject to the bankrupts' claim that it beneficially belonged to them by way of proprietary estoppel.

The position on the ground was that the House was used by the bankrupts except when it was let to paying guests, usually for weddings. During those periods of time, the bankrupts moved into the Cottage.

A businessman wished to purchase the House. A company he controlled ("**the Appellant**") purchased the shares in the company which owned the House. The Appellant employed the bankrupts in the business and they continued to live as before – between the House and the Cottage.

In late 2018, there was a considerable fallout between the bankrupts and the Appellant. The fallout led to litigation on a grand scale. The Court of Appeal recently (in a case involving a dispute between the Appellant and the bankrupts' trustees – see [2023] EWCA Civ 901) suggested there have been 42 reported decisions arising out of the dispute.

Following the fallout, the Appellant wished to buy the Cottage. A deal could not be reached with the partnership liquidators. However, a deal was reached with the bankrupts' then trustee ("TIB"). The TIB agreed to buy the Cottage from the liquidators, apply to court to obtain clean legal title and then sell it to the Appellant. In the meantime, the TIB was to grant the Appellant a licence of the Cottage. The TIB was paid a "facilitation" fee of which one third was paid into the bankruptcy estate and two thirds was paid to the TIB or his firm.

The TIB bought the Cottage and entered into the licence with the Appellant. The Appellant then evicted the bankrupts without a court order. In separate proceedings, the bankrupts successfully sued the Appellant for unlawful eviction – see [2022] EWCA Civ 1302.

The bankrupts also applied to court under section 303 IA 1986. Their basic complaint was that they claimed: (i) the TIB hired out his statutory powers to the Appellant, a stranger to the bankruptcy; (ii) the TIB used his powers as trustee for the improper purpose of assisting the Appellant in its private dispute with the bankrupts; and (iii) the TIB entered into a series of agreements which purported to give the Appellant the power to evict the bankrupts from the Cottage, which caused a substantial interference with their possessory rights.

HHJ Matthews struck out the bankrupts' application on the basis that there was no prospect of a surplus in the bankruptcies (as was common ground). His decision was overturned by the Court of Appeal who held that the bankrupts had a legitimate interest in the relief sought because "*their interests were substantially affected by the grant of the Licence, the consequences which flowed from it and [the TIB's] alleged unlawful acts*".

The Appellant appealed to the Supreme Court.

The Supreme Court's Decision

Lord Richards gave the only judgment, with whom Lord Briggs, Lord Hamblen, Lord Leggatt and Lady Rose agreed. Lord Richards set out at [9] three central principles that are in play where applications are made against an officeholder, whether under section 303 or section 168(5) (the similar provision applying in liquidations).

(C.1) The first principle: genuine economic interest

First, the starting point is that "*subject to very limited exceptions, a bankrupt must show that there is or is likely to be a surplus of assets once all liabilities to creditors, and the costs and expenses of the bankruptcy, have been paid*": at [9].

This first principle is a reassertion of the orthodox view of standing to complain about the actions of an officeholder.

As Lord Richards explained at [13]:

"*The processes of bankruptcy and insolvent liquidation are primarily for the benefit of creditors. They necessarily have an interest in the proper administration by the trustee or liquidator of that process. Equally, though, their standing to challenge the trustee or liquidator is limited to matters which affect their interests as creditors under the statutory trust, and not in some other capacity.*"

In other words, the insolvency process is primarily for the benefit of those with an economic interest in the outcome. Bankrupts and shareholders in insolvent companies are, to use a popular phrase, "out of the money". Any value in the insolvent estate breaks in the creditor class.

That is why, as Lord Richards emphasised, bankrupts and shareholders of insolvent companies have very limited rights in an insolvency process. In the bankruptcy context, as Hoffmann LJ explained in Heath v Tang [1993] 1 WLR 1421, "*the principle that the bankrupt is divested of an interest in his property and liability for his debts remains fundamental*".

(C.2) The second principle: applying in the right capacity

Second, the Supreme Court explained that a person applying to impugn the acts of an officeholder (whether a bankrupt, creditor, shareholder or someone else) must be applying in respect of a matter which affects them in their relevant capacity.

A good example of this principle is the recent Court of Appeal decision in *Lock v Stanley* [2022] EWCA Civ 626. A former director and creditor was being sued by the assignee of the liquidators' claims. She complained about the fact that the claim had not been offered to her prior to the assignment. The court held that she did not have standing – she was not claiming to advance her interests in her capacity as a creditor but, in reality, was in fact seeking to advance her personal interests as defendant, or putative defendant, to the claims being brought by the assignee.

(C.3) The third principle: the limited exceptions

Third, notwithstanding the first principle, there are very limited circumstances in which a bankrupt, or some other person with no direct economic interest in the insolvency process, can apply. However, the subject matter of the application must relate to a "*matter which could only arise in a bankruptcy or liquidation and in which the applicant has a direct and legitimate interest*" (at [9]). Those limited circumstances include:

- Where a bankrupt is applying to annul the bankruptcy on the basis of a payment in full from third party funds; and the bankrupt wishes to challenge the trustee's remuneration and expenses as part of that process: *Engel v Peri* [2002] EWHC 799 (Ch).
- Where a third party (such as the spouse of a bankrupt) applies to annul the bankruptcy and wishes to challenge the trustee's remuneration: *Woodbridge v Smith* [2004] BPIR 247.
- Where a third party's rights are affected by a process or procedure that is "*uniquely available*" in an insolvency process. An example of this is the exercise by a liquidator of his or her power of disclaimer under section 178 of the IA 1986: see e.g. *In re Hans Place Ltd* [1992] BCC 737, [1993] BCLC 768.

(C.4) Applying those principles in this case

Applying those principles, the Supreme Court held that the bankrupts did not have standing under section 303 IA 1986:

- Their complaint was about their possessory rights in relation to the Cottage, which they alleged were wrongfully interfered with by the TIB acting in that capacity.
- However, those possessory rights did not arise "*in their capacity as bankrupts*" (at [80]). Those rights were entirely independent of the bankruptcy and unconnected to their position as bankrupts.
- The bankrupts were, in substance, complaining about things done to them as people who had possession of the Cottage – not as things done to them as bankrupts. It could have been someone entirely unconnected to the bankruptcy who had possession of the Cottage. That person would not be entitled to complain under section 303 and the bankrupts should be in no better position merely because they were bankrupts.
- The bankrupts were complaining about alleged breaches of duty by the TIB in circumstances where no duty was owed to them by the TIB. As Lord Richards said at [87]:

> "*It is contrary to principle for a person to whom a duty is not owed to be able to seek relief in respect of a breach of that duty. If a trustee of a settlement or other trust, or a director of a company, takes steps in breach of fiduciary duty which interfere with the rights of a third party, the third party will have such rights (if any) in tort or otherwise against the trustee or director as the law provides, but the third party will not have any standing to seek relief for breach of fiduciary duty, as that duty is owed to the beneficiaries of the trust or (as the case may be) to the company. There is no reason to suppose that there was any legislative intention to enable such relief to be sought by third parties uniquely against trustees in bankruptcy under section 303(1) or against liquidators under section 168(5) of the IA 1986.*"

- The bankrupts did not have standing and their section 303 application was dismissed. ■

Diary Dates

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

5 December 2023

INSOL Kuala Lumpur Seminar

St Regis, Kuala Lumpur

21 – 23 February 2024

Thought Leaders 4 FIRE Starters Global Summit

Conrad Hotel, Dublin, Ireland

29 February 2024

R3 Fraud Conference

Royal College of Physicians, St Andrews Place, London

12 March 2024

INSOL Cartagena Seminar

Santa Clara Hotel, Cartagena, Colombia

1 – 3 May 2024

R3 Annual Conference

Fairmont Hotel, St Andrews

10 – 11 June 2024

III 24th Annual Conference

Singapore

Also coming in 2024 is the Thought Leaders for FIRE/South Square Fraud conference.
Details to follow.

South Square also runs a programme of in-house talks and seminars – both in Chambers and on-site at our clients 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*

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A New Era of Corporate Insolvency: the Jersey creditors' winding up

James Barratt and Ashley Katz of Fried, Frank, Harris, Shriver & Jacobson (London) LLP, Jared Dann and Lara von Wildenrath of Appleby (Jersey) LLP, and Marcus Haywood and Annabelle Wang of South Square consider the important decision of the Jersey Court of Appeal in *Re Redox PLC S.A.* in relation to Jersey's new creditor winding up procedure.

Introduction

In *Re Redox PLC SA*,[1] the Jersey Court of Appeal has considered the new creditor-led winding up procedure introduced in Jersey under the Companies (Amendment No 8) (Jersey) Regulations 2022 (the "**Regulations**") for the first time, in a significant decision which is likely to have important ramifications for Jersey insolvency law and practice.

Prior to the introduction of the creditors' winding up by the Regulations, the only corporate insolvency process available to creditors (as opposed to the company or its members) under Jersey law was the *désastre*, which vested the assets of the company in the Viscount (the executive officer of the Court).

As the President explained in his judgment in *Redox*:[2]

"What that law did not contain was any procedure equivalent to a creditors' compulsory winding up petition and order in the UK. Instead, the functionally equivalent process was one of Jersey's indigenous insolvency procedures, namely désastre, now regulated under the Bankruptcy (Désastre) (Jersey) Law 1990 (the "1990 Law"). If the court made the appropriate declaration, this placed the administration of the company's assets and liabilities in the hands of the

1. *HWA 555 Owners, LLC v Redox Plc SA (formerly Regus PLC)* [2023] JCA085 (13 June 2023) (Sir William Balihache, President, James Wolfe KC and Paul Matthews).

2. At [24].

Viscount, the executive officer of the Royal Court, but there was no separate liquidator. This procedure did not provide for insolvency to be established by failure to pay a statutory demand, the application was made ex parte rather than inter partes, and the court appeared to enjoy a wide discretion as to whether or not to make the order sought."

In March 2022, the legislature introduced a new procedure under the Companies (Jersey) Law 1991, whereby the Jersey Court may make a winding-up order on the application of a creditor.

The new procedure provides that a creditor can make an application to the court for an order to commence a creditors' winding up if the creditor has a claim against the company "*for not less than the prescribed minimum liquidated sum*" and the company is unable to pay its debts, the creditor has evidence of the company's insolvency, or the creditor has the consent of the company (Article 157A). Upon consideration of a creditor's application, the Court may make an order that a creditors' winding up must commence, or otherwise dismiss the application (Article 157C).

The application before the Court

The application for an order commencing a creditors' winding up was made by HWA 555 Owners LLC ("**HWA 555**"), a special purpose vehicle which is the landlord of a substantial office building in San Francisco. The debtor is a company formerly known as Regus PLC ("**Regus**"), part of the IWG Group of companies, which was both incorporated in Jersey and registered as a *Société Anonyme* in Luxembourg.

Regus acted as a guarantor entity in respect of the rental obligations of IWG Group tenant companies to landlords, including in respect of a lease granted by the Appellant.

Regus was placed into an insolvency procedure in Luxembourg in 2020, following a letter of request issued by the Royal Court upon Regus's request. The Luxembourg insolvency procedure involved the appointment of a Luxembourg trustee in bankruptcy (*curateur*) to oversee the proceedings, under the supervision of the Luxembourg court.

In March 2022, HWA 555 applied to wind up Regus in Jersey on the basis of a costs order made against Regus in litigation between the parties in California concerning termination of the lease. However, HWA 555 also had a substantial but as yet unliquidated contingent claim which it contended was for over $90million against Regus at the time the application was made.

The application for the winding of Regus was made by HWA 555 in the context of concerns, amongst other things, about a distribution made by Regus in January 2019 and the Luxembourg trustee's ability to take appropriate action under Luxembourg law in relation to the distribution. The Luxembourg trustee resisted the application for the winding up of Regus at first instance and on appeal.

The decision of the Royal Court

At first instance, the Royal Court held that HWA 555 was a creditor of the company in a liquidated sum exceeding the prescribed amount on the basis of the costs order made by the California court. The Royal Court also accepted that the place of a company's incorporation was *prima facie* the incorporation in which it ought to be wound up. However, it declined to exercise its discretion to make a winding up order, primarily due to its concerns about the potential impact on the ongoing insolvency proceedings in Luxembourg.

The Appeal

HWA 555 appealed against the Royal Court's refusal to make a winding up order. Regus cross-appealed against the Royal Court's finding that the Californian costs order was a liquidated claim which gave HWA 555 standing to make the application.

Three issues therefore arose on appeal:

1. Whether HWA 55 had standing to make the application under Article 157A;

2. Whether the Royal Court had a discretion to exercise in deciding whether to make a winding up order; and

3. Whether the Royal Court had erred in the exercise of its discretion in declining to make a winding up order.

(a) Standing

The majority of the Court of Appeal (Bailhache and Matthews JJA; Wolffe JA dissenting) held that on the proper construction of Article 157A(1), creditors with contingent and unliquidated claims had standing to make an application for a creditors' winding up order, provided that their claim is established to be of a value exceeding the prescribed minimum.

This, the majority held, was the natural and ordinary meaning of the provision. There was also no logical reason why the legislature should be presumed to have intended that creditors with unliquidated or contingent claims would not also be entitled to apply to the court for a winding up order when such creditors would be entitled to prove in a creditors' winding up (which adopted the approach in a *désastre*). The word "liquidated" in Article 157(1) did not operate so as to qualify a creditor's claim.

In reaching this decision, the Court of Appeal cautioned against the placing of undue reliance on English case law. The legislative context in which the new provisions had been inserted into Jersey law is not the same as that obtaining in the United Kingdom – the new procedure has been grafted on to an existing procedure called 'Creditors' Winding Up' and is located within that part of the 1991 Law which deals with that existing procedure. Furthermore, the provisions for a creditors' winding up borrow heavily from the Bankruptcy (Désastre) (Jersey) Law 1990.[3]

Against the customary law and statutory background, previous Jersey case law had emphasised the need for an applicant to demonstrate that it had a valid liquidated claim against the debtor before *désastre* could be commenced.[4] However, having regard to the legislative history, the majority of the Court of Appeal considered that the legislature intended the Royal Court to have a wider discretion under a creditors winding up application under Article 157A as to who would have standing than had hitherto been the case.[5] Under the new law it is enough that the Court is satisfied to the civil standard of proof that the value of the claim, whatever it ultimately turns out to be, must exceed £3,000, or whatever sum may be prescribed in the future.

This wide interpretation of Article 157A has important consequences. It will allow a creditors' winding up to be commenced in Jersey in a wide variety of circumstances. As the Court of Appeal explained, if an applicant for such an order fears that those behind the company are taking steps to distribute company assets, or otherwise run the business in such a way that he or she is never to be paid, there is on the face of it no reason why the applicant should not have standing to make an application for the winding up of the company assuming that the other requirements can be met.[6]

(b) The existence of discretion

The Court of Appeal held that the correct approach to an application made under the new procedure was that a qualifying creditor of a company incorporated in Jersey is prima facie entitled to the benefits of a creditor's winding up in Jersey, unless there is a sufficiently good reason not to grant that remedy. Although the wording of Article 157C provides that the Court "may" grant a winding up order, it was clear from the English authorities (to which the Jersey Court of Appeal held that it was appropriate to have regard in this context) that, absent exceptional circumstances, a creditor making a compliant application is entitled to a winding-up order as a matter of right. Indeed, the Court of Appeal held, it is clear from the decision of the House of Lords in *Re HIH Insurance Ltd* [2008] 1 WLR 852[7] that a winding up in the place of incorporation is usually the principal liquidation, and a winding up in another place (for example where there are assets) is usually the ancillary winding up.

(c) The exercise of discretion

The Court of Appeal held that the "starting point" when a qualifying creditor applies for the winding up of a company incorporated in Jersey is that the order should be granted unless there is sufficiently good reason not to do so. This is even the case where there are insolvency proceedings on foot in another jurisdiction. In the present case, the Royal Court had, therefore, erred by taking as its starting point that it must act in a manner which was consistent with its decision to issue a letter of request to the Luxembourg court. The fact that the Royal Court had previously issued

3. At [44] to [46].

4. For example, *Minories Finance Limited v Arya Holdings Limited* [1994] JLR 149; *Re Baltic Partners Limited* [1996] JCA 075.

5. At [86].

6. At [89].

7. Especially at [8] (Lord Hoffmann) and [61] (Lord Scott). See at [570]-[571].

a letter of request to the Luxembourg Court inviting it to initiate insolvency proceedings was not a basis for altering the "starting point". Rather the Royal Court should have asked itself whether there was a sufficiently good reason to justify not making an order that a creditors' winding up should be commenced in Jersey, and, if there was not, it should have proceeded straight away to make that order. Since the Court of Appeal considered that the Royal Court had erred in the approach which it took to the exercise of its discretion, it was open to it to address the question itself. Upon exercising the discretion afresh, the Court of Appeal was satisfied that it ought to make an order winding up Regus in Jersey on the basis that:

1. There was nothing usual about opening parallel insolvency proceedings in another jurisdiction. The existence of the Luxembourg insolvency proceedings in this case was not, on its own, a good reason to refuse a winding up order in Jersey. This position was unchanged by the Royal Court's decision to issue a letter of request to the Luxembourg court.

2. The Luxembourg trustee did not appear to possess adequate powers to "look back" in order to investigate or set aside the 2019 distribution.

3. The bare or mere fact that other creditors did not support the winding up was not a sufficient reason to justify refusing to make a winding up order. As a matter of first principle, HWA 555 was a qualifying creditor of a Jersey incorporated company. The Court could not be satisfied that its interests as a contingent creditor of Regus would be adequately protected in the Luxembourg insolvency proceedings. The interests of other creditors in those proceedings did not constitute a sufficient reason to refuse to make a winding up order.

Conclusion

The decision is an important one for Jersey insolvency. The Court of Appeal has adopted a wide construction to the new creditors' winding up procedure, holding that it is available provided that a claim is established to be of a value exceeding the prescribed minimum.

The Court of Appeal has also affirmed its ability and willingness to open parallel insolvency proceedings in Jersey (even where proceedings are ongoing in another jurisdiction), recognising Jersey's popularity as the place of incorporation for many international companies. The Court confirmed that a winding up of a Jersey incorporated company would be the principal winding up.

The Court of Appeal acknowledged that whilst the proceedings had been settled on confidential terms prior to the handing down of the judgment, it considered that the public interest was firmly in favour of handing down and publishing its judgment in view of the important practical guidance contained therein on this new and fast developing area of law.■

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Director Responsibility: *The New Zealand Perspective*

Introduction

On 25 August 2023, the Supreme Court of New Zealand (our apex court) gave judgment on a multi-million dollar claim made by liquidators against directors of a failed construction company, Mainzeal Property and Construction Ltd (Mainzeal): *Yan v Mainzeal Property and Construction Ltd (in liq)*.[1] This was the second judgment that the Supreme Court had delivered on this topic in the last three years. While the first, *Madsen-Ries (as liquidator of Debut Homes Ltd (in liq) v Cooper*[2] *(Debut Homes)* arose out of events in the life of a "one-man" company, *Mainzeal* was concerned with a larger company with a board that included independent directors. Delivering the judgment of the Supreme Court, in *Mainzeal*, Winkelmann CJ and William Young J described the "*issues in [the] appeal [as] of fundamental importance to the business community*". The Supreme Court held that the directors of Mainzeal were liable for breaches of ss 135 and 136 of the Companies Act 1993 (the Act) and awarded compensation under s 301. I discuss those provisions and the Supreme Court's interpretation of them in this article.

The main purpose of this article is to explain the background to the proceeding, the relevant New Zealand legal landscape, the basis on which liability was established and how compensation was fixed. An article of this length necessarily calls for a degree of over-simplification, particularly in relation to the facts. I acknowledge that I may not have captured some of the nuances of the judgment adequately.

Background to the proceeding

From its incorporation in 1987 until its demise in 2013, Mainzeal was a well-known and respected operator within the New Zealand property and construction industry. On 6 February 2013, it was

1. *Yan v Mainzeal Property and Construction Ltd* (in liq) [2023] NZSC 113 (Winkelmann CJ, William Young, Glazebrook, O'Regan and Ellen France JJ).

2. [2021] 1 NZLR 43 (Winkelmann CJ, Glazebrook, O'Regan, Ellen France and Williams JJ)

put into receivership by its major secured creditor, Bank of New Zealand. Liquidation followed on 28 February 2013. The receivers were able to pay the secured and preferential creditors in full. A shortfall to unsecured creditors of about $110 million remained. The claims with which the Supreme Court were concerned were brought by the liquidators for the benefit of the unpaid unsecured creditors.

Initially, Mainzeal was listed on the New Zealand Stock Exchange. In 1995, a consortium with its main investment focus in China acquired a majority interest in its holding company. The consortium was controlled by Mr Richard Yan. His primary reason for investing was to obtain access to the market for leather goods in New Zealand, rather than the construction industry.

In 1996, the holding company was renamed, removed from the Register of Companies in New Zealand and its base was moved to Bermuda. Later, it was decided that Mainzeal should be administered, for operational purposes, by a separate board of directors in New Zealand. That board was established in April 2004. Apart from Mr Yan, its directors were New Zealand business-people, including a former Prime Minister, Dame Jenny Shipley.

The financial problems that led to Mainzeal's receivership and liquidation stemmed from events that occurred after the New Zealand board was formed. In the years ended December 2004 and 2005, Mainzeal advanced about $34 million to its holding company's subsidiaries. Most of those moneys were used to fund acquisitions in China. During the period that those advances remained unpaid, the revenue from Mainzeal's construction business was insufficient for it to meet its liabilities. Between 2005 and 2012 (with the exception of one year) significant operating losses were suffered. In effect, the company traded while balance-sheet insolvent, with its liquidity being supported by its parent company. In 2012, the year before it was put into receivership and liquidation, Mainzeal earnt $333.3 million from construction contracts yet made an operating loss of $13.2 million.

During that period, Mainzeal found a way to structure its construction contracts so as to operate with negative working capital. That was never going to last. Mainzeal's board agreed to continue the company's business in that way because they believed that a strong assurance of financial support had been given by its ultimate parent company, which would always allow it to meet obligations as they fell due. The board's belief was reflected in notes to Mainzeal's audited financial statements. In one year, the auditors noted that the "*ultimate Parent [had] undertaken to provide financial assistance to [Mainzeal], if necessary, to ensure that [Mainzeal] will meet its debts as they fall due*". It transpired that the "undertaking" fell short of legal enforceability.

In 2010, some directors raised concerns about the solvency of Mainzeal and potential director responsibility. The board received a report from EY in January 2011 which highlighted issues with Mainzeal's solvency. Ultimately, the Supreme Court found that trading from that date exposed creditors to substantial risk of serious loss, a peril to which s 135 of the Act is directed.

In November 2011, Mainzeal entered into contracts involving four major projects. By April 2012, it was clear that Mainzeal was not generating the necessary degree of income to manage its cashflow. The Supreme Court held that, from 5 July 2012, members of the board of directors breached s 136 of the Act by agreeing to Mainzeal incurring obligations at a time when they could not reasonably have believed that the company would be able to perform when the obligation fell due.

On 4 December 2012, the board received independent legal advice, following which PwC produced a report highlighting solvency concerns. That report was tendered on 18 December 2012, just before the Christmas (in New Zealand, summer) break. It was akin to directors of an English company receiving such a report in early August.

The immediate events that led to Mainzeal's collapse occurred in late December 2012 and early January 2013. Dame Jenny (as Chair of the Mainzeal board) had been in contact with Mr Yan, to seek a written commitment for the provision of additional equity capital and the supply of building materials from China. On 22 January 2013, Mr Yan declined to give that assurance unless he could secure a release of a mortgage for his wife. By a letter of 29 January 2013, Mr Yan confirmed that shareholder support for Mainzeal had ceased.

Mr Yan acknowledged that withdrawal of that support meant that Mainzeal would "*not be able to pay its debts as they fall due, will be unable to meet the solvency test under the Companies Act and is therefore no longer a going concern*".[3]

Although meaningful attempts were immediately made by others associated with the parent company to reactivate the shareholder support, the damage had already been done. Mr Yan's letter of 29 January 2013 had been shared with the company's bankers, Bank of New Zealand. By letter dated 31 January 2013, the bank advised that it was suspending any further drawings on Mainzeal's facilities. It appointed receivers on 6 February 2013.

The legislative framework

Until 1993, New Zealand company law was governed by the Companies Act 1955, which was broadly based on the Companies Act 1948 (UK). In 1989, the Law Commission[4] proposed a major reform of company law: *Company Law: Reform and Restatement*.[5] A draft new statute was attached to the Commission's report. A strong policy preference against providing for duties to be owed directly by directors to creditors of a company was expressed but the Commission recognised that some provision was required to protect creditors.[6]

Following select committee hearings, held after the Companies Bill 1990 had been introduced into the New Zealand Parliament, changes were made which resulted in the addition of an obligation on a director not to agree to the business of the company being carried on recklessly. When subsequently enacted, the Act contained ss 135 and 136 (both set out below) which captured each of those ideas in discrete legal provisions.

3. I discuss the purpose of "insolvency test" below.

4. An independent statutory law reform agency.

5. Law Commission, Company Law: Reform and Restatement (NZLC R 9, 1989).

6. Ibid, at paras 217–220.

When enacted in 1993, two significant changes were made to the way in which director's duties were to be addressed, in the context of a company of doubtful solvency. The first was to abolish the capital maintenance doctrine and replace it with a regime that required distributions to shareholders to be made only if directors could certify, on reasonable grounds, that after payment had been made the company could pass the solvency test. The second was to articulate more specifically obligations owed by directors to the company. The latter was done in a manner that supplemented existing bases for claims at common law or in equity: in other words, although some statutory causes of action (including ss 135 and 136 of the Act) were added, the statement of duties was not exhaustive.

The first of those changes was designed to protect creditors in situations where directors were considering the distribution of wealth to shareholders.[7] Sections 52–56 of the Act set out the circumstances in which the board can authorise distributions and the way in which those that do not meet the statutory requirements can be recovered from a shareholder. Directors are required to sign a certificate stating that, in their opinion, the company will, "*immediately after the distribution, satisfy the solvency tests and the grounds for that opinion*".[8] The "*solvency test*" is contained in s 4(1) of the Act and has two limbs; one dealing with liquidity (ability to pay debts as they fall due) and the other a balance sheet test.[9] Section 4(1) provides:

4 Meaning of solvency test

(1) For the purposes of this Act, a company satisfies the solvency test if—

(a) the company is able to pay its debts as they become due in the normal course of business; and

(b) the value of the company's assets is greater than the value of its liabilities, including contingent liabilities.

...

The "*solvency test*" is designed to encourage the retention of capital in the company for the benefit of creditors, in a situation where the company cannot establish both that it can pay its debts as they fall due in the normal course of business and that assets exceed the value of liabilities, including those that are merely contingent.[10]

The second was achieved by the enactment of ss 131–137 of the Act. Because they do not act as a code[11], those provisions are better viewed as a means of making such duties more accessible to those in the business community, as well as lawyers. Some of those provisions reflect existing common law and fiduciary obligations, while others arguably create new liabilities.

7. Discussed in *Re DML Resources Ltd (in liq)* [2004] 3 NZLR 490 (HC).

8. Companies Act 1993, s 52(2).

9. Ibid, s 4(1).

10. Ibid, s 4(2)(a)(ii) and (4).

11. Discussed in *Benton v Priore* [2003] 1 NZLR 564 (HC).

Section 131 deals with the orthodox obligation to act in good faith and in the best interests of the company. Section 132 deals specifically with the exercise of powers in relation to employees. Section 133 requires powers to be exercised for a proper purpose. Section 134 is designed to ensure that directors comply with the Act and the company's constitution.[12] Section 137 makes it clear that when exercising powers or performing duties as a director, he or she "*must exercise the care, diligence and skill that a reasonable director would exercise in the same circumstances*". In determining whether that duty has been met, it is necessary to have regard to the nature of the company, the nature of the decision, the position of the director and the nature of responsibilities undertaken by him or her.

As to liability, ss 135 and 136 of the Act were the focus of both *Debut Homes* and *Mainzeal*. The basis on which the Court approached quantification of compensation for breaches of those duties is contained in s 301 of the Act.

In *Mainzeal*, the Supreme Court held that the necessity to give effect to ss 135, 136 and 301 of the Act as part of a distinct legal framework developed for New Zealand meant that it was inappropriate to adopt the approach taken by courts in the United Kingdom to s 214 of the Insolvency Act 1986 (UK), and the notion of "*wrongful trading*". As a result, the Court distinguished the approaches discussed in *BT1 2014 LLC v Sequana SA*[13] *and Stanford International Bank Ltd (in liq) v HSBC Bank Plc*.[14]

Explaining the differences, Winkelmann CJ and William Young J said:[15]

[218] As to the differences between the New Zealand and United Kingdom legislation:

(a) Sections 135 and 136 contemplate liability arising in relation to events that may occur well before it becomes apparent that there is no reasonable prospect of the company avoiding liquidation. In this respect these sections differ considerably from s 214 of the Insolvency Act [UK].

(b) Sections 135 and 136 of the 1993 Act are closely derived from s 320 of the 1955 Act and thus, ultimately, the Companies Act 1929 (UK) as enacted following the Greene Report. Section 214 of the Insolvency Act is far less closely derived from the 1929 Act and its successors.

(c) Section 135 is focused on the interests of creditors and (as we come to) s 136 on the interests of particular creditors in a way that s 214 of the Insolvency Act is not.

The statutory provisions

In both *Debut Homes and Mainzeal*, ss 135, 136 and 301 of the Act were in issue.

As to liability, the directors were sued under ss 135 and 136, which provide:

12. The Companies Act 1993 replaced "*Articles of Association*" and "*Memoranda of Association*" with a "*Constitution*" which regulations the way in which the company is to be managed.

13. *BTI 2014 LLC v Sequana SA* [2022] UKSC 25.

14. *Stanford International Bank Ltd (in liq) v HSBC Bank Plc* [2022] UKSC 34.

15. *Yan v Mainzeal Property and Construction Ltd (in liq)* [2023] NZSC 113, at [218]. The Companies Act 1929 (UK) was a forerunner to the Companies Act 1948 (UK) on which the repealed Companies Act 1955 (NZ) had been based.

16. *Mainzeal Property and Construction Ltd (in liq) v Yan* [2019] NZHC 255.

17. *Yan v Mainzeal Property and Construction Ltd (in liq)* [2021] 3 NZLR 598 (CA).

18. *Yan v Mainzeal Property and Construction Ltd (in liq)* [2023] NZSC 113.

19. I draw primarily on the Supreme Court's "Summary" of its reasons for judgment: *Yan v Mainzeal Property and Construction Ltd (in liq)* [2023] NZSC 113 at paras [359]–[375].

20. *Madsen-Ries (as liquidator of Debut Homes Ltd (in liq) v Cooper* [2021] 1 NZLR 43 (SC) at paras [174]–[182]. I discussed these in an earlier article: *Debut Homes: A Different Perspective* NZ Company & Securities Law Bulletin (April 2021) at 27–30.

21. Ibid, at para [174].

22. Ibid, at para [174].

23. Ibid, at paras [178]–[180].

135 Reckless trading
A director of a company must not—

(a) agree to the business of the company being carried on in a manner likely to create a substantial risk of serious loss to the company's creditors; or

(b) cause or allow the business of the company to be carried on in a manner likely to create a substantial risk of serious loss to the company's creditors.

136 Duty in relation to obligations
A director of a company must not agree to the company incurring an obligation unless the director believes at that time on reasonable grounds that the company will be able to perform the obligation when it is required to do so.
...

Assessment of compensation payable by directors to the liquidators for breach of duty was governed by s 301(1) of the Act, which provides:

301 Power of court to require persons to repay money or return property
(1) If, in the course of the liquidation of a company, it appears to the court that a person who has taken part in the formation or promotion of the company, or a past or present director, manager, administrator, liquidator, or receiver of the company, has misapplied, or retained, or become liable or accountable for, money or property of the company, or been guilty of negligence, default, or breach of duty or trust in relation to the company, the court may, on the application of the liquidator or a creditor or shareholder,—

(a) inquire into the conduct of the promoter, director, manager, administrator, liquidator, or receiver; and

(b) order that person—

(i) to repay or restore the money or property or any part of it with interest at a rate the court thinks just; or

(ii) to contribute such sum to the assets of the company by way of compensation as the court thinks just; or

(c) where the application is made by a creditor, order that person to pay or transfer the money or property or any part of it with interest at a rate the court thinks just to the creditor.
...

The Mainzeal proceedings

In the High Court,[16] Cooke J granted the s 135 claim but dismissed the s 136 claim. He awarded compensation of $36 million, representing about one-third of the $110 million owed to unsecured creditors. On appeal, the Court of Appeal[17] upheld the liquidators' challenge to Cooke J's orders, to the extent that it affirmed liability on the s 136 claim, but remitted the proceeding to the High Court to determine the quantum of compensation to be awarded. An attempt to set aside the s 135 liability was rejected.

The directors appealed to the Supreme Court. The Court[18] allowed the liquidators' appeal against the remittal of quantum back to the High Court and ordered that, in respect of the breaches under ss 135 and 136 which were upheld, Mr Yan (described as far more culpable than his co-directors) pay $39.8 million together with interest from 28 February 2013. The liability of the remaining three of the directors was capped at $6.6 million and interest.

Liability claims[19]

(a) Introductory comments

Just under three years before giving its judgment in *Mainzeal*, the Supreme Court, in *Debut Homes*, had considered both ss 135 and 136 of the Act in the context of a "one-man" company. For present purposes, three propositions emerged from *Debut Homes*, against which *Mainzeal* should be read.

The propositions are:[20]

(a) If a company reaches the point when continued trading will result in a shortfall to creditors and the company is not salvageable, continued trading will be in breach of the reckless trading provisions [contained in s 135] of the Act.[21]

(b) Subject to the use of formal or informal mechanisms to address insolvency concerns, the reckless trading provisions will apply:[22]

... whether or not continued trading is projected to result in higher returns to some of the creditors than would be the case if the company had been immediately placed into liquidation, and whether or not any overall deficit was projected to be reduced.

(c) While informal mechanisms for dealing with an insolvency or near-insolvency situation are available, they can only be used in a manner consistent with directors' duties, the scheme of the Act and salient features of the available formal mechanisms, such as ensuring all affected creditors are consulted and agree with the course of action proposed.[23]

In considering ss 135 and 136 in the context of a company of the size and operational capacity of Mainzeal, the Supreme Court held that ss 135 and 136 of the Act were "*premised on the policy that where a company is insolvent or bordering on insolvency, creditors have an economic interest in the company which requires consideration by directors*". In construing and applying them, it was necessary for the Court to take account of other provisions in the Act dealing with director obligations to ensure coherence within the overall statutory scheme.[24] A focus on coherency means that the quality of acts or omissions of a director, when judged in the context of a corporate collapse, must be assessed against their contemporary obligations.

To ensure coherency, obligations on directors that attach at times of proximate solvency must be interpreted in a manner that does not interfere with the obligation for a director to exercise the care, diligence and skill that any reasonable director would exercise in the same circumstances, and to comply with orthodox fiduciary duties.[25] Although not put this way in the judgment, it seems to me that this approach requires an analysis of what the directors did or did not do on the basis of facts that they knew (or ought to have known) when making their decisions in the board room at the time the decisions were made. In other words, a contemporary boardroom analysis is undertaken rather than one based on the benefits of hindsight.

When a Judge of the High Court of New Zealand, I expressed that view in reasons for verdicts on a prosecution for the issue of misleading prospectuses. I said:[26]

[29] I agree with counsel for the accused that the reasonableness of any such belief should be assessed from the perspective of each individual director, based on the information available to him at the relevant time. I eschew a "hindsight" based evaluation that would likely be over-critical of a director's actions. Deliberately, I take a (contemporary) "boardroom", rather than a (financial autopsy) "courtroom", approach.

(b) The s 135 claim

The Supreme Court considered the s 135 claim in the context of its finding that, from 31 January 2011, Mainzeal entered into four major project contracts at a time when doing so was likely to create a substantial risk of serious loss to the company's creditors contrary to the intent of s 135.

The Supreme Court addressed the s 135 obligation, at least in part, on the premise that it is undesirable for a company to trade on in circumstances in which those who deal with it in the future are exposed to substantial risk of serious loss. Viewed in that way, the duty to "*creditors*" is assessed generically, with an eye to the likelihood that the incidence of creditors will inevitably change between the point in time when the risk appears and the time at which a formal insolvency regime is started.[27] The need to have an "*eye to the future*" is also of importance when compensation is assessed.

Nevertheless, directors of an insolvent or near insolvent company must have appropriate time to take stock of the situation and to obtain advice. Assurances of support on which directors can reasonably rely will be material considerations when evaluating whether directors could have been appropriately satisfied that continuing to trade where balance sheet insolvency existed would not breach s 135.[28]

(c) The s 136 claim

Section 136 of the Act is directed at the incurring of obligations at a time when directors could not have had a belief on reasonable grounds that a particular obligation would be met. The Supreme Court found that the decision to enter into the four large projects triggered s 136, and other liabilities incurred on or after 5 July 2012 had that effect.

Section 136 creates a different standard by which the conduct of directors must be gauged. It encapsulates the idea that directors should not agree to the incurring of obligations unless they have a reasonably held belief that the obligations will be honoured. The standard of "*reasonableness*" is designed to ensure a rigorous inquiry is undertaken if an obligation were taken on in marginal circumstances. That is because agreement to continuation of trading necessarily encompasses the incurring of obligations.[29]

Section 136 does not treat all creditors as if they were a class but contemplates "*an obligation-by-obligation*" and a "*creditor-by-creditor*" approach. Since damage for which compensation should be available under s 136 is the incurring of obligations without belief on reasonable grounds they will be honoured, the extent to which creditors are out of pocket by reason of the directors' breaches provides the most logical method of quantifying loss. Nevertheless, that presumptive position can be displaced.[30]

Application of s 301(1)

The Supreme Court began with a discussion of the historical context against which s 301 had been enacted. This exercise was undertaken in order to address a difference of opinion between Judges in the Court of Appeal about how s 301 should be applied. Without separate judgments being given, the Court of Appeal had recorded:[31]

[307] … Kós P and Miller J provisionally consider that they are bound by Debut Homes to proceed on the basis that the discretion is a broad one, to be exercised having regard to all the circumstances of the breach including concepts of causation, culpability and duration of any breach. Goddard J provisionally considers that this issue is not foreclosed by Debut Homes, and that it remains

24. *Yan v Mainzeal Property and Construction Ltd (in liq)* [2023] NZSC 113 at para [359].

25. Ibid.

26. *R v Moses* [2011] NZHC 646 at para [29].

27. *Yan v Mainzeal Property and Construction Ltd (in liq)* [2023] NZSC 113, at para [361].

28. Ibid, at paras [362] and [363].

29. Ibid, at para [364].

30. Ibid, at para [369].

31. *Yan v Mainzeal Property and Construction Ltd (in liq)* [2021] 3 NZLR 598 (CA), at para [307].

32. Ibid, at para [367].

33. Ibid, at paras [282] and [283].

34. *Holland v Revenue and Customs Commissioners* [2010] UKSC 51.

35. Ibid, at para 124.

36. *Madsen-Ries (as liquidator of Debut Homes Ltd (in liq) v Cooper* [2021] 1 NZLR 43 (SC) at para [182].

37. *Yan v Mainzeal Property and Construction Ltd (in liq)* [2023] NZSC 113 at para [351].

38. Ibid, at para [376].

arguable that the discretion is relatively confined, reflecting the essential procedural nature of s 301, and should only be exercised where there are factors such as knowledge on the part of a creditor that justify a reduction in the amount of compensation to be awarded against one or more directors.

...

In a case where, like Mainzeal, the relevant counterfactual to what happened was liquidation at breach date (11 January 2011), assessment of the loss caused by a breach of s 135 would usually proceed on the basis of net deterioration between that date and liquidation, reflecting the loss to creditors as a whole and with the shortfall acting as a cap on recovery.[32] However, net diminution in value may not be the only measure, particularly in cases where there has been a fundamental change in the incidence of creditors since the inappropriate decision to trade on was made.[33] In other words, there is a risk of a director being liable for a significant award of compensation if, although no net deterioration has occurred, new debts have been incurred, meaning that those who were creditors at the time of the breach have been paid but those whose debts were incurred subsequently, during (for example) the period of reckless trading, remain unpaid when insolvency intervenes have replaced them. In that situation, the losses suffered by the ultimate creditors can properly be said to have been caused by the actionable breaches of duty on the part of the directors.

In deciding how to approach assessment of compensation, the Supreme Court adopted the approach taken by the Supreme Court of the United Kingdom, in *Holland v Revenue and Customs Commissioners*.[34] The Court cited Lord Walker's view that:[35]

The discretion conferred by section 212(3) of the Insolvency Act 1986 is not a wide discretion. It does not replicate or extend the court's power to grant relief under section 727 of the Companies Act 1985 [corresponding to s 468 of the 1955 Act]. What it does is to enable the court to adjust the remedy to the circumstances of the particular case (some examples are given by Dillon LJ in West Mercia ...).

The passage from *West Mercia* to which Lord Walker refers emphasises that the Court has a discretion over questions of relief "*and it is permissible for the delinquent director to submit that the wind should be tempered because, for instance, full repayment would produce a windfall to third parties, or, alternatively, because it would involve money going around in a circle or passing through the hands of someone else whose position is equally tainted*".

Mainzeal recognises that differences of view were reflected in the judgments given in *Holland*, but considered that the passage cited from Lord Walker's reasons reflected "*a general consensus as to the nature of the discretion*".

In *Debut Homes*, the Supreme Court observed that where there had been breaches of duties, any relief ordered under s 301 must respond to and provide redress for the particular duty or combination of duties breached.[36] *Mainzeal* confirms the need for "*flexibility in remedial response*" so that courts are "*free to tailor relief in ways that respond to the particular breach or wrong, to the harm that flows from that and, at least to some extent, the culpability (particularly amongst themselves) of the directors*".[37]

The Supreme Court concluded:[38]

[376] There is a tension between the purpose of s 301 and its text as to the ability of creditors to obtain direct relief. We have resolved this tension with an interpretation that gives priority to its purpose because (a) that purpose is clear and (b) the statutory language, if construed literally, makes no sense. There remains a more general incoherence in relation to ss 135, 136 and 301 as to distribution of the proceeds of a successful claim. In this case, the compensation awarded will be shared between all creditors and not merely those whose debts were taken into account in the new debt calculation. The problems just highlighted are not the only ones that have emerged from our consideration of the present case and we endorse the view expressed by the Court of Appeal that a review of the relevant provisions would be appropriate. ■

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Case Note: *Cithara v Haiman*

Introduction

The BVI Commercial Court held that the ultimate beneficial noteholders of a New York law governed note structure were contingent creditors withstanding to present an application for the appointment of liquidators over the issuer of the notes.

This decision is one of a recent flurry of decisions from common law jurisdictions dealing with this point. The first was the decision of Doyle J in the Grand Court of the Cayman Islands in *In the Matter of Shinsun Holdings (Group) Co. Ltd.* (FSD 192 of 2022) ("*Shinsun*"), which was delivered on 21 April 2023. The second was the judgment of Deputy High Court Judge Suen SC in the Hong Kong High Court in *Re Leading Holdings Group Limited* [2023] HKCFI 1770, issued on 18 July 2023 and largely following *Shinsun*. *Cithara* then followed the next day, with Mangatal J issuing her judgment on 19 July 2023. The decisions were considered briefly by the Court of Appeal of the Eastern Caribbean Supreme Court in the context of a stay application in *Cithara*.

The decision of Mangatal J[1]

This was an application for the appointment of liquidators over the BVI-incorporated financing vehicle of a Chinese property development company brought by the ultimate beneficial noteholders of certain offshore notes issued by the company. The offshore notes had been issued under a New York law governed indenture.

The company disputed the ultimate beneficial noteholder's standing to make the application, on the basis that the applicant was not the "*Holder*" as defined under the indenture. The ultimate beneficial noteholder argued that it had standing as a contingent creditor under the relevant BVI insolvency legislation.

1. BVIHC(COM)2022/0183 (19 July 2023); available at https://www.eccourts.org/judgment/cithara-global-multi-strategy-spc-v-haimen-zhongnan-investment-development-international-co-ltd.

Though the hearing in *Cithara* took place in March 2023, the judge had reserved judgment and the *Shinsun* decision was brought to the judge's attention, with the parties making further written submissions on the decision. Mangatal J reviewed *Shinsun* in detail and concluded that that decision should not be followed in the BVI.

Rather, Mangatal J considered that the starting point to understand the meaning of creditor and contingent creditor was the decision of the UK Supreme Court in *In re Nortel GmbH; Bloom v Pensions Regulator* [2013] UKSC 52, [2014] AC 209. She considered that the *Nortel* decision makes it clear that the modern trend is to give an expanded definition of contingent obligation and that direct contractual claims are not the only legal basis upon which a contingent obligation may arise. Citing extensively from Lord Neuberger's leading judgment, she relied on his formulation at paragraph 77 as follows:

"*It would be dangerous to try and suggest a universally applicable formula, given the many different statutory and other liabilities and obligations which could exist. However, I would suggest that, at least normally, in order for a company to have incurred a relevant "obligation" under rule 13.12(1)(b) , it must have taken, or been subjected to, some step or combination of steps which (a) had some legal effect (such as putting it under some legal duty or into some legal relationship), and which (b) resulted in it being vulnerable to the specific liability in question, such that there would be a real prospect of that liability being incurred. If these two requirements are satisfied, it is also, I think, relevant to consider (c) whether it would be consistent with the regime under which the liability is imposed to conclude that the step or combination of steps gave rise to an obligation under rule 13.12(1)(b).*"

Mangatal J held that in *Shinsun*, and *Bio-Treat Technology Ltd v Highbridge Asia Opportunities Master Fund* [2009] Bda LR 29, an earlier Bermuda case on which *Shinsun* relied, the judge had taken the view that a pre-existing direct contractual relationship between the contingent creditor and the debtor is required. She considered this to be wrong and inconsistent with *Nortel*. A contractual relationship is not necessary. Following *Nortel*, the debtor must simply take steps that may make it liable to a creditor, subject to a contingency. A note structure can be equated and is analogous to the steps taken by the debtor that made it liable to the creditor, subject to a contingency, discussed in *Nortel*.

The judge accepted the applicant's submissions and held that it was a contingent creditor withstanding to present the liquidation application. Mangatal J reached this conclusion on the two bases submitted by the applicant: first, because the ultimate beneficial noteholder was entitled to receive a note itself and become the registered holder and second, because the effect of the operating procedures governing the relevant clearing system (Euroclear) and specific authorisations provided by Euroclear in relation to the notes was that the ultimate beneficial noteholder was the person entitled to enforce the claim against the issuer.

Once the ultimate beneficial noteholder had established its standing, the judge concluded that in the circumstances of the case the liquidation

application ought to be granted. The company was plainly insolvent and the maturity date of the notes had passed without payment of interest or principal having been made.

The stay application in the Court of Appeal[2]

The company filed an appeal seeking to reverse the judgment of the BVI Commercial Court. It also issued an application seeking a stay of execution of the order appointing liquidators over the company pending the determination of the appeal, which was heard by the Court of Appeal of the Eastern Caribbean Supreme Court on 31 July 2023.

In support of its stay application, the company contended that: (a) there was a probability that its group would collapse, and its attempted restructuring efforts would fail if the stay was not granted; and (b) that it had strong grounds of appeal which should be taken into account in considering a stay.

The Court of Appeal rejected the application for a stay. The company's evidence for the first ground was "*tenuous*". There was little more than bare assertion from the company that the liquidation order would have an irreversible and "*nuclear*" effect on the group's efforts to restructure.

As to the strength of the company's appeal, the Court held that the company had not presented a strong enough case to rebut the presumption against the grant of a stay of the liquidation order. The Court accepted Cithara's submissions that the strength of the company's appeal was insufficient to warrant granting a stay, noting that they went "*a long way in derailing the applicant's evaluation of the strength of its appeal*". ■

Peter Burgess appeared for Cithara Global Multi-Strategy SPC before the BVI Commercial Court (Mangatal J) and before the Court of Appeal of the Eastern Caribbean Supreme Court (Michel JA, Price-Findlay JA, Ellis JA).

2. BVIHCMAP2023/0012 (4 August 2023); available at https://www.eccourts.org/judgment/haimen-zhongnan-investment-development-international-co-ltd-v-cithara-global-multi-strategy-spc.

TOBY BROWN

Case Note: *Primeo Fund (in Official Liquidation) v Bank of Bermuda (Cayman) Ltd and another [2023] UKPC 40*

Introduction

In this "stop the press" article, Toby Brown summarises the Privy Council's judgment, which in ending this long running Cayman litigation, raises issues of wider importance for litigators regarding the finality of litigation; the meaning of "deliberate" breach for postponing limitation; and the availability of a contributory negligence defence in contractual claims.

Just before the Digest went to press, on 15 November 2023 the Privy Council handed down the long-awaited judgment in the second appeal in *Primeo Fund v Bank of Bermuda Ltd* [2023] UKPC 40, in the same court room before the Supreme Court handed down their decision that the Home Secretary's Rwanda policy was unlawful. The packed court room and media scrum outside may not have been for the *Primeo* judgment, but a number of the Privy Council's findings are of wider significance for litigators in Cayman, England and the wider common law world, as this article will summarise.

Primeo was a Cayman investment fund which from 1994 to 2008 invested directly and indirectly in BLMIS, the vehicle for Bernard Madoff's fraudulent Ponzi scheme. Primeo's liquidators brought claims in Cayman against the First Respondent ("**BBCL**") and Second Respondent ("**HSSL**") who acted as Primeo's administrator and custodian respectively. The claims were originally dismissed by Jones J of the Grand Court for a number of reasons, including the rule against reflective loss. The parties appealed and cross-appealed various issues to the Cayman Islands Court of Appeal ("**CICA**") and then to the Privy Council which bifurcated the reflective loss issue, holding in [2021] UKPC 22 that the claims were not barred by that rule.

The remaining issues were addressed in a second appeal which was heard over 4 days before the Privy Council in 2021 (Lord Reed, Lord Hodge, Lord Lloyd-Jones, Lord Kitchin, Lord Sales). In their November 2023 judgment, the Board allowed some of Primeo's grounds of appeal and some of Respondents' cross-appeal, with the claims ultimately failing because Primeo could not establish causation

or loss. This summary will focus on three issues of wider importance.

(1) Finality of Litigation

By way of preamble, the Board reviewed the authorities stemming from *Henderson v Henderson* (1843) 3 Hare 100 which dictate the general rule that a party must advance their whole case at trial, as colourfully put by Lewison LJ in *Fage UK Ltd v Chobani UK Ltd* [2014] EWCA Civ 5: "*The trial is not a dress rehearsal. It is the first and last night of the show*".

The Board started by considering the appeal and the cross-appeal regarding Primeo's case that HSSL was liable for BLMIS's acts as its sub-custodian in misappropriating Primeo's cash in breach of the safekeeping duty ("**Strict Liability claim**"). The Board agreed with the CICA that upon each investment, Primeo suffered immediate recoverable loss, applying *Nykredit Mortgage Bank plc v Edward Erdman Group Ltd (No 2)* [1997] 1 WLR 1627, HL, a conclusion of potential relevance to future claims regarding Ponzi schemes.

At trial Primeo had sought to calculate its losses by reference to the net cash invested in BLMIS during the relevant period. However, the judge and CICA rejected Primeo's primary case that BLMIS was sub-custodian from the outset in 1994/1996, instead accepting Primeo's alternative case advanced in closing that BLMIS became sub-custodian in 2002. The relevant period was therefore 2002 to 2007, but during which Primeo received back from BLMIS US$25.25m more than it invested.

In response, Primeo sought to introduce two points before the CICA in order to establish loss. The CICA permitted Primeo to advance a case that it could appropriate sums received back from BLMIS against earlier losses, and that there had been a running account in order to adopt a "*first in, first out*" methodology pursuant to *Clayton's Case* (1816) 1 Mer. 572. The CICA directed these be remitted to first instance for consideration. The CICA, however, refused to permit Primeo to enlarge its claim to argue HSSL assumed responsibility for the purported value of the investments when it became their custodian in 2002.

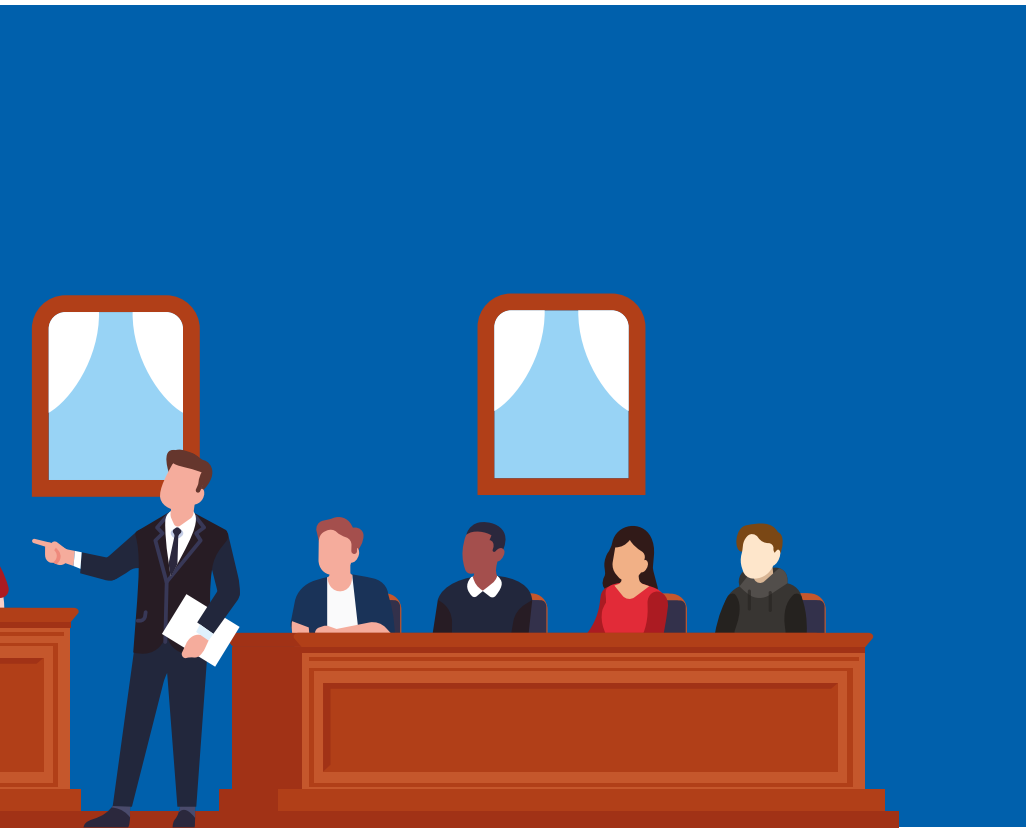
The Board held that it would not be just to allow Primeo to advance either of the new cases, which raised issues of fact which were not explored at trial. "*It would not be just for the Board to allow such a course nor would it be consistent with the efficient resolution of commercial disputes. In short, the principle of finality militates against the presentation of this argument on appeal.*" The Board accordingly concluded that on the Strict Liability claim Primeo failed to established that it suffered a loss.

The Board also considered **causation on the negligence claims**, having upheld the negligence findings against the First Respondent. Primeo's causation case was that, in order to address the unique risks of investing in BLMIS, the Respondents should have implemented certain custody safeguards, which Madoff would have resisted, leading Primeo to withdraw its investments from BLMIS. This causation case was rejected by the trial judge, given Primeo understood and accepted the risks of investing with BLMIS.

Primeo also raised an additional causation case in closing that, had the Respondents not issued custody confirmations to Primeo's auditors E&Y, Primeo would have been unable to obtain a clean audit and would have had to withdraw from BLMIS ("**Auditor Causation**"). The judge was not satisfied of Auditor Causation on the balance of probabilities, the standard advanced at trial. On appeal, Primeo argued an alternative case that the hypothetical actions of E&Y and BLMIS ought to be assessed on a loss of a chance basis, given they are independent third parties (*Allied Maples Group Ltd v Simmons & Simmons* [1995] 1 WLR 1602, CA). The CICA agreed, and in permitting this new case, directed that the evaluation of the percentage loss of a chance be remitted to first instance as part of the assessment of damages.

The Privy Council held that CICA erred in failing to properly consider the finality principle and the prejudice the Respondents would suffer if Auditor Causation was re-tried on a loss of a chance basis. The judge "*after a lengthy trial involving both liability and quantification of damages, decided the case on the basis on which the parties presented it to him. If the issue of causation were to be re-opened, there would need to be further evidence…and such a further trial would not be an efficient or proportionate way of resolving this dispute.*"

The Privy Council's decision on this point accords with recent UK Supreme Court authority, see *Sainsbury's Supermarkets Ltd v Visa Europe Services LLC* [2020] UKSC 24, *FII Test Claimants v IRC* [2020] UKSC 47 and *AIC Ltd v Federal Airports Authority of Nigeria* [2022] UKSC 16, and a question for



discussion is whether these cases reflect a stricter approach.

(2) Limitation: deliberate or reckless breach, and who is an "agent"?

The second issue of wider importance concerns the meaning of section 37 of the Cayman Limitation Act (1996 Revision), which is materially identical to section 32 of the UK Limitation Act 1980. Under section 37(2) time can be postponed where there is a "*deliberate commission [by the defendant] of a breach of duty in circumstances in which it is unlikely to be discovered for some time*". Primeo argued this extended to a "reckless" breach, which the judge and CICA rejected, but which argument was subsequently accepted by Rose LJ in relation to the equivalent UK provision in *Canada Square Operations Ltd v Potter* [2021] EWCA Civ 339.

Arguably the point had not previously been determined by the House of Lords, Supreme Court or Privy Council. The Privy Council agreed that a reckless breach would not suffice, in particular because:

- As a matter of ordinary language, the meaning of "deliberate" in the legislation is clear, and "reckless" has a different meaning. *Cave v Robinson Jarvis & Rolf* [2002] UKHL 18 held that deliberate breach required knowledge that what was done was a breach, which logically means recklessness does not suffice.
- The statutory provision was not intended to be a restatement of the old law of "concealed fraud".
- It would otherwise have drastic implication for professionals (such as a lawyer advising on a difficult point of law) who would be faced with indefinite exposure to stale claims long after indemnity insurance has expired.

The Board accordingly found Rose LJ wrongly decided the point in *Canada Square*, which was directly overturned by the Supreme Court in [2023] UKSC 41, a judgment handed down on the same day by a panel of the same Justices. Primeo therefore could not rely upon section 37(2) to extend time for its negligence claims, thus barring causes of action arising 6 years before the claim was issued.

Separately, the Privy Council considered the cross-appeal regarding the CICA's finding that BLMIS's wilful breach as sub-custodian postponed time for the Strict Liability claim. Under section 37(1) of the Cayman statute, as with the UK equivalent, time may be postponed where "*any fact relevant to the plaintiff's right of action has been deliberately concealed from him by the defendant*", and "*References in this subsection to the defendant include references to the defendant's agent*".

Primeo had alleged that BLMIS was HSSL's agent, and that BLMIS's wilful breaches had the effect of postponing the running of time for limitation purposes. HSSL argued that BLMIS was an independent contractor, and therefore not an "agent" for limitation purposes.

The Board engaged in a detailed analysis of the authorities on agency and limitation. Supported by earlier decisions including *Applegate v Moss* [1971] 1 QB 406, the Privy Council held that "agent" had its conventional legal meaning, and extended to an independent contractor acting as an agent within the scope of the authority conferred by its principal. BLMIS acted as HSSL's agent in (apparently) performing its custody duties, which actions and omissions affected its relationship with a third party, Primeo. Time was therefore postponed for the Strict Liability claim. The Board's decision on this point may be significant in any case where an honest defendant has unwittingly delegated its contractual responsibilities to a dishonest subcontractor.

(3) Contributory negligence for contractual claims

The final issue of wider importance concerns the availability of the defence of contributory negligence in contractual claims. Under section 8(1) of Cayman's Cayman Torts (Reform) Act (1996 Revision), identical to section 1(1) of the UK's Law Reform (Contributory Negligence) Act 1945, any damages recoverable where there is fault on the part of a claimant may be adjusted where the case is one in which the defence of contributory negligence would otherwise have been available at common law prior to the statutes' enactment.

The judge and CICA proceeded on the basis that under the Court of Appeal's decision in *Vesta v Butcher* [1989] AC 852, contributory negligence is available as a defence to a claim in contract where there exist concurrent and co-extensive duties in contract and tort (referred to in *Vesta* as the "category 3" claim). Before the Privy

Council, Primeo argued that *Vesta* had been wrongly decided and should not be followed, on the basis that prior to the 1945 Act the defence was not available for contractual claims.

The point had never been expressly considered by the highest court. In a detailed analysis, the Board reviewed the authorities from England and the Commonwealth, and found that the common law before 1945 did recognise contributory negligence as a complete defence to a category 3 claim framed in contract. *Vesta* was therefore correctly decided. The defence can apply wherever negligence is an essential ingredient of the plaintiff's cause of action, whatever the source of the duty. Thus, "*it is not necessary that the claimant sue on a cause of action in tort, but it is sufficient that the cause of action is founded on an act or omission which gives rise to liability in tort*". Whilst the defence was accordingly available to BBCL as a "category 3 case", the Board found it was not available to HSSL because the duty under the custody agreement to implement the "most effective safeguards" when appointing sub-custodians was not concurrent with a duty in tort. The Privy Council's judgment on this point addresses a further important point of principle as to how indemnity and exoneration clauses should be analysed in the context of a contributory negligence defence.

The CICA had considered that, because the relevant contract excluded HSSL's liability for non-negligent breach of duty, HSSL's duty was merely to take reasonable care, and accordingly a defence of contributory negligence was available. However, the Board accepted Primeo's argument that this was the wrong analysis. In the Board's view, "*the nature of the most effective safeguards duty was not transformed into a duty to take reasonable care in relation to the provision of a service because of the existence of the indemnity and exoneration provisions. This is to confuse the nature of the duty and the issue of breach of the duty with the question of the ultimate liability of HSBC as custodian. Put another way, the exoneration and indemnity provisions do not change the scope and nature of the duty. Instead, they deal with the position once a breach of duty has been established and operate to limit the circumstances in which damages may be payable for that breach*".

Finally, as to the level of contributory negligence, the trial judge had decided that Primeo was to a very substantial degree the author of its own misfortune, and so would have reduced any award of damages against BBCL by 75%. The Privy Council agreed with the CICA that the apportionment should be reduced to 50% because the judge had not attached proper weight to the fact that BBCL was a professional service provider.

Although the assessment of a plaintiff's contributory negligence will always be a highly fact-specific exercise, the Board's decision will doubtless be relied upon by plaintiffs who are met with a contributory negligence defence from a professional service provider. A decision that the client is more to blame for its losses than the professional service provider may be more difficult to justify in future.

Conclusion

Over a decade after being issued, the Privy Council's judgment may have brought the Primeo claim to a close, but as summarised above, the judgment is of wider importance particularly regarding the finality of litigation, the interpretation of the Limitation Act and the availability of contributory negligence. This article has focussed on only three aspects of the judgment. Readers who choose to read the entire 122-page judgment will discover a detailed treatment of a range of other issues, such as the correct interpretation of the House of Lords' decision in *Nykredit* referred to above, when a finding of gross negligence will be justified, and the circumstances in which a plaintiff's loss might be mitigated. ■


Tom Smith KC


Richard Fisher KC


William Willson


Toby Brown


Robert Amey

Case Digest Editorial

Daniel Bayfield KC

Decisions, decisions...

Whilst we await the Court of Appeal's judgment in *Adler* (*Re AGPS Bondco PLC*), there seems to be no shortage of schemes of arrangement and restructuring plans clogging up the diary of the Business and Property Courts. Summaries of the decisions in *Fitness First*, *Prezzo* and *Cimolai* follow and two further notable restructurings will reach their (hotly contested) sanction stage in early February, one with a time estimate of 8 days, including pre-reading.

Some fear that challenges to restructurings are becoming unwieldy. If opposition can readily lead to months of delay and millions in additional expense, will we remain the first choice jurisdiction for European restructurings? It is a real concern. Then again, no-one can sensibly suggest that dissenting creditors should not have a proper opportunity to make their case, valuation evidence and all, or that the Judges should not have sufficient time properly to consider the evidence, the arguments and their decisions. Striking the right balance requires serious thought and, perhaps, discussion between practitioners and the Judges. The judgment in *Adler* is likely to shape that discussion.

The *Prezzo* decision is of note for a different reason. In that case, Richard Smith J held that the term "arrangement" has a different meaning for Part 26A plans than it does for Part 26 schemes of arrangement. It has been the law for over a century that, for the purposes of a scheme of arrangement, an arrangement requires some "give and take". Richard Smith J was persuaded that a plan can involve "give" only where a class is wholly out-of-the-money. He held that: "*...Part 26A provides for the sanction of a plan against the dissenting vote of a creditor class under the Court's 'cram-down' jurisdiction in section 901G of the Act. Since the related statutory condition is that such a class should be "no worse off" than if the plan had not been sanctioned, if it would receive nothing in the alternative scenario, it follows that the Act envisages the compromise of their claims under a plan under which they would also receive nothing.*" This important and controversial aspect of the decision commands a single paragraph of the judgment and may not be the final word on it. The issue was touched upon in argument before the CA in *Adler* – it having been raised from the bench notwithstanding that it was not a live issue in *Adler*. We will have to see whether it features in the judgment.

Fortunately, our practice extends well beyond restructuring and, in *Darty v Carlton-Kelly*, Tom Smith KC and Henry Phillips got back to some pure insolvency law and proved that a loss at first instance is just a temporary setback. The decision of the Court of Appeal (overturning the Judge's finding that a preference claim was made out) makes clear that, for the purposes of preference claims, the desire to prefer has to exist at the time of the decision to give the preference and gives guidance on when the decision is taken.

Decisions are not made only by Judges (and persons giving preferences) and *Morgan-Rowe v Woodgate* serves as a useful reminder that it is critical to identify ones grounds of appeal and arguments at the appropriate time and not to leave the thinking until the appeal comes on for hearing. It will not usually be possible to advance arguments on an appeal which do not have a basis in the grounds of appeal and which are not developed in the skeleton argument. Decisions must be made early if difficulties are to be avoided.

Finally, of real interest in this issue's Case Digest is the decision of the Supreme Court in *Philipp v Barclays Bank* on the scope of the *Quincecare* duty. The limited scope of that duty means that we, as customers, cannot seek to shift the blame onto the bank for making payments we intended to make but wish we hadn't when we discover we have been duped. The Supreme Court made clear that it is for the legislature, not the courts, to decide whether or not to throw the cost of fraud onto the banks. Of course, were it to do so, we would all end up bearing the cost anyway, in terms of increased charges.

Case Digests

Banking and Finance

DIGESTED BY PAUL FRADLEY

Philipp v Barclays Bank Plc

[2023] UKSC 25; [2023] 3 WLR 284 (Lords Reed, Hodge, Sales, Hamblen and Leggatt)
12 July 2023

Quincecare duty – Scope of duty – Authorised push payment fraud

In this case, the Supreme Court considered the scope of what is commonly called the *Quincecare* duty (named after Barclays Bank plc v *Quincecare Ltd* [1992] 4 All ER 363), which has been subject to considerable litigation in recent years. In *Philipp* the defendant was once again Barclays Bank plc. Mrs Phillipp and her husband fell victim to a type of fraud known as authorised push payment fraud. They were deceived by criminals to instruct Barclays to transfer £700,000 from their account to bank accounts in the UAE. The payments were duly made, and the money was lost. Mrs Philipp issued proceedings against Barclays claiming that the Barclays owed her a duty of care under its contract with her or at common law not to carry out her payment instructions if it had reasonable grounds that she was being defrauded. HHJ Russen QC summarily dismissed the claim on the grounds that such a duty was not owed, but the Court of Appeal disagreed.

The Supreme Court unanimously allowed the appeal holding that such a duty was not owed by Barclays to Mrs Philipps. Lord Leggatt, delivering the judgment of the Court, held that it was a basic duty of a bank, generally referred to as its mandate, under its contract with a customer to make payments in accordance with the customer's instructions. That was a strict duty, and the bank was not concerned with the wisdom of the transaction or the risks of the customer's payment decision. The *Quincecare* duty required a bank not to execute a payment instruction given by an agent of its customer without making inquiries if it had reasonable grounds for believing that the customer was being defrauded by the agent. In those circumstances, the agent did not have actual authority (because it was defrauding the customer) and lacked apparent authority (because the bank was on notice of the fraud).

The *Quincecare* duty was simply an application of the general duty of care owed by a bank to interpret, ascertain and act in accordance with a customer's instructions. The *Quincecare* duty did not apply where the customer itself unequivocally instructed the bank to make the payment or where an agent of the customer with apparent authority did so. The fact that a customer's instruction resulted from a mistaken belief, including a deception by another, did not make the instruction any less real or genuine.

The Supreme Court recognised that authorised push payment fraud was a growing social problem which caused great hardship to its victims. The question of whether banks should bear the loss, or whether it should be left to be borne by the victims, was a question of social policy for regulators and ultimately Parliament to decide. Such an issue was not one for the Courts. It was not for the Courts to impose an obligation on banks to which they did not consent and cannot reasonably be presumed to have consented to since it is inconsistent with the normal and established allocation of risk and responsibility in banking contracts.

CPF One Ltd v OSK (UK) II Ltd

[2023] EWHC 2102 (Ch) (Andrew Lennon KC, sitting as a Deputy High Judge)
16 August 2023

Syndicated loan agreement – Scope of duties of mortgagee – Duties of trustee

C1 had agreed to provide a loan of £2.75m to the borrower. C1 agreed with D1 and C2 to structure the loan as a syndicated loan, with D1 providing funding as senior creditor and C2 as junior creditor. C1 was appointed as security trustee to hold the benefit of the debt and the charged property as trust property. D1, as senior creditor, had the sole right to instruct C1. After the borrower defaulted, D1 replaced C1 as security trustee and the new trustee on D1's instructions accepted an offer of £3.5m to settle the debt with D1 being owed £3.54m. C1 and C2 considered the charged property was worth £5.7m.

The Judge held that neither C1 nor C2 were subsequent encumbrancers and their relationship with D1 and D2 was one of senior creditor and trustee not one of subsequent mortgagees.

There was only one charge in which each creditor had a beneficial interest as a participant. The Judge considered that the Cs were seeking to extend the duties of a mortgagee when exercising a power of sale to fashion a duty owed by a security trustee to a junior participant in a syndicated loan agreement when deciding to settle the debt owed by the mortgagor and to release the securities. The Judge held that the duty did not extend that far. A mortgagee was generally free to do as it wished with its security. It was only if a decision to sell the charged property was made that equity intervened to impose a narrow duty to obtain the best price reasonably achievable. On the facts there had been no exercise of a power of sale – the security trustee had desisted from exercising that power by entering into a settlement.

The fact that the junior creditor might suffer a loss was not enough to warrant the imposition of the duty.

The Judge also held there was no breach of the duty of care owed under the Trustee Act 2000. D1 was not a trustee and C1 was not the beneficiary of any trust. C2 (the junior creditor) was also not owed any duty of care by the security trustee. The trust deed required the security trustee to comply with the senior creditor's instructions and did not require it to take into account the junior creditor's interests. The senior creditor was entitled to instruct the security trustee to settle the debt with the borrower and release the securities. The security trustee had been under a duty to comply with those instructions.

Civil Procedure

DIGESTED BY ANNABELLE WANG

Mints v PJSC National Bank Trust & Anor

[2023] EWCA Civ 1132 (Flaux (Ch) Newey, Popplewell LJJ)
6 October 2023

Russia – Sanctions – Causes of Action – Control – Designated persons

The Court of Appeal gave an important decision on a number of issues relating to the effect of sanctions imposed under the Sanctions and Anti-Money Laundering Act ("SAMLA") and the Russia (Sanctions) (EU Exit) Regulations 2019 (the "Regulations") on the ability of sanctioned persons to pursue and engage in litigation in the English Courts.

The litigation arises out of claims brought by the claimant banks against the appellants on the basis that they conspired with representatives of the claimant banks to enter into uncommercial transactions with companies connected with the appellants.

The second claimant bank became a designated person under the Regulations after the commencement of the litigation. The first claimant was not sanctioned but the appellants nonetheless contended that it fell within the scope of the sanctions because it was "*owned or controlled*" within the meaning of Regulation 7 of the Regulations by at least two designated persons.

At first instance, Cockerill J had dismissed the appellant's applications for a stay of the proceedings and discharge of their release date undertakings on various grounds concerning the ability of a sanctioned person to pursue and or engage in litigation before the English Courts.

The issues on appeal
There were three key issues on appeal:

(1) Whether a judgment can be lawfully entered for a designated person by the English court following a trial at which it has been established that the designated person has a valid cause of action? (the entry of judgment issue);

(2) Whether, in circumstances where the Office of Financial Sanctions Implementation ("OFSI") can license the payment of a designated person's own legal costs, OFSI could also license (i) the payment by a designated person of an adverse costs order; (ii) the satisfaction by a designated person of an order for security for costs; (iii) the payment by a designated person of damages pursuant to a cross-undertaking in an injunction and (iv) the payment of a costs order in favour of a designated person? (the licensing issue);

(3) Whether a designated person "*controls*" an entity within the meaning of Regulation 7 where the entity is not a personal asset of the designated person but the designated person is able to exert influence over it by virtue of the political office that he or she holds at the relevant time? (the control issue).

The entry of judgment issue
The entry of judgment in the favour of a designated person does not "*make funds available*" thereto and/or those words are not apt to describe the exercise by the Court of one of its prime judicial functions, of entering judgment on a valid cause of action. Entry of a judgment also does not constitute exchanging a cause of action for funds (namely, a judgment debt) in breach of Regulation 11(5)(b) and Section 60(4) of SAMLA.

The licensing issue
The various litigation steps set out above could be licensed by the OFSI. The wording of paragraph 3 of Schedule 5 of the Regulations is neutral as to whether the legal services, for which reasonable professional fees can be paid under licenses granted by the OFSI, are being provided to the designated party or to another party.

The control issue
It was therefore not strictly necessary to address the control issue as, even if the first claimant was a controlled person and to be regarded as designated, both claimants were entitled to pursue the proceedings (and, if they were successful, the Court would be able to lawfully enter a money judgment in their favour).

The Court nonetheless addressed the issue and concluded that the first claimant bank was controlled by the identified designated persons:

(1) The wording of Regulation 7(2) was apt to cover the case of a designated person who, for whatever reason, is able to exercise control over another company, irrespective of whether the designated person has an ownership interest in the other company, economic or otherwise.

(2) The wording of Regulation 7(4) was also drafted in wide terms, and the use of the words, "*in all the circumstances*" and "*by whatever means*" makes it clear that the provision does not have any limit as to the means or mechanism by which a designated person is able to achieve the result of control, that the affairs of the company are conducted in accordance with his wishes.

The Court found that the first instance judge, in reaching the contrary conclusion, had put an impermissible gloss on the language of Regulation 7 because of a concern on her part that if the appellants were correct about the construction thereof, the consequence might well be that every company in Russia was "*controlled*" by Mr Putin and hence subject to sanctions. If that was the consequence, the remedy was not for the judge to put a gloss on the language contained in Regulation 7, but rather it was for the executive and Parliament to amend the wording of the Regulations to avoid that consequence.

FXF v English Karate Federation Limited & Anor

[2023] EWCA Civ 891 (Sir Geoffrey Vos MR, Nicola Davis LJ, Birss LJ)
26 July 2023

Set aside default judgment – Denton principles

The claimant brought an action seeking damages for alleged sexual abuse by her karate coach. The defendants were said to be both vicariously and directly liable for the abuse. The claimant had obtained default judgment, following the defendant's failure to file a defence in time. The second defendant applied to set aside the default judgment.

The Master hearing the set aside application held that the second defendant had a real prospect of successfully defending the claim, but also that the application had not been made promptly and there was no good reason for the delay. He was referred to the *Denton* principles but held that their application under CPR Rule 13.3 was qualified.

On appeal, following a lengthy review of the relevant authorities, the Court of Appeal confirmed that the Denton principles apply "*in their full rigour*" to applications to set aside default judgment. Whilst the principles expressly applied to cases where a rule or order expressly provides for a sanction to apply on non-compliance, they also applied to cases where a further step is taken in consequence of the non-compliance, such as the entry of a default judgment. The Denton principles had particular application to the exercise of discretion required once the two specific matters mentioned in CPR Rule 13.3 had been considered.

In the instant case, the Court held that the Master had understood the application of the *Denton* principles and exercised his discretion appropriately.

Morgan-Rowe v Woodgate

[2023] EWHC 2375 (KB) (Moulder J)
27 September 2023

Appeals – Grounds of appeal – Skeleton arguments

The underlying claim arose out of a road traffic accident in which the claimant's and defendant's vehicles collided and were damaged. The claimant had been awarded damages in respect of credit hire charges and repair costs on a higher rate on the grounds that she was impecunious, subject to a finding of 50% contributory negligence. The defendant appealed the award for damages.

The defendant had changed counsel since the first instance hearing. At the appeal hearing, the defendant's counsel sought to rely on (1) new matters which had not been mentioned in the grounds of appeal, and (2) an argument which had been set out in the grounds of appeal but not in his skeleton argument.

In respect of the first point, the judge refused to allow the defendant to argue grounds that were not in the grounds of appeal. The judge held that the attempt to raise new grounds in the skeleton argument amounted to an attempt to circumvent the rules applicable to the amendment of an appeal notice, without permission of the appellate court. Furthermore, the new point which was sought to be argued had been expressly conceded at first instance. The judge held that the new point, if argued at trial, would have changed the course of the evidence given at trial. That was obviously prejudicial to the claimant.

The judge also refused to allow the defendant to rely on the second point, observing that a skeleton argument which differs from the grounds of appeal would not readily fulfil the objective of the Practice Direction, to assist the court by setting out the arguments on which the party intends to rely. It was not open to litigants to "chop and change" how they advance their case.

Viegas v Cutrale

[2023] EWHC 1896 (Comm) (Dame Clare Moulder DBE (sitting as a Judge of the High Court)
24 July 2023

Leave to amend – Limitation – Relation back

The claim related to an alleged cartel between several Brazilian undertakings. The first and second defendants were directors and shareholders of one of the undertakings that was alleged to have participated in the cartel. The defendants challenged the jurisdiction of the court and applied to strike out the claimants' amendments to their claim made prior to service.

The defendants sought an order that the amendments be disallowed under CPR Rule 17.2(1) on the basis that there was an arguable case that the limitation period for those claims had expired. The judge did not accept that there was an implied extension of the 14 day period in which an application to disallow amendments was required to be made in circumstances where the applicant had challenged the jurisdiction of the court. It was open to the defendants to expressly state in the application notice that the application was made without prejudice to their jurisdiction challenge.

The judge clarified the correct test for refusing leave to amend where there were limitation issues. The test was whether there was an arguable case that the limitation period had expired, and whether the defendants' case on limitation would be prejudiced by relation back of the new claim under section 35 of the Limitation Act 1980. As the original claim and the amended claim were contended to be equally out of time, there was no such prejudice and the court exercised its discretion to refuse the defendant's application.

Commercial Litigation

DIGESTED BY JAMIL MUSTAFA

Granville Technology Group Limited and ors v LG Display Co. Limited & Anor

[2023] EWCA Civ 980 (Bean, Males and Whipple LJJ)
16 August 2023

Cartels—Compound Interest—Equity

The defendants participated in a price-fixing cartel in relation to liquid crystal display ("LCD") panels within the European Union, including the UK. This led to the sale of LCD panels at inflated prices contrary to Article 101 of the Treaty on the Functioning of the European Union ("TFEU"). On 8 December 2010, the European Commission issued a Decision addressed to the defendants and other members of the Cartel which found them in breach of Article 101 TFEU and imposed fines on the participants, including the defendants in the amount of €215 million.

The claimants then made a "*follow-on*" damages claim against the defendants. The claimants alleged to have been victims of the price-fixing by the cartel and sought damages for breach of statutory duty. The claimants claimed £19.75 million in damages from the defendants. £13.5 million of that amount comprised interest, calculated on a compound basis to 30 June 2022. The claimants had, however, all entered administration many years earlier. In respect of the period since they entered administration, the claimants asserted that they were entitled to recover compound interest on their damages from the defendants pursuant to the Court's equitable jurisdiction.

The defendants applied to successfully strike out this part of the claimants' claim at first instance. The Court of Appeal agreed that the claimants' claim to compound interest on damages should be struck out. The Court of Appeal explained that the rationale of the equitable jurisdiction to award compound interest against a fiduciary or fraudulent wrongdoer was essentially restitution. The jurisdiction existed to prevent the wrongdoer from benefiting from their wrongdoing by restoring to the claimant both the property which had been taken from them and also the profits which have been, ought to have been, or fairly presumed to have been, earned from the wrongdoer's use of the claimant's property in the meantime. Importantly, the Court of Appeal clarified that compound interest was not awarded in equity simply because a defendant had behaved fraudulently.

Republic of Mozambique v Privinvest Shipbuilding SAL and ors

[2023] UKSC 32 (Lord Hodge (DP) Lord Lloyd Jones, Lord Hamblen, Lord Leggatt, Lord Richards)
20 September 2023

Arbitration— Arbitration Agreements—Stays

Three special purpose vehicles ("SPVs") indirectly owned by Mozambique entered into supply contracts with three of the respondents ("Privinvest") in connection with the development of Mozambique's exclusive economic zone (the "Contracts"). The SPVs borrowed funds with the benefit of guarantees granted by the then finance minister of Mozambique purportedly with sovereign authority (the "Guarantees"). Mozambique later accused the Privinvest and others of paying bribes to corrupt officials in Mozambique which potentially exposed Mozambique to a liability of c.US$2 billion under the Guarantees. Mozambique brought proceedings in England alleging bribery, unlawful means conspiracy, dishonest assistance and knowing receipt.

The Guarantees were governed by English law and subject to the jurisdiction of the English Court. The Contracts, however, were governed by Swiss law and contained arbitration agreements. Mozambique was not a party to the Contracts, but Privinvest alleged that Mozambique's claims fell within the scope of the arbitration agreements in the Contracts. Privinvest therefore sought a stay of the claims brought by Mozambique under section 9 of the Arbitration Act 1996 (the Act). A preliminary issue arose as to whether the claims brought by Mozambique were "*matters*" which fell within the scope of the arbitration agreements within the meaning of section 9 of the Act. At first instance, the Court held that they were not. That decision was overturned on appeal. The Supreme Court allowed the appeal.

When applying section 9 of the Act, the Supreme Court stated that the Court would follow a two-stage approach. At the first stage, the Court must identify the matters which the parties have raised or foreseeably would raise in the court proceedings and then, at the next stage, determine whether each such matter falls within the scope of the arbitration agreement on its true construction. In this respect, the Court had to ascertain the substance of the dispute between the parties and have regard to the defences raised or which reasonably foreseeably could be raised.

The Supreme Court further explained that the 'matter' did not need to encompass the whole dispute between the parties, but a 'matter' was a substantial issue that is relevant to the outcome of the legal proceedings rather than a peripheral issue. Accordingly, if a matter was not an essential element of the claim or defence, it was not a matter in respect of which legal proceedings were brought. The Supreme Court explained it was necessary to use common sense, and the Court should have regard to the context within which the matter arises in the legal proceedings and recognise a party's autonomy to choose which of several claims it wished to advance.

Applying this approach, the Supreme Court held that the substance of dispute was whether the Contracts and Guarantees were procured through bribery and whether Prininvest knew about the alleged illegality of the Guarantees. The Supreme Court held that when considering Mozambique's allegations, it was not necessary to examine the validity of the Contracts, while a defence that the Contracts were valid would not be relevant to Privinvest's liability. Neither the commerciality of the Contracts nor whether any value for money was provided thereunder were therefore 'matters' for the purpose of section 9 of the Act in relation to the question of Privinvest's liability. That left Privinvest's partial defence on quantum, namely that credit needed to be given for goods and services provided under the Contracts. The Supreme Court held that Swiss law approached the scope of arbitration agreement analogously to English law, and taking a common-sense view, rational businesspeople would not seek to send such a subordinate factual issue such as the quantification of loss to arbitration. It followed that the partial defences relating to quantification did not fall within the scope of the arbitration agreements.

Company Law

DIGESTED BY PETER BURGESS

FamilyMart China Holding Co Ltd v Ting Chuan (Cayman Islands) Holding Corp

[2023] UKPC 33 (Lord Reed, Lord Hodge, Lord Lloyd Jones, Lord Briggs, Lord Kitchin)
20 September 2023

Arbitration – Winding up petition – Just and equitable – Cayman Islands

This appeal was concerned with the issue of whether an agreement to arbitrate disputes in a shareholders' agreement prevents a party to that agreement from pursuing a winding up petition of the company, or whether an application to wind up a company on the just and equitable ground makes all matters that are the subject of those court proceedings non-arbitrable

FamilyMart China Holding Co Ltd ("FMCH") and Ting Chuan (Cayman Islands) Holding Corporation ("Ting Chuan") were shareholders, owning 40% and 60% respectively, of China CVS (Cayman Islands) Holding Corp (the "Company"), which was the subject of the winding up proceedings. The Company operates a substantial convenience store business in the People's Republic of China (the "PRC"). The relationship between FMCH and Ting Chuan was governed by a shareholders' agreement (the "SHA"). The SHA contained an arbitration agreement subjecting any disputes under the SHA to arbitration.

FMCH alleged in its petition for the winding up of the Company that Ting Chuan had caused the majority directors to act in breach of their duties. FMCH alleged (i) that it has lost trust and confidence in the conduct and management of the Company's affairs as a result of that lack of probity and (ii) that its relationship with Ting Chuan has irretrievably broken down. FMCH avers that it is just and equitable that the Company be wound up. FMCH sought an order that Ting Chuan be required to sell its majority stake to FMCH.

On the basis of the arbitration agreement in the SHA, Ting Chuan applied to strike out the petition or dismissal or a stay of the petition pending arbitration under section 4 of the Foreign Arbitral Awards Enforcement Act (1997 Revision) ("FAAEA").

At first instance, Kawaley J had granted a mandatory stay of the petition under section 4 of the FAAEA. The Court of Appeal had overturned that decision, holding that the court had exclusive jurisdiction to determine whether a company should be wound up on the just and equitable ground and that, as a result, the underlying disputes were not susceptible to arbitration, despite falling within the arbitration agreement.

Lord Hodge gave the judgment for the Board allowing the appeal and reinstating Kawaley J's decision. Two of the issues between the parties were substantive disputes between FMCH and Ting Chuan which provided the factual basis for the winding up petition on the just and equitable ground. They fell within the scope of the parties' arbitration agreement and must be determined by an arbitral tribunal unless the parties waive their right to arbitration. There must therefore be a mandatory stay of the winding up petition in relation to those issues under section 4 of the FAAEA. There should be a discretionary stay in relation to the other issues between the parties, since the determination of the two matters subject to a mandatory stay was the precursor to the determination of the petition.

Hilary Stonefrost

Old Park Capital Maestro Fund Ltd (in liquidation) v Old Park Capital Ltd (in liquidation)

[2023] EWHC 1886 (Ch) (Richards J)
27 July 2023

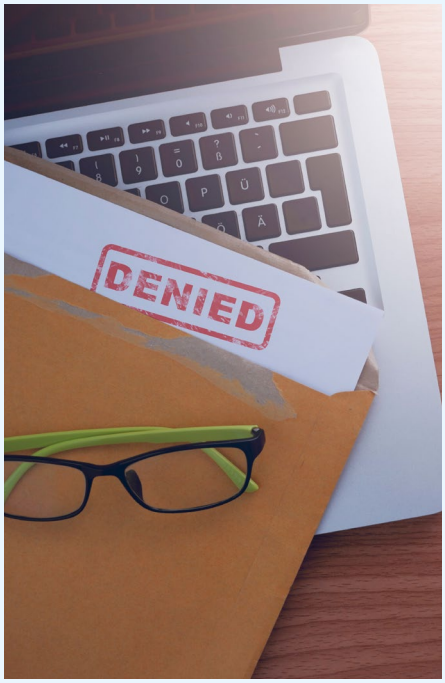
Investment fund – Directors' duties – Exoneration clauses – Cayman Islands

The liquidators of a Cayman Islands incorporated investment fund brought proceedings against its investment manager, one of its directors, and a director of the investment manager, alleging deceit, breach of contract, and breach of fiduciary duty. The fund's claim against the director of the investment manager succeeded on the basis of deceit. Its claims against the defendant director all failed. The fund's claims for breach of trust and breach of contract against the investment manager would succeed if the claim had not been stayed under s 130(2) of the Insolvency Act 1986.

As part of the decision, Richards J considered the effect of exoneration clauses in the fund's articles of association, which provided that no director would be liable to the fund unless the liability arose through actual fraud or wilful default of the director.

The fund argued that the exoneration clauses were not capable of protecting the defendant director from liability for the irreducible core of his fiduciary duties to the fund, of which his duty to avoid a conflict of interest, formed a key part. Accordingly, the fund argued that any breach of such duties fell outside the scope of the exoneration clauses as a matter of Cayman Islands law.

Richards J considered that the fund's argument failed. The cases on which it relied did not support the proposition. As a result, he concluded that the exoneration clauses in the fund's articles were capable of excluding the defendant director's liability for breach of the fiduciary duty to avoid conflicts of interest. Accordingly, though the defendant director was in breach of his duty on the facts, the exoneration clauses excluded liability for the breach of duty.



Corporate Insolvency

DIGESTED BY RABIN KOK AND IMOGEN BELTRAMI

Darty Holdings SAS v Geoffrey Carton-Kelly; Re CGL Realisations Ltd

[2023] EWCA Civ 1135 (Lewison, Newey and Laing LJJ)

Preferences – Section 239 – Desire to prefer – Decision to prefer – Board minutes

For a transaction to be voidable as a preference under s 239 of the Insolvency Act 1986, the preference-giver must be "*influenced in deciding to give it by a desire* [to prefer]".

So the *decision* to prefer must be identified, and that decision must be tainted by the forbidden desire to prefer. If one enters the alleged preference transaction by decision A, but a desire to prefer emerges at some unconnected point B, section 239 is not engaged.

In *Darty*, KIL was the parent of Comet, in liquidation. KIL sold Comet's shares to OpCapita. The SPA provided for a £115m intra-group loan to be repaid to a KIL-linked entity. Comet's liquidator alleged this to be a preference. Falk J found that it was.

Her decision turned on a finding: that the 'real' decision to repay was made on the day the SPA was entered into (9 November 2011), rather than on the date of a Board resolution to repay the loan (3 February 2012). That was because the minutes recited the SPA and loan repayment as having been made "*for the commercial benefit of the Company*", i.e., not in consequence of a desire to prefer. The board minutes were not challenged. But Falk J inferred from the circumstances that, as a matter of commercial reality, Comet had little choice but to repay the intra-group loan when the SPA was executed on 9 November 2011 – so in her eyes the decision to prefer was made then.

Lewison LJ disagreed. In his view, the evidence showed that Comet was expected to repay the intra-group loan, but that expectation was not a decision. Even if there was a 'decision to repay conditional on Board ratification', that was not a true, operative decision.

Accordingly, Lewison LJ found that the actual decision to repay the loan was made on the date of the relevant board resolution (3 February 2012). The unchallenged content of the minutes recording the resolution contained no trace of desire – so Darty's appeal was allowed, and the liquidator's claim failed.

Tom Smith KC

Henry Phillips

Re Praesidiad Ltd

[2023] EWHC 2745 (Ch) (Sir Alastair Norris, sitting as a High Court Judge)
1 November 2023

Scheme of arrangement – Sanctions - Right to vote

On 17 October 2023, Sir Alastair Norris made an order (the "Convening Order") convening a single meeting of specified creditors of Praesidiad Ltd (the "Company") for the purposes of seeking their approval of a proposed scheme of arrangement (the "Scheme"). In making the Convening Order, Sir Alastair Norris dismissed a challenge brought by a lender under the Company's existing lending arrangements whose debt was to be compromised and restructured by the Scheme. The lender was Bank GPB International S.A. ("GPB"), an entity wholly owned by Gazprombank JSC. Gazprombank JSC is a "*designated person*" for the purposes of the asset-freeze provisions of the Russia (Sanctions) (EU Exit) Regulations 2019/855 (the "Russia Regulations"), rendering GPB itself a sanctioned entity subject to the Russia Regulations. It is the first decision that includes a reasoned judgment, following adversarial argument, on the impact of the Russia Regulations.

The challenge brought by GPB was two-tiered. First, GPB contended that a single meeting of creditors was inappropriate to consider the Scheme and that it should be placed in a separate class. Secondly, GPB objected to its inability to vote at the relevant meeting of creditors, a restriction imposed as a result of GPB's status as a sanctioned lender.

As to the first challenge, Sir Alastair Norris considered a single class meeting to be appropriate and "*fully in accord*" with prior jurisprudence. Whilst GPB had been, by virtue of necessity as a sanctioned entity, subject to slightly different treatment in comparison to other Scheme Creditors (e.g. it was unable to participate in the Lock-Up Agreement or interim funding facility arranged by the Company, and its scheme consideration would be placed into a holding period trust), those matters could not fracture the class or justify placing GPB into a single member class "*with the power to veto the scheme*". This was because opportunities such as the Lock-Up Agreement and participation in the new money to be put in place pursuant to the scheme were offered to all Scheme Creditors. GPB was simply unable to accept these offered benefits due to its status as a sanctioned entity. This restriction was generated by GPB's own personal status rather than any action of the Company. Instead, such matters could instead go to fairness at the sanction hearing.

As to the second objection, Sir Alastair Norris rejected GPB's contention that it should be permitted to vote at the Scheme Meeting. The question of whether scheme creditors subject to applicable sanctions legislation may be permitted to vote has been raised in relation to previous schemes: see for example *Re Nostrum Oil & Gas plc* [2022] EWHC 1646 (Ch) and *Re CFLD (Cayman) Investment* [2022] EWHC 3496 (Ch).

In analysing the correct position, Sir Alastair Norris reviewed Regulation 11(4) of the Russia Regulations, which details the restrictions on dealing with funds imposed on sanctioned entities. He rejected two arguments advanced by GPB, which alleged that (i) the exercise of a vote does not constitute "*dealing with*" or "*use of*" an economic interest, thereby falling outside the Scope of Regulation 11; and (ii) a vote was simply a preparatory act which did not in itself affect "*the volume, amount, location, ownership, possession, character or destination*" of the relevant frozen economic interest or its characteristic as a tradable financial asset. Instead, the court held that the exercise of voting rights would constitute "*dealing with*" GPB's loan participation in the Company's existing debt as a tradable financial asset, and that it was not possible to determine the ability of a sanctioned lender to vote by virtue of how they intended to exercise that vote.

In holding against GPB, Sir Alastair Norris created a "*clear rule which is capable of straightforward application*"; sanctioned lenders are not permitted to exercise voting rights.

David Allison KC **Imogen Beltrami**

Superdrug Stores plc v Protein World

[2023] 7 WLUK 547 (Deputy ICC Judge Parfitt)
13 July 2023

Injunctions to restrain advertisement – Disclosure application

The Judge dismissed the debtor company's application for a disclosure order against the petitioning creditor and for an injunction to restrain advertisement of a winding-up petition. The Judge held that the company had been unable to provide any meaningful substance to back up its assertion that the debt was disputed and had only attempted to articulate a dispute as a response to the petition. The alleged crossclaim was even harder to fathom.

The company asserted that it was in a 'chicken and egg' situation because it did not have the documents required to be able to articulate the dispute and crossclaim. The Judge held that the company's approach was in essence a fishing expedition to attempt to gather material to support a claim that does not presently exist, a claim of the most ephemeral nature which, if it had any substance, would be capable of being proved from documents that would already be in the company's possession. The Judge accepted the petitioner's submission that the jurisdiction to order disclosure on a winding-up petition was sparingly exercised. The approach in *Highberry v Colt*, in the context of an administration application, should be applied to winding-up petitions. A winding-up petition is a fairly summary process which requires a speedy resolution, which is relevant to whether it is in accordance with the overriding objective to order disclosure. It was not appropriate to order disclosure on the facts, in particular given the breath of the disclosure order sought.

Finally, the CICA refused to order the Rs to pay security for costs. Both Rs were emanations of the State of Kuwait. The starting position is that security for costs will not usually be ordered against a state, and there was no reason to depart from this approach in the present case.

Paul Fradley

Re Fitness First Clubs Ltd

[2023] EWHC 1699 (Ch) (Michael Green J)
29 June 2023

Restructuring - Out of the money - Third parties

On 29 June 2023, Mr Justice Michael Green sanctioned a Part 26A restructuring plan ("the Plan") proposed by Fitness First Clubs Limited, the company which operates the Fitness First group of gyms in London and around the UK ("the Company"). In doing so, the Judge dismissed two separately brought challenges by different classes of landlord creditors, whose claims under their leases were to be compromised under the Plan. Notably the Plan and its proposition for an instalment plan to repay historic VAT liability was supported by His Majesty's Revenue and Customs ("HMRC"), despite its active opposition to preceding restructuring plans.

In engaging the jurisdiction in section 901G of the Companies Act 2006 (the "2006 Act"), Green J relied on the cross-class cram down power to impose the Plan on five creditor classes who had voted against it. All opposing creditor classes comprised landlords of premises at which the Company operated its gyms.

The landlords' opposition concentrated on two points: first, the satisfaction of Condition A (the "*no worse off test*") under section 901G(3) of the 2006 Act; and secondly, the exercise of the Court's general discretion to sanction the Plan.

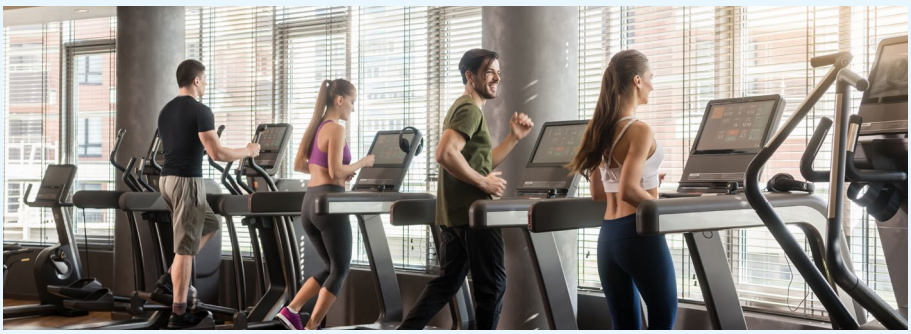
In relation to Condition A, Green J accepted that the Company had correctly identified the relevant alternative for the purposes of deciding whether the dissenting landlords were no worse off under the Plan: being a pre-packaged administration sale of the business and assets. The Judge rejected the suggestions advanced by the opposing landlords that the Company could in fact survive outside of a formal insolvency process, labelling such argument "*unsustainable on the factual evidence*". Green J also held that the no worse off test was ultimately satisfied given that the recoveries for all Plan Creditors including the landlords would be either greater or more rapidly realised (in the case of HMRC) under the Plan than in the relevant alternative as identified.

In relation to the exercise of the Court's discretion, Green J held that all of the opposing landlord creditors were "*out of the money*", meaning that their views on the fairness of the Plan distributions faced "*serious difficulties*" and little weight could be afforded to them. Further, in considering the fairness of the Plan, the Judge endorsed a wider approach to the compromise of third-party claims than that taken under the plan jurisdiction thus far. Specifically, it was held that an ultimately valueless third-party guarantee claim, which did not have the capacity to trigger a ricochet claim, could nonetheless be compromised without causing unfairness, and was in fact justifiable to "*safeguard the success of the Plan*".

Tom Smith KC

Georgina Peters

Robert Amey



Re Prezzo Investco Ltd

[2023] EWHC 1679 (Ch) (Richard Smith J)
5 July 2023

Restructuring - Jurisdiction - Fairness

On 5 July 2023, Mr Justice Richard Smith sanctioned a Part 26A restructuring plan ("the Plan") proposed by Prezzo Investco Limited (the "Company"), the parent company of Prezzo Trading Limited ("Prezzo Trading"), which operates a popular chain of Italian restaurants across the UK. The Plan sought to restructure the liabilities of both the Company and Prezzo Trading.

The Judge relied upon the jurisdiction afforded by section 901G of the Companies Act 2006 (the "2006 Act") to cram down two opposing creditor classes who had voted against the Plan. The opposing classes comprised His Majesty's Revenue and Customs ("HMRC") and certain "*other creditors*", namely landlords of loss-making restaurant sites and local authorities to which business rates and council tax were owed.

The decision made a number of advancements for the restructuring jurisdiction.

Firstly, a novel jurisdictional point was determined. To found the restructuring jurisdiction, Condition B of section 901A(3) of the 2006 Act requires a proposed "*compromise or arrangement*" between the company and its creditors; the latter has traditionally been interpreted as requiring an element of "*give and take*" *(Re Lehman Brothers International (Europe) (No 2)* [2019] Bus LR 489). The Judge held that in the context of a restructuring plan, the concept of "*arrangement*" could not require compensation to be provided to "*out of the money*" creditors. This was the first time the point has been decided under Part 26A and marks a departure from the conventional approach to jurisdiction taken under the scheme jurisdiction.

Secondly, Smith J considered the ambit of Part 26A and refused to endorse the restrictive interpretation suggested by HMRC. HMRC "*in effect*" contended that the Court should not, as a matter of principle, entertain the possible sanction of any restructuring plan without the discharge of, or proper provision for, all preferential liabilities incurred by the relevant plan company to HMRC during the period in which a plan was developed. The Judge "*firmly*" rejected this proposition, holding that such a conclusion would impose an "*inappropriate fetter on the power afforded by Part 26A*".

This was the first decision since *Re Nasmyth Group Limited* [2023] EWHC 998 (Ch) and *Re Great Annual Savings Company Limited* [2023] EWHC 1141 (Ch) to dismiss a challenge by HMRC. In doing so Smith J distinguished those cases on their facts, rejecting the contention that the Company had intentionally traded at HMRC's expense during the promulgation of the Plan and holding that the Plan was not being used as an instrument of abuse. He recognised HMRC's position as an involuntary creditor and the general need for caution in considering the cram down of its (often preferential) debts but was nevertheless satisfied that the allocation of benefits under the Plan was fair, and properly reflected the priority in which creditors would be paid in the relevant alternative of an administration.

Tom Smith KC

Georgina Peters

Re Cimolai SpA

[2023] EWHC 1819 (Ch) (Trower J)
14 July 2023; [2023] EWHC 2193 (Ch)

Restructuring - Relevant alternative - Class composition - Ricochet claims

On 25 August 2023, Mr Justice William Trower sanctioned the restructuring plans ("the Plans") proposed by Cimolai SpA ("Cimolai") and Luigi Cimolai Holdings SpA ("LCH") (together, the "Companies") to restructure disputed English law derivative claims against the Companies. The Plans operated in parallel to Italian *concordato preventivo* proceedings (the "CPs") necessary to restructure the Companies' debts under Italian and other EU laws. Many of the creditors with claims under the English law derivative contracts declined to submit to the jurisdiction of the Italian courts, necessitating the Plans.

This case is the first English restructuring plan to work in parallel to an Italian *concordato preventivo* process and is the first time such a process has been formally recognised by the English courts. In his "Convening Judgment", Trower J found that the desirability of rendering the restructuring effective holistically in as many jurisdictions as practicable provided a "*rational basis*" for the Companies to conclude that a parallel English restructuring was an appropriate process to commence in conjunction with the Italian proposals.

In his Convening Judgment, Trower J made a number of findings on class composition. Trower J first identified the appropriate comparator to the Plans as a scenario in which the *concordato* proposals were sanctioned but the Plans were not, meaning that English law creditors would not be bound by the CPs nor have their claims compromised as a matter of English law due to the rule in *Gibbs*. As such, a class distinction existed between these English law creditors and those who would be bound by the CPs, with the difference in applicable law constituting a material difference in rights.

Additionally, Trower J accepted that, at a primary level, all unsecured creditors, whether their claims are disputed or undisputed, will normally be faced with "*the same essential decision to make*" at a scheme or plan meeting, making it possible for all such creditors to be placed in the same class. However, the class constitution exercise is "*fact-sensitive*", and a distinction was subsequently drawn between disputed and undisputed claims in this case given that the motivations of the litigating creditors were necessarily influenced by the impact of the restructuring plan on "*such matters as litigation tactics*", thereby fracturing the class.

In sanctioning the Plans, Trower J engaged the cross-class cram down jurisdiction after three single creditor class meetings in respect of Cimolai and one single creditor class meeting in respect of LCH failed to vote on the Plans at all.

In relation to Condition A (the "*no worse off test*"), the Judge first identified the most likely relevant alternative, which replicated the comparator identified in the Convening Judgment. The evidence submitted proved that the value of the Companies' assets outside of Italy were "*insufficiently substantial*" to make it worthwhile for any creditor to enforce an uncompromised English law claim in a manner inconsistent with a sanctioned Italian restructuring. Given this reality, Trower J found it "*speculative*" that any English law creditors may recover more than that offered under the Plans via the enforcement of their English law rights outside of the CPs, thereby holding the no worse off test satisfied.

As to discretion, Trower J found the provisions of the Plans to be fair and reflective of the statutory priorities applicable in Italian insolvency proceedings. The Judge also cited with approval (obiter) the analysis of Mr Justice Michael Green in *Re Fitness First Clubs Ltd* [2023] EWHC 1699 (Ch) in relation to the alteration of creditors' rights against third parties, regardless of their capacity to trigger a ricochet claim. Trower J considered (obiter) that the release of a creditor's claim against LCH by the terms of the Cimolai plan was ancillary to that plan due to the need to ensure that LCH would be "*cleansed*" of the claim. Had the claim not been released, it would have had a "*potentially destabilising effect*" if the LCH plan had not been sanctioned.

Adam Al-Attar

Lottie Pyper

Hunt v Singh

[2023] EWHC 1784 (Ch) (Zacaroli J)
17 July 2023

Sequana – Directors' duties – Zone of insolvency

When a company enters the '*zone of insolvency*', each of its directors must take the interests of creditors – not just shareholders – into account when carrying out their duties. In *BTI v Sequana* [2022] 3 WLR 709 (UKSC), the Supreme Court held that company does not enter the zone of insolvency simply because that company is at a 'real risk' of insolvency at some point in the future – even if the risk is 'more than remote'. Rather, the creditor duty will be triggered when the directors actually knew, or were reckless as to the fact that, either (a) insolvency was *imminent* or (b) that it was probable. Knowledge of a 'real risk' of insolvency is simply not enough.

The liability in Sequana was a contingent liability (to pay for the costs of pollution clean-up if certain events occurred). The Justices held that the directors knowledge of the risk of this contingent liability arising was insufficient to trigger the '*zone of insolvency*'.

That leaves a number of unanswered questions. One is: when does the zone of insolvency arise when the Company faces a liability which is so large that it threatens the Company's solvency if valid?

Zacaroli J answered this question in *Hunt*. The insolvent company brought a claim against a director. When that director was in office, the Company faced a claim by HMRC to pay interest on unpaid NIC. It disputed this liability. Zacaroli J held that the company had entered the 'zone of insolvency' despite its challenge to the tax liability. Though disputed, the liability was not contingent but present. Unlike Schrödinger's cat, it either existed right now, or did not. And if the liability did exist, it was so large that the Company would be insolvent.

Re Greensill Capital (UK) Ltd

[2023] EWHC 2429 (Ch) (Sir Anthony Mann, sitting as a Judge of the High Court)
19 September 2023

Part 36 offers – Insolvency Rules – Insolvency Applications

Insolvency Act applications often serve as the originating process for hostile litigation, such as preference claims, undervalue claims and claims under s 423 of the Insolvency Act 1986. In *Greensill*, where the administrators of Greensill brought an application for directions as to the owners of certain funds held by the Company. But this litigation turned hostile when opposing parties made opposing claims to the funds, and the Court ordered points of claim as well as a trial. The Judge held that the case "*might just as well have been brought by a Part 7 and a Part 8 claim*".

One party's solicitors made a Part 36 offer to settle the litigation. The question before Sir Anthony Mann was whether the Part 36 regime applied to proceedings that begin life as Insolvency Act Applications, or otherwise under the Insolvency (England & Wales) Rules 2016.

Sir Anthony Mann decided that Part 36 did apply to insolvency proceedings. R 12.1 of the Rules provides that the provisions of the CPR apply to all proceedings under the Act and Rules, so far as disapplied by or inconsistent with the Rules. The Judge held that r 12.4(1), which sets out a separate regime for dealing with costs, was not inconsistent with r 12.1. The Judge's decision does suggest at certain points, however, that Part 36 may not apply in non-hostile proceedings, such as non-hostile applications for directions.

Ryan Perkins

Galapagos Bidco Sarl v Kebekus

[2023] EWHC 1931 (Ch) (Trower J)
28 July 2023

Restructuring - Distressed disposal - Contractual interpretation - Debt

On 28 July 2023, Mr Justice William Trower determined that the 2019 restructuring of a group of companies to which Galapagos Bidco S.à r.l. ("Bidco") belonged (the "Group") was validly effected in accordance with the terms of an English law intercreditor agreement (the "ICA"). Prior to the restructuring Bidco was the wholly owned subsidiary of Galapagos S.A ("GSA"), which was itself a wholly owned subsidiary of Galapagos Holdings S.A. ("GHSA").

Seeking a declaration that the restructuring was not effective was Signal Credit Opportunities (Lux) Investco II S.à r.l. ("Signal"), a junior creditor and minority holder of a proportion of high yield notes ("HYNs") issued by GHSA. with a face value of c. €73.3 million. Signal sought declarations that the restructuring had not been effected in accordance with the terms of the ICA and that the liabilities and security in respect of the HYNs were not validly released. The English proceedings represented just one in a series of legal challenges to the restructuring of the Group made by Signal in a number of jurisdictions.

The rights of certain "Primary Creditors" including Signal in respect of "Original Debt" such as the HYNs and various other financing arrangements including a series of senior secured notes issued by GSA ("SSNs") were governed by the ICA, which provided the terms upon which the rights of such creditors could be enforced and discharged.

The ICA included provision for "Distressed Disposal", in the event of which an appointed Security Agent gained powers permitting the release of the claims of Primary Creditors in relation to the Original Debt. These powers were governed by Clause 17, which contained a number of conditions, the most relevant of which being that (i) the proceeds of any sale or disposal would be in cash or substantially in cash ("Condition A"); and (ii) all claims of Primary Creditors against any member of the Group would be unconditionally released concurrently with the relevant sale and would not be assumed by the relevant purchaser ("Condition B").

It was pursuant to such a Distressed Disposal that the full share capital of Bidco was sold or disposed of on 9 October 2019 to Mangrove LuxCo IV S.à r.l. ("Mangrove") (the "Disposal"). The restructuring ensured that the proceeds from this disposal were applied to repay creditors in the order of their ICA-designated priority and release their liabilities. The central question for the Court was whether these releases were effective.

In holding the restructuring to have been effective, the Court made a number of findings pursuant to the Distressed Disposal provision of the ICA.

In relation to Condition B, Signal argued that the Disposal left a number of Primary Creditors as creditors of the new purchaser group of which Mangrove formed part. This argument was premised on the fact that Mangrove's parent company had issued a series of new senior secured notes (the "New Notes") following completion of the Disposal, a substantial proportion of which were issued to holders of the SSNs.

Trower J found that there was nothing in the language of Condition B to prevent existing creditors from agreeing to engage in fresh lending to the new purchaser group following the Disposal. Proper construction of the ICA showed that its definition of Primary Creditor did not encompass a creditor under the New Notes or further security created following the Disposal. The claims arising under those instruments were held by re-subscribing noteholders in a "*different capacity*", and by creditors who had not acceded to the ICA in that capacity. Trower J considered it to be an "*unjustified leap in the logic*" to contend that prior lenders such as the holders of the SSN's were effectively barred from becoming creditors of the Group under alternative financing arrangements following completion of a Distressed Disposal. He found that such an "*illogical*" result would be a "*wholly uncommercial consequence*" of Signal's proffered construction of the ICA given that typically the most fruitful source of finance for businesses in distress will usually be the funders with existing commitments.

In relation to Condition A, Signal primarily contended that the proceeds of the Disposal were not in cash or substantially in cash because the obligation to pay a material portion of the purchase consideration was satisfied (c.65%) by way of set-off. This set-off discharged the sums owed by re-subscribing noteholders in respect of the New Notes against Mangrove's obligation to pay consideration to those noteholders pursuant to the distributions due to them following the Disposal.

Trower J disagreed with this reasoning, holding that restricting the construction of this requirement to one necessitating only a traditional transfer of cash in the form of legal tender would be a "*most improbable stipulation*". The Judge considered that the proceeds of the Distressed Disposal constituted what was generated from the promise to pay in cash. As a matter of principle there was no reason why the proceeds of the Disposal could not be treated as being "in cash" if by applying those proceeds as a set-off against the subscription price for New Notes, the obligation arising under the promise to pay was discharged.

Finally, the Court made findings on Bidco's "*fallback position*", pursuant to which it was argued that upon true construction of the ICA, the conditions laid down in Clause 17 did not require satisfaction if the holders of HYNs had no economic interest in the assets of the Group and would receive no return if the Distressed Disposal did not occur.

Trower J held that the ICA could operate "*perfectly satisfactorily*" without implying a term to the effect that the provisions need not be satisfied if the HYN holders were "*out of the money*".

Such implication would in fact run contrary to the express language of Clause 17, as well as engendering commercial uncertainty and lack of predictability. The Court therefore refused to imply the term. Despite these findings, the Judge did go on to consider that "*overwhelming evidence*" proved that there would be no return to the holders of the HYNs if Bidco had been subjected to a formal insolvency proceeding (identified as the correct counterfactual) rather than the restructuring. As such, Signal was considered "*significantly out of the money*" at the time of the Disposal.

Tom Smith KC

David Allison KC

Henry Phillips

Ryan Perkins

Re Sova Capital

[2023] EWHC 2690 (Ch) Miles J
3 October 2023

Client Monies – Client Assets – Bar Dates – Adjudication Procedures

The joint special administrators of Sova Capital Limited applied for: first, pursuant to Regulation 12C(3) of the Investment Bank Special Administration Regulations 2011, for the court's approval of a hard bar date for the submission of claims for the return of client money held by Sova; second, an order under Regulation 12D(1)(c) of the Regulations , alternatively para.63 of Schedule B1 of the Insolvency Act 1986 or, alternatively, the inherent jurisdiction of the court, for the court's approval of an adjudication procedure in relation to client money claims and other non-client money custody asset claims. Held, in relation to the first application, that the court must read the phrase "*no reasonable prospect*" in Regulation 12(D)(2) in the light of the policy behind the hard bar regime, namely the expedition of and assistance of the closure of the client money pool, and that the test should be applied or interpreted in a manner which makes these goals sensibly achievable; and that jurisdictional requirement had been met on the facts (and it would be appropriate for the Court to exercise its discretion and make the order). Held, in relation to the second, that the Court had an inherent jurisdiction to approve an adjudication procedure (*Re MF Global* [2013] EWHC 1655 (Ch) applied), and that on balance, it would be helpful to have a formal procedure for crystallising matters and bringing any such claimants out of the woodwork.

William Willson

Liberty Commodities Ltd v Citibank Na London

[2023] EWHC 2020 (Ch) (Chief ICC Judge Briggs)
28 June 2023

Winding-up petitions – Substitution – Failure to prosecute – Disputed debt

If a petition is dismissed by the Petitioner's consent, but there are supporting creditors who wish to be substituted, the Court's practice is to order substitution of the supporting creditors first and determine any dispute about the supporting creditors' debt, that is, its standing to petition, later. In Liberty, Chief ICC Judge Briggs labelled this '*Substitution First, Standing Later*'. As Mr Fisher KC told the Court, this has been the Court's practice for all of Mr Fisher's working life at the Bar.

In *Liberty*, it was argued that substitution could not take place until and unless the Court first found that the Petitioner had standing to present a petition. This argument was based on one made by Professor Keay in *McPherson & Keay*, at 3.077.

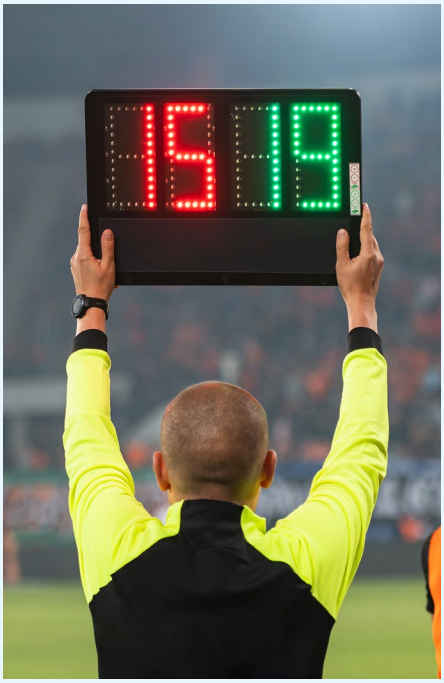
Chief ICC Judge Briggs disagreed. The court almost never has the necessary evidence to decide on standing at the time of the substitution application, which is normally made in a crowded list of over 200 petitions. The Court therefore upheld the '*Substitution First, Standing Later*' practice, but noted that the debtor company should raise the issue of standing at the time of the substitution application to enable directions to be given.

The Court also noted that the practice of the Court is to dismiss a petition which is not advertised by the first hearing (though many judges will wait until the second hearing). It is also the Court's practice to dismiss a petition where the petitioner fails to attend. These are important reminders.

Richard Fisher KC

Marcus Haywood

Georgina Peters



Personal Insolvency

DIGESTED BY LOTTIE PYPER

Brake and another v The Chedington Court Estate

[2023] UKSC 29 (Lord Briggs, Lord Hamblen, Lord Leggatt, Lady Rose and Lord Richards)
10 August 2023

Trustees in bankruptcy - Section 303(1) IA 1986 – Standing - Capacity

Mr and Mrs Brake were both bankrupt ("Bs"). In their personal capacities, Bs were partners in a partnership with another individual (the "Partnership"), as well as being trustees of a family trust (the "Brake Trust"). The Partnership owned a property (the "Cottage") with the partners in the Partnership, including Bs, being registered owners of the Cottage. Bs sought to purchase the Cottage on behalf of the Brake Trust but were outbid by another purchaser (the "Purchaser"). The individual who was at the time the single trustee in bankruptcy of Bs estate (the "Trustee") agreed to enter into an arrangement dated 10 January 2019 with the Partnership and the Purchaser in order to transfer all interests in the Cottage to the Purchaser, in exchange for a lump sum and monthly fee for assisting with the transfer, with such funds to be used to cover the Trustees costs of assisting with the transaction and otherwise for the benefit of Bs' creditors.

Bs sought to challenge the actions of the Trustee under section 303(1) of the Insolvency Act 1986. This section entitles a bankrupt, a creditor or any other person who is "*dissatisfied by any act, omission or decision of a trustee*" to apply to the court, and on such application the court may confirm, reverse or modify the act or decision complained of, or make any other order as it sees fit. The question was whether Bs had standing to make such an application in this case, either in their capacity as the bankrupts, or in their capacity as trustees of the Brake Trust.

In order for a bankrupt to have standing under section 303(1), he had to show that there was or was likely to be a surplus in the bankruptcy estate. That was the not the case here so Bs did not have standing in their capacity as the bankrupts.

The circumstances in which "*any other person*" has standing under section 303(1) are limited to situations where their rights or interests are directly affected by a matter arising from powers conferred on the officeholders under the bankruptcy regime. Bs did not fall into this category in their capacity as trustees of the Brake Trust.

The Supreme Court's findings on the scope of section 303(1) were narrower than the Court of Appeal below. They allowed the appeal and, therefore, Bs' application.

Patley Wood Farm LLP and others v Kristina Kicks and others

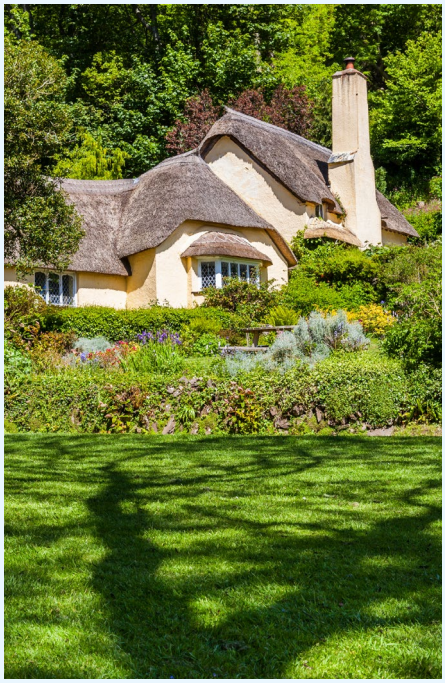
[2023] EWHC Civ 901 (Lewison, Asplin and Arnold LJJ)
28 July 2023

Trustees in bankruptcy - Section 303(1) IA 1986 - Appeals

This case also concerned Mr and Mrs Brake ("Bs"). Following an application under section 303(1) of the Insolvency Act 1986 made by (inter alia) two creditors of Bs, the first instance judge made an order directing the current joint trustees of Bs bankruptcy estates (the "Trustees") to make an application (the "Eviction Claim") to join and oppose a claim made by Bs seeking a declaration that they were the registered proprietors of a property (the "Cottage") and entitled to exclusive possession of it.

Since the application under section 303(1) was made by Bs' creditors, there was no issue as to standing. The question here was whether and in what circumstances it is appropriate to interfere with the Trustees' discretion. The Court held that, although it was the Trustee's duty to act in the creditors' interests, they are not required to do so at all costs. The reasons given by the Trustees for their decision not to join and oppose the Eviction Claim was that it was unlikely to result in any benefit to the creditors, there were various significant downsides in terms of time and expense, and there was a risk of the Trustees' independence being compromised. In the circumstances their decision not to join the Eviction Claim was not perverse.

The Court of Appeal therefore allowed the appeal against the first instance decision, such that the application under section 303(1) was dismissed.



Property and Trusts

DIGESTED BY DANIEL JUDD

Bhaur v Equity First Trustees (Nevis) Ltd

[2023] EWCA Civ 534 (Snowden LJ)
18 May 2023

Mistake – Voluntary dispositions – Tax avoidance

This was a case about whether or not a tax avoidance arrangement could be unwound on the basis of mistake, and is the latest decision in the *Pitt v Holt* line of authority. The tax avoidance arrangement involved an employee benefit trust ("EBT"). Mr and Mrs Bhaur sought to avoid inheritance tax on their property business by using the scheme, and paid fees to a tax advisor for this purpose.

The scheme was an artificial one and previous aspects of the arrangement been challenged by HMRC. One aspect of the scheme was that certain shares were held on trust for employees of a newly incorporated English company. Importantly, these beneficiaries excluded Mr and Mrs Bhaur and persons connected with them (except for payments of income). In the face of possible challenge by HMRC, this first trust was replaced by a second trust on materially the same terms. Mr and Mrs Bhaur believed that the scheme was reversible, save for the costs of the tax advisor.

The trustee corporation and protector of the second trust was connected with the tax advisor. After investigations by HMRC into schemes promoted by the tax advisor, the second trust began to be administered according to its terms. The trustee proposed payments of income to Bhaur family members. Mr and Mrs Bhaur refused to accept them. The disagreement was not resolved, and the trustee resolved to bring the trust to an end, and the NSPCC was appointed as the recipient of the entirety of the remaining trust fund. Mr and Mrs Bhaur then sought to unwind the scheme on grounds of mistake.

The High Court refused to grant relief for mistake. The court considered the three-part framework laid down by the Supreme Court in *Pitt v Holt* [2013] AC 108 for setting aside a voluntary disposition on grounds of mistake: (i) a mistake, which is (ii) of the relevant type, and (iii) sufficiently serious so as to render it unjust or unconscionable on the part of the done to retain the property. Mr and Mrs Bhaur were not "mistaken" in the essential tax evasiveness of the scheme. Rather, they knew the scheme to carry the risk of failure and possible adverse consequences, and made a "*misprediction*".

The Court of Appeal considered the debate regarding the fine distinction between a "*mistake*" and "*misprediction*", but disposed of the appeal independently of that issue. The key point was that it was known that there was a risk that the scheme would not work, even if the full extent of adverse potential consequences were not appreciated. A deliberate decision was made to implement the scheme, in the knowledge that there was a risk that the scheme would not work, and that family may be worse off than before. Even if a "*mistake*" had been made, relief would have been refused under the third stage of the *Pitt v Holt* test, and it was of considerable weight that the scheme concerned artificial tax avoidance. Snowden LJ added that, even where a person was a victim of a dishonest adviser, this was not a basis for invoking the equitable jurisdiction in mistake where they later discover that the adviser acted dishonestly.

PROFESSOR
CHRISTOPH G. PAULUS
ASSOCIATE SOUTH SQUARE

Euroland

A little update on what in this Digest is called Euroland might be warranted in sight of an ongoing discussion about the latest proposal for a harmonisation Directive[1] as well as a few judgments already rendered by the CJEU or to be rendered soon.

I. Directive for the harmonisation of certain aspects of insolvency law

As a reminder: This proposal[2] for a new Directive from December 2022 looks to harmonise the member states' insolvency laws with regard to a variety of topics, in particular with regard to avoidance actions, tracing of assets belonging to the estate, pre-pack proceedings, directors' duty to submit a request for opening of an insolvency proceeding, simplified winding-up proceedings for microenterprises, creditors' committees, and the drawing-up of a key information factsheet by Member States on certain elements of their national law on insolvency proceedings. As of October 2023, the discussions with the member states' legislative authorities continue.

It was clear (and expected) from the outset that the December 2022 proposal would provoke intense debates in the member states and it seems as if each member state has insofar its own "pet subject". Take Germany, for instance – whereas the proposal for harmonisation of avoidance rules there is said to be acceptable without further ado (no wonder: the more or less in toto accepted draft from Bork and Veder[3] appears in large parts like a copy of the existent German avoidance rules), the administrator-free proceeding for microenterprises has ignited heated discussions. It is primarily, though not solely, the lobby of insolvency administrators which opposes such an idea – the (not really very convincing) argument being that 80% of the German insolvency proceedings would then be without supervision from a neutral instance. In contrast, Italy seems

1. Cf. South Square Digest April 2023, p. 72
2. COM(2022) 702 final.
3. Harmonisation of Transaction Avoidance Laws, 2022

to focus primarily on the pre-pack proceeding and others sense a filing duty for the opening of an insolvency proceeding as unbearable.

This diversity of alleged unbearability is in itself telling – it is to be feared that it is an expression of another diversity far more fundamental than those particular subjects covered by the proposal. It seems that the purposes of the member states' insolvency laws differ widely. The most notorious difference is the one between the German and the French law – whereas the latter strives to rescue as many enterprises and working places as possible, the former is looking for the best possible satisfaction of the creditors. This difference leads, in a case where a French and a German administrator happen to have shared responsibility, to the weird result that one of them is looking for the bidder with the highest offer and the other for the bidder who guarantees the preservation of most working places. But beyond this evident difference, too, one finds varying priorities in the target setting of the insolvency laws. To remind the English reader: the goal of the English law since 2002 is fostering of entrepreneurship. Accordingly, when administrators from different jurisdictions talk about their intent to achieve better results in their proceedings, they are likely to all have a different understanding of what they mean by "*better*". It seems as if this "*better*" should first be clarified and harmonised before one turns the rules in detail.

II. CJEU decisions

I shall discuss two decisions here, both rendered by the CJEU in the first half of this year.

A. CJEU, decision from 16 February 2023 – C-710/21 – IEF Service

This judgment is about the Directive 2008/94/EC on the protection of employees in the event of the insolvency of their employer. The underlying case deals with the refusal of the Austrian guarantee institution (Insolvenz-Entgelts-Fonds, 'IEF Service GmbH'=) to grant compensation to HB. IEF Service GmbH was established in accordance with the said Directive and tasked to provide such compensation in the event of the insolvency of an employer. HB is a German who has his main residence in Germany but is employed by the Austrian company S at its registered office in Graz (Austria). According to the employment contract, HB's place where he primarily and habitually worked was Austria. In mid-2019, S went bankrupt.

Since 2017, HB was been employed as head of strategic business development and in this position, he managed two departments; he was responsible for the employees in the Graz office. The company offered its services also in Germany where it collaborated with a self-employed sales engineer, but did not employ further staff there. HB had divided his work for S in a way that he worked alternatively one week in Graz and the next in his home office. HB applied for insolvency benefit regarding unpaid breaks in payment of his salary after his employer's (S) insolvency. He filed his application not only with IEF Service GmbH but also with the German equivalent institution which had previously issued a certificate that determined that German social security legislation was applicable to him. It appears that the German institution had not rendered any decision as long as the Austrian case was pending.

IEF justifies its refusal by referring to art. 9 of the said Directive which is incorporated into the rules on transnational situations and which states: '*If an undertaking with activities in the territories of at least two Member States is in a state of insolvency within the meaning of Article 2(1), the institution responsible for meeting employees' outstanding claims shall be that in the Member State in whose territory they work or habitually work.*' And yet, the Austrian courts of first and second instance decided in favour of HB who requested with the law suit the grant of compensation.

It is, thus, the Austrian Supreme Court (Oberster Gerichtshof, 'OGH') which refers the question of applicability of art. 9 of the Directive 2008/94/EC in the present case to the Luxembourg court.

In its reference decision, the OGH explains its doubts regarding the correct European law interpretation in the following way: First of all, pursuant to a previous decision of the CJEU[4], a valid A1 certificate issued by the competent institution of a Member State in accordance with Article 19(2) of Regulation No 987/2009 is to be understood as binding not only on the institutions of the Member State in which the activity is carried out, but also on the courts of that Member State. In light of this decision, and following from that fact the HB is working at least 50% of the time in Germany it could be concluded that the German counterpart of IEF is in charge of the applied for compensation.

On the other hand, pursuant to the relevant Austrian law as transposed from the European Directive, HB is to be seen as an employee in Austria with all its entitlements. Therefore, the correct interpretation of the said art. 9 of the Directive 2008/94/EC is decisive in the present case. The OGH assumes that in light of previous CJEU decisions[5] it needs to be clarified whether the fact that S was offering services in Germany by establishing a partnership with the self-employed sales engineer, plus the fact that HB was working every second week in Germany at his main residence, there constitute a sufficient connecting factor to conclude that the employer S had a '*stable economic presence*' in Germany.

Given this lack of clarity, the OGH asks the court in Luxembourg to answer the following questions:

"*Is Article 9(1) of [Directive 2008/94] to be interpreted as meaning that an undertaking within the meaning of that [provision] carries out activities in the territories of at least two Member States where it offers its services in another Member State, employs a freelance sales engineer there for that purpose and an employee employed at the registered office of the undertaking regularly works every second week in his or her home office in the other Member State?*"

Two follow-up questions in case of affirmative answers regard a request for clarification of what is to be understood as "*habitually*" working within the meaning of art. 9 and the clarification of the factors decisive for determining the relevant guarantee institution.

The CJEU confines its response to the first question alone; its answer to the first question is, thus, negative. It begins its reasoning be referring to the previous '*Holmquist*'-judgment (see fn 5) where it had to clarify a question regarding the predecessor rule of art. 9. It had held then that establishing an undertaking as having activities in another member state it is necessary to have some sort of permanence, i.e. the "*permanence takes the form of the enduring employment of a worker or workers in that territory.*" The court continued its reasoning by adding that modern communication tools make physical presence far less necessary than in previous times. But, nevertheless, a "*stable economic presence*" is said to be indispensable also nowadays, "*featuring human resources which enable it to perform activities" in that other member state*.

This interpretation's consequence for the case at hand is that since S did not employ any other employee save for the free-lancing sales engineer, and since HB, irrespective of his bi-weekly absence from Austria, had his main work in managing two of his employer's departments and was responsible for the workers in the employer's office in Graz, it cannot be said that S carried out activities in the territory of (at least) two member states within the meaning of art. 9 Directive 2008/94/EC. Regarding the binding effect of the German guarantee's certificate, the CJEU confirms that this is generally true but in the present case of no relevance because the Directive 2008/94/EC is to be seen as *lex specialis* which insofar derogates the general rule.

Even though the result of this answer makes a lot of sense in the specific case, it is nevertheless to be feared that the same question will come up again and again in Luxembourg, probably even acceleratingly so for precisely the reasons which the court mentions itself. The increasing use of modern communication and the increasing use

4. CJEU, judgment of 6 Sept., 2018 – Alpenrind and Others, CJEU C-527/16, EU:C:2018:669.

5. CJEU, Judgments of 16 Oct. 2008 – Holmqvist, C 310/07, EU:C:2008:573, and of 10 March 2011 – Defossez, C 477/09, EU:C:2011:134.

of artificial intelligence make it possible, for instance, to repair my machine in Berlin from the repair person's home office in Mombasa/ Kenya. The more the internet of things becomes every-day reality the more artificial becomes the CJEU's interpretation of what stable economic presence means – with the consequence that in the end the working place might become to be determined by the underlying employment contract. This, however, would open doors for abuse. It is to be assumed accordingly, that the last word is not yet spoken here.

B. CJEU, decision from 16 March 2023 – C-696/21 – P.

In this case, the appellant GABO ('GABO', mi Gesellschaft für Ablauforganisation:milliarium mbH & Co. KG) seeks to have set aside a judgment by the General Court of the EU by which the General Court dismissed as manifestly inadmissible its action for, *inter alia*, reimbursement of the eligible costs incurred by the appellant in the period from 1 August 2015 to 30 June 2016 under the grant agreements concluded in the context of the sixth and seventh framework programmes for research, technological development and demonstration activities and the 'Horizon 2020' Framework Programme for Research and Innovation. I will not report the entire reasoning but will concentrate on a particular insolvency issue which played a role in this case.

The background to the dispute may be summarised as follows: GABO participated in a number of research projects financed by the EU budget under grant agreements concluded, *inter alia*, with the European Commission in the context of several framework programmes. The appellant received payments for the purposes of pre-financing the costs relating to the performance of its tasks in the context of those projects. Following two audits concerning the costs declared by the appellant and an exchange of documents, in particular the Commission's email of 29 July 2015 by which the appellant was informed of the suspension of all payments by the Commission to the appellant, and an email of 6 August 2015, by which the appellant objected to that measure, the Commission issued a debit note on 2 December 2015 requesting the appellant to pay the total sum of EUR 1 770 417.29 in repayment of the claim arising as a result of those audits. Subsequently, the Commission proceeded to recover the claim by offsetting and sent the appellant a series of seven set-off letters, by which it deducted from the amount of the claim referred to in the debit note the amounts of the suspended payments and, in so doing, reduced the amount of the claim from EUR 1 770 417.29 to EUR 587 774.81.

On 14 January 2016, the appellant brought an action before the General Court based in particular on Article 272 TFEU, concerning, in essence, the alleged unlawfulness of the Commission's recovery of the claim by offsetting. After that action had been brought, the Commission pursued the recovery by offsetting of the debt referred to in the debit note, sending the appellant two further set-off letters to that end. It thus reduced the amount of the claim from EUR 1 770 417.29 to EUR 402 211.51. Those two set-off letters incorporated the subject matter of the dispute in that action.

Upon the appellant's request for the initiation of insolvency proceedings, the Amtsgericht München (Local Court, Munich, Germany) appointed a preliminary insolvency administrator by decision of 27 April 2016. The appellant nevertheless continued to provide services under the grant agreements at issue until 30 June 2016. In the judgment of 25 September 2018, the General Court declared the Commission's claim against the appellant, referred to in the debit note, to

be unfounded as regards the declared expenses relating to the '*central travel/meeting budget*' and the liquidated damages relating thereto, and dismissed the action as to the remainder. Following that judgment, the appellant requested the Commission, by letter of 29 July 2019, to pay it the sum of EUR 1 680 681.81, together with interest calculated in accordance with Paragraph 247 of the Bürgerliches Gesetzbuch (German Civil Code). In that request for payment, the appellant claimed that, under German insolvency law, the set-offs made by the Commission were ineffective.

Following correspondence with the appellant, the Commission acknowledged that, in accordance with the judgment of 25 September 2018, the appellant was entitled to payment of EUR 274 248.27, together with default interest, which is not disputed by the appellant. By letter of 3 December 2019, the Commission informed the appellant that, since the appellant remained liable to pay EUR 1 927 495.27 because of the excess pre-financing paid in connection with various projects, the Commission would recover by means of set-off an amount corresponding to the sum of EUR 274 248.27.

By application lodged at the General Court Registry on 31 December 2019, the appellant brought an action for an order by the General Court requiring the Commission to pay it the sum of EUR 1 680 681.82, together with interest of EUR 76 552.60, under 38 grant agreements concluded in the context of the framework programmes. By the order under appeal, the General Court dismissed that action as manifestly inadmissible. In particular, the General Court held that the application did not meet the requirements of the first paragraph of Article 21 of the Statute of the Court of Justice of the European Union, applicable to the proceedings before the General Court in accordance with the first paragraph of Article 53 of the Statute, or of Article 76(d) of the Rules of Procedure of the General Court, on the ground that, first, the action lacked consistency and, second, the essential elements of fact and law on which the action was based were not apparent from either the application or the reply.

By its appeal, the appellant claims that the Court should, *inter alia*, order the Commission to pay EUR 1 304 465.36, together with interest of EUR 74 024.01, to the insolvency administrator for the appellant; in the alternative, declare the action brought before the General Court admissible and refer the case back to the General Court for a judgment on the merits; in the further alternative, refer the case back to the General Court.

The appellant raised two grounds of appeal, the one of interest here is the second, alleging infringement of Article 76(d) of the Rules of Procedure of the General Court. In that context, the appellant argues that, having regard to the principle of effective judicial protection, which includes the principle of equality of arms, the requirements for justifying the claim in question should not be excessively strict. In particular, in a situation in which the defendant has access to more information, it is sufficient that the applicant explains, to the best of its knowledge, the basis of the claim, the amount claimed and the reasons why the claim has not ceased to exist. It was, therefore, for the Commission to make its documents available to the Court in order to enable a comparison to be made with those produced by the appellant. In this context it was obviously stated by the appellant that, under German insolvency legislation, all set-offs made in the period corresponding to the

preliminary insolvency proceedings are void or ineffective respectively.

The CJEU states with regard to this ineffectiveness and voidness: "*According to the explanations provided in the application, under Paragraph 133(1) of the Insolvenzordnung (Insolvency Code; 'InsO'), in the version applicable at the material time, the right of set-off is voidable where the debtor's claim which is affected by that right arose or became recoverable at a time when the parties involved, in this case the appellant and the Commission, were aware of impending insolvency proceedings. Since, according to the appellant, the Commission had been aware of impending insolvency proceedings since 6 August 2015, all the set-offs made by the Commission in the period between 1 August 2015 and 30 April 2016 are void. Consequently, the Commission should repay all the eligible costs corresponding to that period, a sum of EUR 1 418 644.60, together with default interest.*

Moreover, pursuant to point 2 of Paragraph 130(1) of the InsO, the right of set-off is in particular voidable where the debtor's claim which is covered by that right arose or became recoverable no earlier than at the time when the other party became aware of the insolvency petition. Since, according to the appellant, the Commission had been informed on 28 April 2016 of the opening of preliminary insolvency proceedings, any set-off declared by the Commission in the period from 1 May 2016 to 30 June 2016 is deemed ineffective pursuant to point 3 of Paragraph 96(1) of the InsO. Consequently, the Commission should repay all the eligible costs corresponding to that period, a sum of EUR 262 037.22, together with default interest.

Without prejudging the question as to whether, on the one hand, an applicant may ask the General Court, pursuant to Article 272 TFEU, to order the Commission to repay, under national insolvency legislation, sums which that institution had allegedly recovered by means of set-off, and whether, on the other hand, national law governing insolvency proceedings involving a co-contractor of the Commission is capable of preventing the Commission from setting off its debts against its claims against that co-contractor or of requiring the Commission to pay that co-contractor sums allegedly recovered by means of set-off, a question that represents the substance of the action, it must be noted in the first place that, in order to satisfy the requirement to set out clearly the elements of law on which the action was based, and thus to comply with the requirements of Article 76(d) of the Rules of Procedure of the General Court, the appellant should have explained clearly the legal effects, in the light of the set-offs made by the Commission, of the application of German insolvency law as invoked by the appellant in support of its request for payment.

However, it is clear from reading the application that such legal effects were not clearly set out by the appellant. While the appellant describes those set-offs as 'void' in par. ... of the application, it describes them as 'ineffective' in par. ... of the same application. The explanations given by the appellant in the reply which it submitted to the General Court and in its appeal merely add to the lack of clarity in that respect, since the appellant seems to identify different legal consequences for set-offs made in the period between 1 August 2015 and 30 April 2016, which are said to be 'merely ineffective' or 'ineffective,' and set-offs made in the period from 1 May 2016 to 30 June 2016, which are said to be 'void'.

In the second place, for the purposes of ruling on the merits of the action in accordance with German insolvency law, it was 'decisive,' as the appellant itself stated in paragraph 4 of the reply lodged with the General Court, to determine whether the Commission's set-offs during the periods at issue were 'effective' or 'ineffective' under that legislation. In that regard, it is clear from the information contained in the application, as set out in paragraphs 69 to 72 of the present judgment, that the 'effectiveness' or 'ineffectiveness' of the set-offs depended exclusively on the date on which they were made, and whether they were made before or after either the date on which the Commission became aware of the impending insolvency proceedings or the date on which those proceedings were opened.

Furthermore, it would appear to follow from the application of German insolvency law that those of the appellant's claims that are covered by the Commission's set-offs and which are 'effective' under German insolvency legislation must be deemed to have been paid by that institution, whereas those covered by the Commission's set-offs which are not effective under German insolvency legislation cannot be deemed to have been paid by the Commission, and the Commission must actually pay those claims.

It follows that, to enable the Commission to prepare an adequate defence as regards determination of the eligible costs claimed, which, under German insolvency legislation, might be deemed to have been paid already, and to enable the General Court to exercise its power of review in that regard, the appellant should have specified the actual number of set-off decisions which, in its view, were ineffective under that legislation, the date of each of those decisions and the eligible costs, from among all the costs claimed, specifically covered by each of those decisions."

This reasoning is interesting insofar as it clarifies the necessary precision for any appellant and plaintiff regarding its submissions. Voidability and voidness or ineffectiveness are indeed different mechanisms but, as a matter of fact, present no different outcome at the end of the day. The medieval rule still valid today in many civil procedure legislations all over Europe '*iura novit curia*' (the court knows the law) is obviously not applicable at the Luxembourg courts. A similar elevated positioning becomes visible in the argumentation which casts some doubts on the possibility to recover means from the European Commission payments (directly or through set-off) which are voidable under national insolvency law. The CJEU seems here to float in its own universe.

III. Requests for a preliminary ruling

The following judgments have in common to be "mere" requests for preliminary rulings. Since the reader of this Digest will presumably be more interested in answers than questions those requests shall be introduced here only briefly in order to give a feeling for those issues presently at stake. Once the CJEU will have given its rulings, to be sure, I will describe cases and reasoning in much greater detail in a future South Square Digest. It is mere happenstance that all four.

C. Request for a preliminary ruling from the Audiencia Provincial de Alicante (Spain) from 7 November 2022 — Julieta, Rogelio v Agencia Estatal de Administración Tributaria (Case C-687/22)

Here the court from Alicante wishes to know whether it is possible to apply the (quite fundamental) principle that national law must be interpreted in conformity with European law where the relevant facts in the case occurred at a time when the Directive 2019/1023 on preventive restructuring frameworks had already entered in force, but at which the time for transposition had not yet elapsed. The law to be applied for that case is not the law as the one after the transposition has been enacted by the Spanish legislation.

The following question is zooming in closer to the issue of the case by asking whether the Spanish (old) rule which exempts claims governed by public law from discharge of debt is compatible with the said Directive art. 23(4) which lists various exemptions but not one regarding specifically claims governed by public law? In so far as that legislation excludes claims governed by public law from discharge of debt and is not duly justified, does it compromise or jeopardise the attainment of the objectives established in the directive?

And finally, the court wants to know whether the list contained in art. 23(4) of the Directive is exhaustive or just exemplary.

It appears as if this request is the first regarding the Restructuring Directive. This makes one wonder whether the CJEU will apply somewhat different standards in its interpretation from those regarding the Insolvency Regulation.

D. Request for a preliminary ruling from the Tribunal da Relação do Porto (Portugal) from 16 January 2023 — SF v MV, Instituto da Segurança Social, IP, Autoridade Tributária e Aduaneira, (Case C-20/23, Instituto da Segurança Social and Others)

The court in Porto addresses not only the Restructuring Directive, too, but also the very same paragraph of the same article as the Alicante court. It centres around the same issue, the possibility to provide a tax exemption. It wants firstly to know whether the exclusion of other debts (than those listed in art. 23(4)) is permitted only when 'duly justified'.

Secondly, the court asks whether it is permissible for the legislator to provide its own state a privileged position by excluding tax claims from the possibility to become discharged.

Thirdly, when and if the answers to the previous questions are affirmative, which criteria must a justification fulfil, in order to comply with the general principles of EU law and the protection of fundamental rights, to which the European and national legislatures are subject ['*prohibition*

of discrimination on grounds of nationality' (Article 18 TFEU), '*freedom to conduct a business*' (Article 16 of the [Charter of Fundamental Rights of the European Union]) and the fundamental economic freedoms of the internal market]?
Finally, If the answer to the aforementioned question is in the negative, do the definitions (within the meaning of EU law and for the purposes of interpreting the directive in question) of '*debts arising from or in connection with criminal penalties*' and '*debts arising from "tortious liability"*' also include tax debts as provided for in the Portuguese legislative act transposing Directive 2019/1023?

These two requests from the Spanish and the Portuguese court give an interesting indication as to the old and wide-spread tradition of establishing a privilege for the tax authorities, occasionally called "*crown privilege*" or "*Prinzen Pfennig*" (Prince penny). It has always run counter to the principle of equal treatment of creditors and has always been a bit unfair insofar as the rule setter used its power to grant itself a privilege over equally situated creditors.

E. Request for a preliminary ruling from the Juzgado de lo Mercantil n°1 de Palma de Mallorca from 24 November 2022 – 115/20-1 and 115/20-2
The Commercial Court in Palma de Mallorca deals with two cases resulting from the secondary proceeding there to the German Air Berlin main proceeding. In each of those cases, it submits a request for a preliminary ruling to the Luxembourg court. The first request relates to the term in art. 7 par. 2(g) European Insolvency Regulation (EIR) *"the claims which are to be lodged against the debtor's insolvency estate and the treatment of claims arising after the opening of insolvency proceedings"*. Does this refer to the opening of the main proceeding or to the opening of the secondary proceeding?

The second request deals with the peculiarity of a secondary proceeding "*to be restricted to the assets of the debtor situated within the territory of the Member State in which those proceedings have been opened*", art. 34 EIR. Is "*situated*" to be understood as referring to the point of time of the opening of the main proceeding, or of the opening of the secondary proceeding? Moreover, is the power of the main proceeding's insolvency administrator pursuant to art. 21(1) EIR to collect assets without applying for the commencement of a secondary proceeding, or to give an undertaking in the meaning of art. 36 EIR compatible with such collection of assets when, and if, this insolvency administrator is aware of local creditors who hold judicially confirmed claims from their employment contracts and the competent local court has issued a security order? Finally, is the insolvency administrator of a secondary proceeding entitled to recollect those assets pursuant to art. 21(2) EIR which the insolvency administrator of the main proceeding previously has collected?

Both requests address important questions regarding the correlation between a main and a secondary proceeding. It should be noted, however, that a secondary proceeding is just a technical instrument to alleviate the handling of one insolvency of one debtor. Thus, irrespective of the term '*secondary insolvency proceeding*' it is not in itself dealing with a separate insolvency case. ■

New Tenants at South Square

South Square is absolutely delighted to welcome four new Members of Chambers: Oliver Hyams, Jon Colclough & Philip Judd join us as lateral hires, and Imogen Beltrami joins following successful completion of her pupillage at South Square.

Oliver Hyams

South Square was delighted to welcome Oliver Hyams as a lateral hire in July 2023.

His practice focuses on insolvency, fraud and asset recovery, and commercial disputes.

Oliver's insolvency work is varied and encompasses schemes and restructuring plans, office-holder claims, and insolvency applications, such as to restrain presentation of a winding-up petition. His work often has an international or cross-border element, and he is currently instructed in cases with clients or assets in the US, Canada, Germany, Gibraltar and range of other jurisdictions.

His recent instructions include a claim concerning the priority of equitable liens arising in favour of purchasers of apartments in a failed off-plan development (*Williams & Anr v Alter Domus Trustees (UK)* Ltd & Ors [2023] EWHC 1820 (Ch)); the restraint of trade doctrine in relation to bonus clawback clauses (*Steel v Spencer Road LLP* [2023] EWHC 2492 (Ch)); and the circumstances in which an appeal court can interfere with a trial judge's findings of fraud (*Floreat Investment Management Ltd v Churchill & Ors* [2023] EWCA Civ 440).

He is currently instructed in LA Micro, a case which has been to the Court of Appeal twice (see [2023] EWCA Civ 214), and will be heard in the Supreme Court in early 2024, on issues concerning the proper operation of constructive trusts.

Oliver is ranked as a leading junior for both Insolvency and Civil Fraud in the Legal 500, and as a leading junior in Chambers UK for Restructuring/ Insolvency. The Legal 500 says "*Oliver is clearly clever and very familiar with the way the insolvency courts work. He has a reassuring manner and is friendly and nice to interact with*."

Jon Colclough

Jon is a commercial chancery practitioner, who specialises in insolvency, restructuring and company matters.

His recent reported cases include *Brakes v The Chedington Court Estate Ltd* [2023] UKSC 29 – the Supreme Court's decision as to the circumstances in which a bankrupt has standing to challenge acts, omissions or decisions of the trustee.

Other recent appellate decisions include: (i) *Financial Conduct Authority v Ferreira* [2022] EWCA Civ 397, a case concerning the interpretation of the Financial Services and Markets Act 2000; (ii) *Brakes v The Chedington Court Estate Ltd* [2022] EWCA Civ 1302, a case relating to the alleged unlawful eviction of bankrupts; and (iii) *Parker v Financial Conduct Authority* [2021] EWCA Crim 956.

He regularly acts for insolvency officeholders. Recent decisions in which he has acted for officeholders (or their assignees) include: (i) *Mitchell v Al Jaber* [2023] EWHC 1239 (Ch), a misfeasance claim brought by BVI liquidators against a former director; (ii) *Re Fastfit Station Ltd (in liquidation)* [2023] EWHC 496 (Ch), a misfeasance and antecedent transaction claim; and (iii) *Re Lloyds British Testing Ltd (in liquidation)* [2023] EWHC 567 (Ch) concerning the ability of a judgment creditor (an insolvency litigation funder) to cause the debtor to draw down on his pension.

Both *Mitchell and Lloyds British* are due to be heard by the Court of Appeal in 2024. Jon is instructed by the respondent in each appeal.

Other recent insolvency decisions include *Chopra v Katrin Properties Ltd* [2022] EWHC 2728 (Ch), *Allen v Bulatovic* [2023] EWHC 612 (Ch) and *Little Miracles Ltd v Oliver & Ors* [2022] EWHC 2553 (Ch).

Jon has experience of insolvency regimes in offshore jurisdictions and is currently instructed by officeholders in the Isle of Man, the BVI and the Cayman Islands.

Jon previously worked for the Boston Consulting Group and the Financial Conduct Authority. He re-trained as a barrister and was awarded Lincoln's Inn "Student of the Year" for achieving the highest mark in the BPTC.

Philip Judd

Phil joined South Square in October 2023 after spending five years in practice at 3 Hare Court, where he completed his pupillage.

Before coming to the Bar, he was awarded a First in History at Oxford University before working in private equity and strategy consulting. During that time he was involved in the largest capital restructure of a financial institution in response to Basel III regulation, helped draw up the ring-fencing requirements flowing from The Banking Reform Act 2013, and worked on the response to a consultation regarding EU financial solvency directives for Globally Systemically Important Insurers. He then moved to an M&A practice where he focused on valuation and due diligence during the acquisition of payment providers, biotech companies and industrial manufacturers.

Upon converting to law, he studied for the GDL and BPTC as a Queen Mother Scholar of Middle Temple and full-fee postgraduate scholar of City Law School, and whilst on the BPTC he won the Rosamund Smith Mooting Competition.

Phil has since developed a practice in insolvency, commercial litigation and company law disputes, as well as related chancery matters. He regularly appears as sole counsel in the Insolvency and Companies Court, Business and Property Courts, as well as the County Court. He has also appeared (led) in the Privy Council in matters from the Caribbean, in particular Trinidad and Tobago, and will appear in early 2024 in an appeal determining the scope of legislation governing the Tobago House of Assembly's ability to enter into commercial leasing arrangements.

Over the last few years, a significant portion of his practice has involved Russian and CIS clients. He has acted as sole counsel for Bulgaria's largest oil and gas provider and acted for a series of Russian corporate investors in UK proceedings related to a large corporate action in Europe. He was also junior counsel to a Russian émigré being pursued in this jurisdiction over Russian judgment debts.

He is described as a 'rising star' in insolvency by the Legal 500, where he is also described as 'approachable' and 'good on his feet'.

Imogen Beltrami

Imogen studied undergraduate law at the University of Cambridge before going on to read for an LLM specialising in Commercial and Corporate Law at The London School of Economics and Political Science, from which she graduated with a Distinction. She was also awarded the Colombos Public International Law Essay Prize, a Certificate of Honour and a Queen Mother Scholarship by Middle Temple prior to joining South Square.

Before coming to the Bar, Imogen mooted competitively. She represented Cambridge at the Philip C. Jessup International Law Moot Court Competition, achieving a top ten advocate ranking at the UK National Rounds and going on to compete at the International Rounds held in Washington DC.

Imogen is developing a practice in insolvency, civil fraud, company and financial disputes – both in England & Wales and offshore. Her current instructions include acting company side on two schemes of arrangement for a large investment fund and global manufacturer of security solutions respectively, building on the extensive exposure she had to schemes and restructuring during her pupillage.

As a pupil Imogen assisted with a variety of complex insolvency, commercial and financial litigation, including the breach of exclusivity litigation launched by IS Prime Limited regarding the provision of matched principal brokerage services in FX and index swaps. She also assisted with *Re Sova Capital Ltd.* [2023] EWHC 452 (Ch), which involved the first approval by an English Court of an unsecured credit bid against a background of interlocking US, UK and Russian sanction restrictions, as well as multiple cases triggered by the collapse of Greensill Capital including a $440 million claim lodged by Credit Suisse against SoftBank Group Corp based on section 423 of the Insolvency Act 1986.

Imogen has also gained extensive experience in the restructuring side of Chambers' practice and was involved in the preparation for multiple contested restructuring plan sanction applications including those for Nasmyth Group Limited, AGPS BondCo PLC, Prezzo Investco Limited and Fitness First Clubs Limited.

Mourant and South Square Litigation Forum 2023

London • October 5th, 2023

On 5 October 2023 the highly successful annual Mourant/South Square Litigation Forum was held at 200 Aldersgate in London. This year the co-chairs were Hilary Stonefrost, of South Square, and Peter Hayden, of Mourant, both with a wealth of expertise in domestic and cross-border insolvency litigation.

The keynote speaker on this occasion was Philip Collins, British journalist and former speechwriter for Tony Blair when he was in office as Prime Minister.

It was good to once again see so many colleagues and friends in person at an event that was both professionally informative and socially enjoyable!

The summaries below of the different sessions have been prepared by Angus Groom and Charlotte Ward, who are undertaking pupillage at South Square.

Session 1: The restructuring landscape in the UK and offshore: more to unite than to divide?

Glen Davis KC (South Square) as Chair, Nicholas Fox (Mourant), Clara Johnson (South Square), Kate Stephenson (Kirkland and Ellis LLP) and Julie Nettleton (Grant Thornton UK LLP) discussed recent developments in the UK, Cayman, the British Virgin Islands and Hong Kong, focussing on the divergence in the approach to restructuring across these jurisdictions and the problems of international recognition.

It was not until recently (December 2018) that the BVI Commercial Court appointed "light touch" provisional liquidators to facilitate a cross-border restructuring as a route to restructuring when (in *Constellation*) the BVI Court concluded that the power to appoint provisional liquidators extends to circumstances where there is a need to protect the company's assets from creditors pending a restructuring. In taking this course, the BVI Court followed what, until recently, had been the approach of the Cayman Court.

In the meantime, Cayman has moved on from "light touch" provisional liquidation as its approach to restructuring. With effect from 31 August 2022, The Cayman Islands has introduced, in legislation, the concept of a Court-appointed Restructuring Officer. Although one of the pre-conditions for appointment is insolvency or likely insolvency of the company, one advantage of this change is that the process is separate from the winding up regime and therefore avoids the perception that a company was being liquidated when it was undergoing a restructuring process. A further advantage is that there is no longer a live issue in the Cayman Islands as to whether provisional liquidators can be appointed to restructure as opposed to liquidate a company.

The Hong Kong Court has not taken the same approach to provisional liquidation. As far as the Hong Kong court is concerned, the statutory power to appoint a provisional liquidator may not be exercised for the sole purpose of restructuring a company's debt. It is only if provisional liquidators can be appointed on the traditional protective grounds that the provisional liquidators may be granted the power to promote a restructuring.

On recognition, Hong Kong Court has been willing to recognise the

appointment of foreign provisional liquidators appointed for restructuring purposes who seek assistance and recognition of their appointment in Hong Kong. But, the Hong Kong Court will refuse an application for recognition and assistance if the foreign liquidation is not taking place in the jurisdiction of the company's centre of main interest subject to exceptions where the liquidator needs authority to act for the company in its place of incorporation, or needs practical assistance to undertake limited administrative steps in its place of incorporation.

It remains to be seen how the Hong Kong Court will treat a restructuring officer appointed in Cayman, or whether the Hong Kong Court would take a different approach to the recognition of light touch Provisional Liquidator appointments if companies can show active engagement with creditors and a genuine desire to improve the economic outcomes for companies operating in Hong Kong and in mainland China.

Restructuring in England is achieved by way of schemes of arrangement or the relatively new restructuring plan. There is no stay or moratorium and neither features a provisional liquidator or a restructuring officer. The stand-alone moratorium introduced in the Corporate Insolvency and Governance Act 2020, which was intended to be an addition to restructuring tools, has too many short comings to be of much practical use. In particular, many companies are not eligible, and certain debts are excluded from the moratorium, in particular debts or other liabilities arising under a contract or other instrument involving financial services.

The panel ended with a discussion of possible future developments, whether the Rule in *Gibbs* (that English law governed debts may only be validly discharged by an English process unless the creditor agrees otherwise) might be revisited, and whether we might see a shift away from the Centre of Main Interests (COMI) test as the touchstone for international recognition. Despite movement in some jurisdictions towards territorialism, the panel stressed the benefits to clients that come from modified universalism and international recognition.

Session 2: In conversation with Mr Justice Zacaroli

The second panel was a 'fireside chat' with Mr Justice Zacaroli (Judge of the High Court of England and Wales, Chancery Division, and former Member of South Square) conducted by Marcus Haywood (South Square) and Jennifer Jenkins (Mourant).

The conversation began with a comparison of the differences between life at the Bar and life on the Bench, with Mr Justice Zacaroli outlining the different pressures that come from deciding a case as opposed to preparing it. The Judge also offered his thoughts on how advocates can best assist judges, stressing that structure, clarity and concision will help advocates to ensure their points land with busy judges.

Sir Anthony also stressed the importance of Pro Bono work either through Advocate or through schemes such as The Chancery Bar Litigant in Person Support Scheme ("CLIPS") for the operation of the Chancery division. On the question of diversity at the Bench and the Bar, the Judge highlighted the broader work that can be done to make a wider pool of the population see that a career in the legal profession is possible for them.

The panel also asked the Judge about the UK Restructuring Plan, introduced by the Corporate Insolvency and Governance Act 2020, and related issues. The Judge considered that the Plan has been broadly successful. He praised the way that the courts have continued in the common law tradition of incrementally developing the practical principles of application that give structure and guidance to what would otherwise be an opaque statutory regime. He considered that this flexibility was one of the great benefits of such systems and urged parties and judges to work together to see how the flexibility in the regime could be applied to allow SMEs to pursue Restructuring Plans without the same cost burden that might come with the restructuring of a multinational group.

The discussion concluded with an insight into Mr Justice Zacaroli's role in deciding the Ed Sheeran "*Shape of You*" case, *Sheeran & Ors v Chokri & Ors* [2022] EWHC 827 (Ch). The case demonstrates how a judge must be able to turn their mind to anything from pentatonic scales and melody to a forensic examination of email threads to establish what facts were known to different parties at different times.

Session 3: Keynote Speaker Philip Collins

Philip Collins is nowadays a British journalist and columnist for the Times and the Evening Standard. He was a speech writer for British Prime Minister Tony Blair between 2005-2007. Mr Collins drew on his experience as a speechwriter and public communications expert to analyse the state of the British Conservative and Labour Parties as they head into the next election. He outlined the factors that indicate a likely change in power and discussed how each Party could best position itself in the months to come.

He was a very popular speaker and his remarks drew lively engagement from the audience. Of note was his observation that the gateway for some traditional Labour voters to vote for Conservative candidates was their support for Brexit, and that it was a mistake for the Conservative leadership to "Get Brexit Done" as this takes away that reason for voting Conservative. After the formal sessions, there was an opportunity to network over drinks and canapés, and we are looking forward to repeating this regular fixture next autumn.

News in Brief

Legal 500 Bar Awards

We are delighted that, on 3 October, Mark Phillips KC was awarded Chancery Silk of the Year at the Legal 500 2023 Bar Awards, held at the London Hilton Park Lane. Adam Al-Attar and Charlotte Cooke were shortlisted for the Chancery Junior of the Year award, and Georgina Peters was shortlisted for Financial Services and Insurance Junior of the Year. South Square was shortlisted for both Chancery Set of the Year and Financial Services and Insurance Set of the Year. Thank you to all our clients and friends for their generous support.

Imogen Beltrami gains the Advocate Pupillage Pledge

Whilst new tenant Imogen Beltrami (see page 65) was still a pupil at South Square she gained the Advocate Pupil Pledge award, by undertaking pro bono work during her second six.

We are extremely proud that so many Members of Chambers show such commitment to access to justice.

A Fishy Business?

A legal challenge filed by Nilima Amin, from California, against the sandwich chain Subway was dismissed by US District Judge Jon Tigar in late July 2023. The claim, dating from 2021, alleged the Subway's tuna products did not, in fact, contain any tuna and the company's tuna sandwiches, salads and wraps were made of "*anything but tuna*".

As the legal battle unfolded media outlets began to investigate whether or not the products included tuna or a mystery meat. A reporter on the New York Times sent some Subway tuna to a food testing lab, with the paper subsequently publishing a report that found the 'tuna' was either so processed that no amounts could be found by testing, or alternatively that a substance other than tuna was being used. Inside Edition conducted a similar experiment, but the lab they used found Subway was using real tuna. Subway itself went to great lengths to reassure customers that "*Subway serves 100% real, wild-caught tuna*" even creating the website www.subwaytunafacts.com.

In May of this year Amin asked to withdraw the lawsuit because she was experiencing morning sickness and other conditions that left her unable to remain a plaintiff. Court records show that Subway and Amin had "*come to agreement regarding dismissing the case with prejudice*", which means it cannot be brought again. Judge Tigar will rule later on Subway's request that Amin's lawyers be sanctioned for bringing a frivolous class action that has "*caused damage to Subway franchisees and the brand*".

Recovery Room Scams Rise

The Insolvency Service has issued a warning to investors and its customers regarding a recent increase in fraudulent activity, including recovery room scams, with fraudsters impersonating genuine Insolvency Service employees sending emails, phone calls and letters.

Recovery room scams usually follow an investment scam, where victims have already lost money. To legitimise their contact, recovery room fraudsters impersonate a legitimate employee of the Insolvency Service.

Ban and £1.8 million Fine for Former Barclays Boss

The Financial Conduct Authority ('FCA') have meted out what is thought to be the largest fine imposed on an individual by the regulator to Jes Staley, former CEO of Barclays Bank, and banned him from holding senior positions in the financial services industry in the future.

Investigations into whether Staley was a 'fit and proper person' to be a senior banker began in February 2020 when questions arose over his relationship with Jeffrey Epstein. Staley approved as fair and accurate a letter (which he did not personally draft) sent by Barclays to its regulators which claimed Staley did not have a close relationship with the convicted sex offender and that he had ceased all contact with Epstein well before he joined Barclays in 2015. The FCA found these two claims to be misleading. In e-mails Staley had described Epstein as one of his '*deepest*' and '*most cherished*' friends. He was also in contact with Epstein in the days leading up to his appointment as CEO of Barclays in October 2015. Staley left Barclays in November 2021 as investigations continued and Barclays froze £22 million of his bonus payments in 2022 pending the outcome.

In a press release, Therese Chambers of the FCA said "*Mr Staley is an experienced industry professional and held a prominent position within financial services. It is right to prevent him from holding a senior position in the financial services industry if we cannot rely on him to act with integrity by disclosing uncomfortable truths about his close personal relationship with Mr Epstein.*"

Late-Night Deal for Metro Bank

High Street challenger bank, Metro Bank, announced £325 million in new funding and refinancing of £600 million of debt in a deal announced on the evening of Sunday 8 October 2023.

At the start of October Sky News reported that Metro Bank was seeking new investment and in discussion to sell up to £3 billion-worth of residential mortgages, sending the share price of the bank down by nearly 30%. On the Monday following the funding and refinancing announcement, the share price rose by 26%, just shy of its 1 October level – but still down nearly 60% since the start of the year and well below its 2018 peak.

Whilst many banks have closed almost all branches and moved to predominantly online banking – a move accelerated during the Covid pandemic – Metro continues to focus on bricks and mortar branches, sticking to their promise of being open 7 days a week, 362 days a year. Simon Samuels (former managing director at Barclays and Citi) told the BBC's Today programme on 9 October that this strategy was "*very expensive*" and left Metro with "*an unsustainable cost base*".

Metro was launched in 2010 – the first new High Street bank in the UK for 150 years. It now has 2.7 million customer accounts, making it one of the 10 largest banks in Britain.

Bernie's Tax Fraud

In a surprise visit to Southwark Crown Court on Thursday 12 October, Bernie Ecclestone pleaded guilty to fraud by false representation, failing to declare approximately £400 million hidden in Kinlan Trust, a Singapore trust involved in currency dealing. He was due to stand trial next month in November.

Ecclestone was given a 17-month prison sentence, suspended for two years, and agreed to pay over £650 million in a civil settlement over unpaid tax, interest and penalties.

This is not Ecclestone's first brush with the law. In August 2014, he paid £60 million to end proceedings in a bribery case in German without any admission of guilt.

Insolvencies Jump Again

The number of firms going bust in England and Wales has jumped yet again as the higher-for-longer interest rate environment continues to put pressure on businesses and consumers. Monthly data from the Insolvency Service showed there were 2,315 insolvencies among registered companies in October 2023, up 18 percent from October 2022.

Around 82 percent were creditors' voluntary liquidations (CVLs), where an insolvent company's directors choose to wind up. There were an additional 256 compulsory liquidations, 146 administrations, 23 company voluntary arrangements and one receivership appointment. The quarterly statistics showed the number of insolvencies hit its highest level since the height of the financial crisis in 2009.

News in Brief *(cont.)*

The South Square Story in Action

Towards the end of October Simon Mortimore KC (who writes our regular 'South Square Story' article) visited Liverpool University to inspect the Muir Hunter papers held there. This was arranged the custodian, Dr John Tribe.

In return, Simon was asked to give a lecture to the third-year students. To give the students an understanding of what happens during a high-profile and long-running insolvency, Simon spoke about the Barings case from 1995 to 2004, in which he had acted for the administrators/liquidators.

Simon is pictured below with the Dean of the School of Law: Professor Valsamis Mitsilegas, who is also Professor of European and Global Law. Before taking his post at Liverpool, he was Head of the Department of Law at Queen Mary University in London.

And it's Bust for La Perla

The UK operation of La Perla, a luxury lingerie company has been wound up in the High Court after failing to pay outstanding tax debts.

La Perla, based in Savile Row, designs, manufactures and sells high end lingerie, nightwear and beachwear. It has several high street shops in London and the Southeast as well as a website and various department store concessions.

HMRC took the company to court via a winding up petition for an outstanding debt of £2.8 million in unpaid tax.

La Perla's lawyer confirmed at the hearing that the tax payment had been postponed as a shareholders' cash injection had not gone ahead as expected.

WeWork: WFH Not Working

The US arm of office-space leasing behemoth WeWork filed for Chapter 11 bankruptcy at the beginning of November, with the situation in the UK currently unclear. WeWork is London's largest commercial tenant, leasing some 3.6 million square foot of office space in the capital.

WeWork was founded in New York in 2010 by Adam Neumann and by 2018 massive expansion, driven by investment from Japanese conglomerate SoftBank, had taken the company from one office in Manhattan to 779 locations in 39 countries around the world. In 2019 it was valued at $47 billion.

Financial damage caused by the Covid-19 pandemic and its continued legacy of remote working have exposed weakness in a business model that relied on the company locking in to long-term leases in buildings which it then sublet to tenants on short-term deals.

First, let's Bomb all the Barristers

Businessman Jonathan Nuttall was jailed for eight years and two months in late September 2023 for targeting two barristers in Gray's Inn with fake bombs back in September 2021, together with two lesser sentences for his pair of accomplices.

In 2015, Andrew Sutcliffe KC and Anne Jeavons were instructed by the National Crime Agency ('the NCA') to investigate Nuttall and his wife, who were suspected of being involved in an international money-laundering ring. The investigation resulted in £1.4 million in assets being seized from Mrs Nuttall. Distressed at the prospect of losing his stately home, Embley Manor in Romsey, Hampshire, Nuttall became fixated on the barristers and planned a targeted attack involving his driver, Michael Sode, as a middleman to instruct former marine, Michael Broddle, to plant two suspicious envelopes near the barristers' chambers and detonate a smoke grenade to intimidate them.

The attack resulted in evacuations and road closures as police investigated. Bomb disposal experts found the envelopes to have been filled with nails, tacks, shrapnel, ball bearings, a nose trimmer, a bag of power, fun snaps, an electronic thermometer and a note making a "*an extremely serious, scandalous and false allegation*" about Sutcliffe calculated to cause him "*maximum humiliation*". Eventually Sutcliffe resigned from the case due to the intimidation.

The National Terrorist Financial Investigation Unit has now applied for the continued detention of seized cash "*the applicant having reasonable grounds for suspecting that it is recoverable property ... under the Proceeds of Crime Act 2002*".

3Pillars Project

At the beginning of the year, William Mackinlay, our Chamber's Director, was invited to join the 3Pillars Project as Chair of the Trustees. He had been in touch with the charity on and off for about four years and was delighted to get involved in a formal, voluntary role.

The statistics are stark. The reoffending rates for adults are 50% within a year of release. For children its 69%. The 3Pillars Project's aim is to help break the cycle of reoffending. The charity provides sports-based mentoring to inspire, challenge, and empower young men within the criminal justice system. Through mentoring, training, helping them to gain qualifications, and providing employment opportunities, apprentices are able to build a better future whilst in prison and beyond. The charity supports over 100 young people each year and want to build upon this through a cutting-edge post-release community mentoring model, which leads to sustainable work experience and employment. 3Pillars is a small but extremely focused charity that is changing the prospects and the lives of young men coming out of prison. Will is extremely grateful for the ongoing assistance provided to him and to the 3Pillars Project by the barristers and the staff at South Square, including by participating in the mentoring scheme. Further details of the charity can be found on its website: www.3pillarsproject.com.

Supreme Court Reject VAT Exemption for Loan

On Wednesday 11 October 2023, the UK Supreme Court ruled that administration services, such as processing payments on bank loans, are not exempt for value-added taxes ('VAT') merely on the basis that they are a ledger of financial services rather than a transfer.

In *Target Group Ltd v HMRC* [2023] UKSC 35, the Court held that the earlier Court of Appeal decision in FDR was wrongly decided and that it is not sufficient to fall within the scope of the VAT exemption that a person gives instructions to a financial institution to make a payment or a transfer, even it is necessary and even if that payment occurs automatically as a result of that instruction.

Target provided loan servicing for Shawbrook, a bank, which covered the lifecycle of loans to the bank's customers other than the making of the initial advance, the terms and interest rates. Although Target was involved in dealing with arrears, any enforcement action was a decision for the bank. As such, Target claimed such supplies were exempt from VAT and in particular relied on the Court of Appeal decision in *C&E Comrs v FDR Limited* [2000] STC 672. This was a view with which HMRC disagreed. HMRC considered that such services were either a supply of standard rated credit management services or standard rated debt collection.

The Supreme Court considered the history of jurisprudence in this area, reviewing a number of cases from the CJEU. In its judgment, the Supreme Court confirmed "*it is now apparent that domestic law took a wrong turn in FDR and the Court of Appeal's conclusion … in that case must be overruled*".

SOUTH SQUARE CHALLENGE

Welcome to the last South Square Challenge of 2023 which is, again, a picture quiz!

All you have to do is look at the picture, or set of pictures, work out to what they are clues and then identify the link between all the answers.

The winner, drawn from the wig tin in the event of multiple correct entries, will receive a magnum of champagne and one of our splendid South Square umbrellas!

1. **2.**

3. **4.**

5. **6.**

7. **8.**

9. **10.**

11. **12.**

Please send your answers to Kirsten either by e-mail to **kirstendent@southsquare.com**, or to the address on the back cover, by Saturday 20th January 2024.

We had many correct answers from the July edition but the winner, drawn from the wig tin, is Matilda Jacobs, a trainee solicitors at Wedlake Bell. Congratulations, Matilda, you will be receiving a magnum of champagne and a South Square Umbrella!

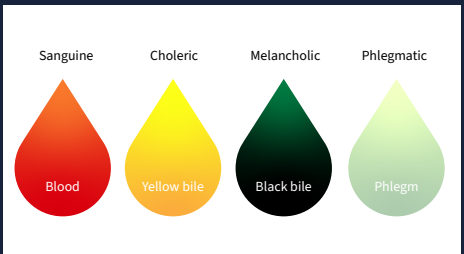
The correct answers to our July 2023 challenge were:

The link between them is that they all have something law-based in their names – e.g bar, law, wig, bench

1. *Lucy Lawless*
2. *Jude Law*
3. *Bar Refaeli*
4. *Hazel Court*
5. *Andrew Bonar Law*
6. *Igor Judge*
7. *Dugar Clerk*
8. *Bradley Wiggins*
9. *Johnny Bench*
10. *Anton Gavel*

1.

2.



3.

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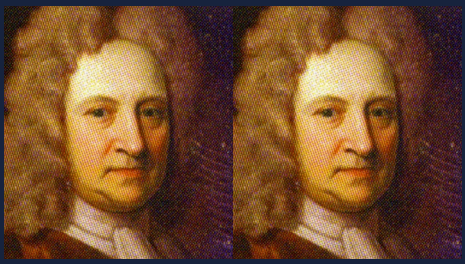

9.

10.

11.

12.

SOUTH SQUARE

"Winner of Company / Insolvency Set of the Year"

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