International Corporate Rescue – Special Issue

South Square Articles 2019/20

1 *Re Lehman Brothers International (Europe) (In Administration)* [2018] EWHC 924 (Ch) (24 April 2018)
Rose Lagram-Taylor

3 *Burnden Holdings (UK) Ltd v Fielding* [2018] UKSC 14
Edoardo Lupi

6 *Goldman Sachs International v Novo Banco SA* [2018] UKSC 34
Rose Lagram-Taylor

10 *Orexim Trading Limited v Mahavir Port and Terminal Private Limited* [2018] EWCA Civ 1660 (Lewison, Gross, and Leggatt LJJ, 13 July 2018)
Lottie Pyper

13 *Carlos Sevilleja Garcia v Marex Financial Limited* [2018] EWCA Civ 1468
Stefanie Wilkins

16 *Burlington Loan Management and others v Lomas and others (as the joint administrators of Lehman Brothers International (Europe) (in administration))* [2017] EWCA Civ 1462
Madeleine Jones

20 *Lehman Brothers Australia Limited (in liquidation) v Anthony Victor Lomas, Steven Anthony Pearson, Russell Downs, Julian Guy Parr (The Joint Administrators of Lehman Brothers International (Europe) (in administration))* [2018] EWHC 2783 (Ch), 24 October 2018, Hildyard J
Lottie Pyper

23 *Wiemer & Trachte GmbH v Tadzher* [2018] EUECJ C-296/17 (14 November 2018)
Rose Lagram-Taylor

26 *Bresco Electrical Services Ltd (in liquidation) v Michael J Lonsdale (Electrical) Ltd; Cannon Corporate Limited v Primus Build Limited* [2019] EWCA Civ 27
Lottie Pyper

29 *Re Carluccio's Ltd (in administration)* [2020] EWHC 886 (Ch)
Daniel Judd

ChaseCambria · SOUTH SQUARE · Centre for Commercial Law · UCL LAWS

Publishers

Chase Cambria Company (Publishing) Ltd
4 Winifred Close
Barnet, Arkley
Hertfordshire EN5 3LR
United Kingdom

Annual Subscriptions

A hardcopy subscription is EUR 730 / USD 890 / GBP 520; online: EUR 730 / USD 890 / GBP 520; and hardcopy + online: EUR 840 / USD 1045 / GBP 625. Rates per additional hardcopy or online user are: EUR 165 / USD 220 / GBP 145.

VAT is charged on online and hardcopy + online subscriptions. Hardcopy-only is zero-rated for VAT purposes. For package subscriptions, VAT is charged on the entire package.

For enquiries, please contact our sales department at: + 44 (0) 114 255 9040 or sales@chasecambria.com

Special Issues

Price for individual Special Issues for subscribers: EUR 125 / USD 175 / GBP 105; for non-subscribers: EUR 165 / USD 225 / GBP 135. Online access to all Special Issues for subscribers: EUR 375 / USD 535 / GBP 315; for non-subscribers: EUR 495 / USD 695 / GBP 420. Online subscription plus access to all Special Issues: EUR 995 / USD 1250 / GBP 740. Hardcopy + online subscription plus access to all Special Issues: EUR 1150 / USD 1450 / GBP 875.

Advertisements

For advertisements please contact:

ads@chasecambria.com

Copyright

ISSN: 1572-4638

Re Lehman Brothers International (Europe) (In Administration) [2018] EWHC 924 (Ch) (24 April 2018)

Rose Lagram-Taylor, Barrister, South Square, London, UK

Summary

Costs associated with the Waterfall IIC proceedings, and specifically the costs arising from the proper interpretation and effect of standardised ISDA master agreements were determined to be payable out of the estate given that proceedings had been initiated by the administrators so that they could proceed with the distribution of a surplus to creditors. Accordingly, as the application had been made in the interests of the general body of creditors, the usual principle that costs follow the event was not appropriate. However, in relation to issues arising out of a German master agreement, it was determined that as this had been instigated by the senior creditor group for its own benefit, this rightly entailed a costs liability for that group.

Introduction

On 25 April 2018, Mr Justice Hildyard handed down judgment *in Lehman Brothers International (Europe) (In Administration), Re* [2018] EWHC 924 (Ch). The case concerned the question of costs in relation to the Waterfall IIC tranche of the Lehman Waterfall proceedings.

Factual background

Waterfall IIC concerned the construction and effect of various standardised pre-administration agreements on creditors' entitlement to statutory interest.

In particular, the Lehman group had entered into various derivative transactions under International Swaps and Derivatives Association ('ISDA') master agreements and a German master agreement ('GMA'). Early termination amounts were payable to creditors following the close-out of the ISDA agreements. The administrators of Lehman Brothers International (Europe) ('LBIE') brought the proceedings to seek directions from the court, in particular with regards to the statutory interest accruing on the amounts payable to creditors, asserting this was necessary before they could proceed with distribution.

In judgement on Waterfall IIC, the fourth respondent prevailed on many of the issues decided. The fourth respondent therefore claimed its costs on the basis of the general rule that costs follow the event, and a successful party is entitled to its costs from the unsuccessful party. The fourth respondent also opposed applications by the senior creditor group ('SCG') and the sixth respondent for their costs to be paid out of the estate, contending that the proceedings were no different in substance from ordinary adversarial litigation.

Issues

The primary issues to decide were therefore (i) whether the usual principle of costs follow the event should be applied, or whether it should be departed from, and (ii) whether the claims brought by the SCG and sixth respondent should be properly characterised as adversarial litigation, or as necessary for the proper administration of the LBIE estate.

Decision

Taken as a starting point, reference was made to Briggs J's judgment in *Pearson & Ors v Lehman Brothers Finance SA & Ors* [2010] EWHC 3044 (Ch) at [7], where it was held that the general rule that costs follow the event was a position from which the court may depart having regard to all the relevant circumstances of the case.

It was also acknowledged that in the context of an insolvent estate, the court has been disposed to depart from the general costs follow the event principle and to allow costs as an expense in the relevant process of administration. In giving judgment, Hildyard J noted that this disposition was evident from the earlier Waterfall proceedings where in every instance the court had directed for the payment of all parties' costs out of the administration estate.

It was accepted that the question was ultimately one of discretion. However, Hildyard J was guided by authority pointing to discretion being deployed cautiously according to the characterisation of the substance of the proceedings. See for example Henderson J's decision in *Kositc v Chaplin & Ors* [2007] EWHC 2909 (Ch).

Accordingly, in reaching judgment, it was necessary to determine the proper characterisation of the Waterfall IIC proceedings. On this, it was evident that on the form of proceedings, Waterfall IIC was brought by the Joint Administrators of the LBIE estate to seek directions from the court on issues they considered had to be judicially determined in order to proceed with the administration of the estate. Further, although not formally appointed as representative respondents, it was noted that each of the Respondents was intended and called upon to advance arguments from the point of view not just of itself, but of all creditors having a like interest. The overall objective was clearly therefore for the resolution of issues in the interests of all creditors and the administration as a whole.

In making submissions, it was pointed out by the SCG that the fourth respondent (Wentworth) held £1.6 billion worth of ISDA claims alone, which materially exceeded the entire unsecured claims held by the members of the SCG. It was said that this illustrated the essentially sponsored and representative nature of the proceedings with participants playing roles which did not necessary reflect their actual overall interests, serving to emphasise that the usual costs follow the event order would not in truth reflect the economic realities, and would therefore be unjust and unfair. In supporting this contention, the SCG pointed to the circumstances of Waterfall II more generally, highlighting that the proceedings were divided into parts solely for the convenience and efficiency of determination. It had not been suggested that the decision on how to divide the application reflected that the different parts were of a different nature, or that they deserved different treatments on costs. In Waterfall II A and B, costs were ordered to be paid as an expense of the administration, and so it followed that the same treatment should be afforded in Waterfall IIC.

However, to the contrary of the SCG's (and sixth respondent's) position, the fourth respondent submitted that the court should look beyond the form to the substance of the proceedings. On this, they pointed the court to the fact that the proper characterisation of the proceedings was that of hostile commercial litigation in which the SCG and sixth respondent sought to establish a right against LBIE pursuant to pre-administration contracts with them, which provided for the payment of interest at rates greater than 8% p.a. Given Waterfall IIC concerned the construction of pre-administration contracts between those parties, this had nothing to do with the interpretation of the statutory scheme, such that costs should not be paid out of the administration estate in respect of those claims.

In balancing these competing claims, Hildyard J held that in respect of the adjudication of the ISDA agreement issues, this should be characterised and treated for the purposes of costs as a necessary application for direction to be given in the interest of the general body of creditors, despite the process being necessarily adversarial. Overall, the application was required to clarify the interest and was conducted to the overall benefit of the administration estate, therefore meaning that the costs should come out of the LBIE estate.

However, on the adjudication of the GMA issues, Hildyard J considered that they should be characterised as a commercial claim against the interests of the LBIE estate, which were raised for no identified benefit beyond that of the SCG. There were no sufficient factors to displace the ordinary rule that costs follow the event, and so costs were ordered to be paid accordingly.

Comment

This case highlights yet again the complexities that can arise in costs proceedings. It also provides further commentary on the circumstances when it is appropriate to divert from the usual cost follow the event principle in the context of applications brought by the administrators of an insolvent estate. Parties involved in such litigation should consider the true purpose behind their position, and whether that stance will benefit the wider estate, or whether the stance is being taken solely for their own benefit. Whatever the answer will ultimately have costs consequences.

Burnden Holdings (UK) Ltd v Fielding [2018] UKSC 14

Edoardo Lupi, Barrister, South Square, London, UK

Synopsis

In *Burnden Holdings (UK) Ltd v Fielding*, the Supreme Court provided clear guidance regarding the application of section 21(1)(b) of the Limitation Act 1980 to company directors. In short, in contrast with express trustees, it now appears that for the purposes of section 21(1)(b) a company director will generally be treated as having 'previously received' trust property or the proceeds of trust property by virtue of being the fiduciary steward of the company's property, such that the focus of the Court's attention under the sub-section will principally be whether the property was 'converted to his use'.

Company Directors and section 21 of the Limitation Act

In what circumstances will no period of limitation under the Limitation Act 1980 run against a company director who has acted in breach of his or her fiduciary duties? A number of recent Court of Appeal decisions have considered different aspects of this vexed issue in recent times.[1] In *Burnden Holdings (UK) Ltd v Fielding* [2018] UKSC 14, the Supreme Court recently provided clear and welcome guidance in relation to the application of section 21(1)(b) of the Limitation Act to company directors.

Insofar as relevant, section 21 of the Limitation Act provides:

> '21 (1) No period of limitation prescribed by this Act shall apply to an action by a beneficiary under a trust, being an action –
>
> (a) in respect of any fraud or fraudulent breach of trust to which the trustee was a party or privy; or
>
> (b) to recover from the trustee trust property or the proceeds of trust property in the possession of the trustee, or previously received by the trustee and converted to his use.
>
> [...]
>
> (3) Subject to the preceding provisions of this section, an action by a beneficiary to recover trust property or in respect of any breach of trust, not being an action for which a period of limitation is prescribed by any other provision of this Act, shall not be brought after the expiration of six years from the date on which the right of action accrued. For the purposes of this subsection, the right of action shall not be treated as having accrued to any beneficiary entitled to a future interest in the trust property until the interest fell into possession.'

Pursuant to section 38(1) of the Limitation Act, the terms 'trust' and 'trustee' have the same meanings as in the Trustee Act 1925. The broad definitions of 'trust' and 'trustee' under section 68(17) of the Trustee Act 1925 encompass constructive trusts. By way of relevant legal background, it is now well established that there are two types of constructive trustee for the purposes of limitation.[2] In *Paragon Finance plc v D B Thakerar & Co* [1999] 1 All ER 400, Millett LJ drew a frequently cited distinction between, on the one hand, a constructive trustee who owes pre-existing duties in respect of trust property pre-dating any breach of duty (a so-called 'Class 1 constructive trustee') and, on the other, a constructive trustee who only becomes such by virtue of having committed some wrongdoing (a 'Class 2 constructive trustee').

In *JJ Harrison v Harrison* [2002] BCLC 162, the Court of Appeal accepted that there was 'no doubt' that a company director is properly treated as Class 1 constructive trustees for limitation purposes because a director, on appointment:

> 'assumes the duties of a trustee in relation to the company's property. If, thereafter, he takes possession of that property, his possession 'is coloured from

Notes

1 In particular, see the recent Court of Appeal decision in *First Subsea Ltd (formerly BSW Ltd) v Balltec Ltd* [2017] EWCA Civ 186 in relation to section 21(1)(a) of the Limitation Act.

2 This twofold categorisation was confirmed by the Supreme Court in *Williams v Central Bank of Nigeria* [2014] AC 1189 at [9] and [28]. See also *Peconic Industrial Development Ltd v Lau Kwok Fai [2009] 5 HKC 135*, a decision of the Hong Kong Court of Final Appeal in relation to the statutory equivalent of section 21, *per* Lord Hoffmann.

> the first by the trust and confidence by means of which he obtained it'. His obligations as a trustee in relation to that property do not arise out of the transaction by which he obtained it for himself. The true analysis is that his obligations as a trustee in relation to that property predate the transaction by which it was conveyed to him.'[3]

It is apparent from some of the cases in this area[4] that section 21 has been applied to company directors *by analogy*, as permitted by section 36(1) of the Limitation Act. But in *First Subsea Ltd (formerly BSW Ltd) v Balltec Ltd* [2017] EWCA Civ 186S, Patten LJ (with whom Kitchin and Briggs LJJ agreed) considered that a director is actually a 'trustee' within the extended definition of section 38(1) of the Limitation Act, and that section 21 is accordingly directly applicable to claims made against a director for breaches of fiduciary duty.[5]

In general, therefore, a director who has acted in breach of fiduciary duty will be able to rely on section 21(3) of the 1980 Act, under which a 6-year limitation period applies, unless the breach falls within section 21(1) of the 1980 Act, which disapplies any statutory limitation period in the case of fraud or fraudulent breach of trust to which the director was party (section 21(1)(a)), or where company property is in the possession of the director, or was previously received by the director and converted to his own use (section 21(1)(b)).[6]

First Instance and the Court of Appeal

In *Burnden v Fielding* itself, the limitation issue arose in the following way. On 12 October 2007, with a view to selling a shareholding in one of the claimant company's wholly-owned subsidiaries, the claimant's directors authorised the distribution *in specie* of the shares in the subsidiary to a Newco of which they were the majority shareholders and directors. By a number of additional transactions, the shares were transferred on to a further holding company, and the directors' shareholdings in that entity were, in turn, sold to a third party purchaser for GBP 6 million.

The claimant company went into liquidation in 2009. Proceedings against the directors were issued on 15 October 2013. It was alleged that the distribution *in specie* of the shares in the subsidiary was an unlawful distribution, amounting to a breach of fiduciary duty to which the directors were party. Though hotly contested in the main proceedings, it was assumed for the purposes of the summary judgment application that followed and the limitation arguments that this was indeed the case. *Prima facie*, therefore, the limitation period applicable to the directors was six years pursuant to section 21(3), subject to the contrary provisions of the Limitation Act. It was agreed that six years and three days had elapsed from 12 October 2007 by the time the claim form was issued, such that the claim would have been time-barred if section 21(1) or section 32 (deliberate concealment of a cause of action) did not apply.

At first instance, HHJ Hodge QC held that the claim brought by the claimant for alleged breach of duty against the two directors was time-barred, and summary judgment was entered in favour of the defendant directors. The Court of Appeal disagreed and upheld the claimant's appeal on the basis that limitation did not run against the claimant by virtue of section 21(1)(b) of the Limitation Act. The Court of Appeal considered that, on its proper construction, section 21(1)(b) included within its terms a transfer to a company directly or indirectly controlled by the trustee, such that no limitation period applied to the claimant's claim. David Richards LJ said at [37]:

> 'If section 21(1)(b) were construed to apply only to those cases where the trustee directly and personally acquires the trust property, its evident purpose would be much constrained and easily avoided. In my judgment, a construction which includes within its terms a transfer to a company directly or indirectly controlled by the trustee is within the meaning of this provision.'

Alternatively, the Court of Appeal held that the claimant was entitled to succeed on the basis of section 32 of the Limitation Act, given that it was not possible, in the context of summary judgment, to determine when the claimant could have discovered the directors' breach with reasonable diligence.

The Supreme Court's judgment

By the time the appeal had reached the Supreme Court, it was accepted that there could no longer be summary judgment for the defendant directors, because the claimant had (after permission to appeal had been granted) amended its statement of claim to allege that the unlawful distribution amounted to a fraudulent breach of trust to which the defendants were a party, thereby engaging section 21(1)(a) of the Limitation Act. Nevertheless, the issue as to the meaning of

Notes

3 At paragraph 29.
4 See for example, Mummery LJ's judgment in *Gwembe Valley Development Co Ltd v Koshy (No 3)* [2004] 1 BCLC 131.
5 At paragraph 50.
6 A defaulting director may, of course, also rely on section 32 of the Limitation Act.

section 21(1)(b) was of sufficient importance to have made it appropriate for the appeal to proceed.

In the Supreme Court, the defendants' principal contention was that the relevant trust property (the shareholding in the subsidiary) was never in the possession of the directors, nor had it been previously received by them and converted to their own use within the meaning of section 21(1)(b); rather the shareholding had been in the ownership and possession of the claimant and thereafter a succession of different corporate entities. To ignore that the shareholding was transferred to a succession of corporate entities – and not to the directors themselves – involved impermissibly lifting one or more corporate veils.

Giving the Court's unanimous judgment, Lord Briggs considered that the starting point was the purpose of section 21(1)(b). In that connection, his Lordship approved the statement of Kekewich J in *In re Timmis, Nixon v Smith* [1902] 1 Ch 176 in respect of section 21(1)(b)'s statutory antecedent:

> 'The intention of the statute was to give a trustee the benefit of the lapse of time when, although he had done something legally or technically wrong, he had done nothing morally wrong or dishonest, but it was not intended to protect him where, if he pleaded the statute, he would come off with something he ought not to have, i.e., money of the trust received by him and converted to his own use.'

Second, Lord Briggs noted that it was necessary to bear in mind that section 21 was primarily aimed at express trustees and applicable to company directors 'by what might fairly be described as a process of analogy' (compare *First Subsea Ltd v Balltec Ltd* at [50] above). Whereas express trustees might or might not from time to time be in possession or receipt of trust property, directors of a company are necessarily treated as being in possession of the trust property from the outset because they are the fiduciary stewards of a company's property (paragraphs 18 to 19). Thus it followed that:

> 'if [the directors'] misappropriation of the company's property amounts to a conversion of it to their own use, they will still necessarily have previously received it, by virtue of being the fiduciary stewards of it as directors.
>
> It may well be that, in relation to trustees who are company directors the requirement in section 21(1)(b) that the property be received by them before its conversion adds little or nothing to the conditions for the disapplication of any limitation period which would have operated in their favour' (paragraphs 19 to 20).

Third, on the assumed facts, the defendant directors converted the claimant company's shareholding in the subsidiary when they procured or participated in the unlawful distribution of it to the Newco. It was a conversion because it was a taking of the company's property in defiance of the company's rights of ownership of it. It was a conversion to their own use, because of the economic benefit which they stood to derive from being the majority shareholders in the company to which the distribution was made. Lord Briggs concluded at paragraph 22: '[b] y the time of that conversion the defendants had previously received the property because, as directors of the claimant company, they had been its fiduciary stewards from the outset.'

Accordingly, the appeal in relation to section 21 was dismissed, albeit the Supreme Court's analysis differed to some extent from the Court of Appeal's reasoning. The appeal in relation to section 32 was dismissed on the basis that it was unsuitable for summary judgment because there would still be fact-intensive issues calling for trial. Lord Briggs expressed no view on the correctness or otherwise of the analysis adopted by the Court of Appeal in respect of section 32(2) of the Limitation Act.

In light of this decision, it now appears that, in general, company directors will be treated as having 'previously received' trust property for the purposes of the second limb of section 21(1)(b) of the Limitation Act by virtue of having assumed fiduciary obligations in respect of company property from the time of entering office, such that, in the main, the court's focus will be on whether the directors converted company property to their own use.

Goldman Sachs International v Novo Banco SA [2018] UKSC 34

Rose Lagram-Taylor, Barrister, South Square, London, UK

Synopsis

The Supreme Court held that it had no jurisdiction over a debt claim against a bridge institution ('Novo Banco') set up by the Bank of Portugal in compliance with the EBRRD and the Reorganisation Directive despite a jurisdiction clause specifying that the loan in question was to be governed by the law of England and Wales, with any disputes under the agreement to be resolved by the exclusive jurisdiction of the English courts. This was because the decision of Banco de Portugal not to transfer the liability to Novo Banco had the effect of meaning that it was never party to the jurisdiction clause, and thus the English court had no jurisdiction.

Introduction

On 4 July 2018, the Supreme Court handed down its decision in *Goldman Sachs International v Novo Bank SA* [2018] UKSC 34. The appeal concerned the recognition in the United Kingdom of measures by a foreign 'Resolution Authority' in accordance with its own national legislation implementing the European Bank Recovery and Resolution Directive, Parliament and Council Directive 2014/59/EU of 15 May 2014 (the 'EBRRD'). The EBRRD established a framework for the recovery and resolution of credit institutions and investment firms and amended the earlier Directive 2001/24/EC of 4 April 2001 on the reorganisation and winding up of credit institutions (the 'Reorganisation Directive').

The Reorganisation Directive applied to credit institutions in the course of reorganisation or winding up in a member state. It provided for their assets and liabilities to be dealt with in a single process under the law of the home member state, and for the legal consequences to be recognised in all other member states, irrespective of any other relevant law. However, the EBRRD amended this and required member states to confer on their domestic Resolution Authorities (usually the Central Bank) certain minimum powers and tools for reconstructing the businesses of failing credit institutions and investment firms. One such power was the use of the 'bridge institution tool' (dealt with by section 3 of the EBRRD). This required designated national Resolution Authorities to have the power to transfer to a 'bridge institution' any assets, rights of liabilities of a failing credit institution (and to leave any problematic assets and liabilities with the failing institution). The EBRRD also made supplementary provisions for co-operation among member states in giving effect to those measures.

Factual background

The claim was brought under the assignment of rights of Oak Finance Luxembourg SA ('Oak'). Oak had entered into a facility agreement in June 2014 with the Portuguese bank, Banco Espírito ('BES') under which it agreed to lend it approximately $835 million (the 'Loan' and the 'Oak Liability'). The facility agreement was governed by English law and provided for the English courts to have exclusive jurisdiction in respect of 'any dispute arising out of or in connection with this Agreement.'

The first scheduled repayment was due in December 2014. However, it soon became clear that BES was in serious financial difficulty. On 30 July 2014 BES reported losses for the first half of 2014 exceeding $3.5 billion. The following day, BES applied to Banco de Portugal, the Central Bank of Portugal for emergency liquidity assistance.

Banco de Portugal is the designated Resolution Authority for the purposes of EBRRD. It decided to invoke the provisions of the EBRRD (as incorporated into Portugal's national banking laws) to protect depositors' funds, and accordingly incorporated Novo Banco to serve as the bridge institution. Banco de Portugal provided that certain, but not all, liabilities of BES would be transferred to Novo Banco. One such liability not transferred was the Oak Liability, which had the effect of re-transferring that liability back to BES. This was on the basis that (i) Oak had entered into the facility agreement on behalf of Goldman Sachs, and (ii) Goldman Sachs held more than 2% of BES's share capital, both of which meant, in accordance with Portugal's banking law, that the liability could not be transferred to a bridge institution. Goldman Sachs objected to this asserting that (i) whilst they had arranged the facility agreement, they were not the true lenders, and (ii) they were not holders of more than 2% of BES's share capital. Nevertheless, Banco de Portugal maintained their decision.

Accordingly, Goldman Sachs issued proceedings in England under the Facility Agreement as assignees of Oak, seeking to obtain repayment of the Loan. They also initiated proceedings against Banco de Portugal in Portugal to suspend the effect of their decision to not allow the transfer of the Oak Liability to BES, and for a judicial review of the same. In response, Novo Banco applied for the English proceedings to be set aside or stayed pending the Portuguese proceedings, on the grounds that the High Court had no jurisdiction as Novo Banco were not party to the Facility Agreement in relation to the Oak Liability, which meant that the jurisdiction clause did not apply to them.

At first instance, Hamblen J in the High Court held that it was sufficiently established for the purpose of jurisdiction that Goldman Sachs held less than 2% of the share capital of BES and that it was not the real lender under the facility agreement. It followed that for the purpose of jurisdiction it was to be assumed that the Oak Liability had been transferred to Novo Banco when it was created as a bridging institution, meaning Novo Banco was subject to the facility agreement's jurisdiction clause. Hamblen J therefore decided in favour of the claimant and rejected the defendant's application.

In the Court of Appeal, the argument took a different turn as a result of the intervention of Banco de Portugal. Counsel for both Novo Banco and Banco de Portugal submitted that the Directives required the recognition of the entire process of reorganisation under the EBRRD, meaning it was wrong in principle to consider the effect of Banco de Portugal's decision to utilise the bridging institution tool, independently of the decision not to transfer the Oak Liability to Novo Banco such that the English court was bound to recognise its effect as a matter of Portuguese law. The Court of Appeal allowed the appeal, principally on that ground.

Issues

The primary issue with which the Supreme Court had to grapple was that of jurisdiction. In setting out the relevant test, Lord Sumption, in giving judgment, set out that the traditional test has been whether the claimant had 'the better of the argument' on the facts going to jurisdiction. This was re-formulated in *Brownlie v Four Seasons Holdings Inc* [2018] 1 WLR 192 as being:

> '(i) that the claimant must supply a plausible evidential basis for the application of a relevant jurisdictional gateway; (ii) that if there is an issue of fact about it, or some other reason for doubting whether it applies, the court must take a view on the material available if it can reliably do so; but (iii) the nature of the issue and the limitations of the material available at the interlocutory stage may be such that no reliable assessment can be made, in which case there is a good arguable case for the application of the gateway if there is a plausible (albeit contested) evidential basis for it.'

It was common ground that the test must be satisfied on the evidence relating to the position as at the date when the proceedings were commenced.

The claimant's primary argument on appeal was that whilst Banco de Portugal's earlier decision to incorporate Novo Banco to serve as the bridge institution falls to be recognised in England, the legal effect of the later decision not to transfer the Oak Liability to Novo Banco does not.

Decision

In reaching judgment, the Supreme Court focused on the relevant Directives. It was acknowledged that the rescue of failing financial institutions commonly involves measures affecting the rights of their creditors and other third parties which can include the suspension of payments, the writing down of liabilities, moratoria on their enforcement, and transfers of assets and liabilities to other institutions. Sumption LJ pointed to the fact that prior to the Reorganisation Directive and EBRRD, at common law, measures of this kind taken under a foreign law only had limited effect on contractual liabilities governed by English law. This was because the discharge or modification of a contractual liability was treated in English law as being governed only by its proper law, so that measures taken under another law, such as that of a contracting party's domicile, were normally disregarded (*Adams v National Bank of Greece SA* [1961] AC 255). The exception to this was the fact that the assumption of contractual liabilities by another entity by way of universal succession could be recognised in England (*National Bank of Greece & Athens SA v Metliss* [1958] AC 509).

Turning to the Reorganisation Directive, article 3 was identified as the relevant substantive provision which provided that (i) 'the administrative or judicial authorities of the home member state shall alone be empowered to decide on the implementation of one or more reorganisation measures in a credit institution, including branches established in other member states', and (ii) 'the reorganisation measures shall be applied in accordance with the laws, Regulations and procedures applicable in the home member state, unless otherwise provided in this Directive'. As to what reorganisation measures constitute, article 2 of the Reorganisation Directive, as amended by article 117(2) of the EBRRD, defined these as 'measures which are intended to preserve or restore the financial situation of a credit institution or an investment firm...and which could affect third parties pre-existing rights, including measures involving the possibility of a suspension of payments, suspension of enforcement measures or reduction of claims'.

As it was not disputed that Banco de Portugal had power under Portuguese law to employ the bridge institution tool, the Supreme Court found it unnecessary to examine the detailed provisions of the EBRRD relating to the reconstruction of bank liabilities. Instead, the relevant provisions were those dealing with mutual recognition of the legal effects of measures taken in accordance with the 'tools' and the provisions dealing with challenges to those measures in the courts of the home member state.

On mutual recognition, recital 119 of the EBRRD provided for 'the mutual recognition and enforcement in all member states of decisions concerning the reorganisation or winding up of institutions having branches in member states other than those in which they have their head offices.' Article 66 of the EBRRD, a supplementary recognition provision, dealt with dispositions of assets and liabilities in the course of a reorganisation of a creditor institution in its home state. This provided that (i) any transfer of assets, rights or liabilities under the law of another member state would be effected in or under the law of that other member state, and (ii) shareholders, creditors or third parties affected by the transfer would not be entitled to prevent, challenge or set aside the transfer under any provision of law of the member state where the assets are located or under the law governing the rights or liabilities.

As to proceedings to challenge measures taken in accordance with the tools, recitals 88 and 89 of the EBRRD specify the need for the decisions of a Resolution Authority to be subject to appeal to the courts on the ground (amongst others) of insufficient factual basis. By recital 90, the lodging of any appeal does not result in automatic suspension of the effects of the challenged decision, and by recital 91 remedies for a wrongful decision are limited to the award of compensation. This is substantiated in article 85 of the EBRRD.

In applying the Directives, Lord Sumption asserted that the first thing that struck him about the claimant's submission was its inherent implausibility. This was because the result of separating Banco de Portugal's decision to incorporate Novo Banco to serve as the bridge institution from the later decision not to transfer the Oak Liability to Novo Banco, giving effect only to the first decision, was that in the eyes of the English court, Portuguese law must be treated as having transferred the Oak Liability to Novo Banco, although it would not be seen that way in the eyes of the Portuguese courts. This, it was said, would be a paradoxical result given that the ordinary purpose of a choice of law rule is to ascertain which legal rules should be applied in the relevant foreign jurisdiction.

In assessing the argument of the claimant, the Supreme Court determined that the relevant provision was article 3 of the Reorganisation Directive, as amended by the EBRRD to apply to 'reorganisation measures' taken in the exercise of its various 'tools'. On enforcement, article 66 of the EBRRD required member states to take active steps to enforce transfers of assets or liabilities made in the course of a reorganisation in the home state and to prevent challenges to such transfers in their own jurisdictions.

On article 3, the Supreme Court asserted that the only way in which the purpose of article 3 could be achieved was to take the process of reorganisation as a whole, applying the legal effects attaching to the process under the law of the home members state in every other member state. It was not consistent with the language or the purpose of article 3 that a decision such as the one not to transfer the Oak Liability (termed an 'administrative act') should have legal consequences on credit institutions' debts which were recognised in the home state, but that were not recognised in other member states (applying *LBI hf v Kepler Capital Markets SA* (Case C-85/12) EU:C:2013:697, and *Kotnik v Drzavni Zbor Republike Slovenije* (Case C-526/14) [2017] 1 CMLR 26).

Further, the decisions of Banco de Portugal did not occur in a legal vacuum. The broader framework of public law had to be considered. Article 3 did not only give effect to 'reorganisation measures', it required them to be 'applied in accordance with the laws, Regulations and procedures applicable in the home member state, unless otherwise provided in this Directive', and to be 'fully effective in accordance with the legislation of that member state'. It was therefore held that it would not make sense for the court of another member state to give effect to a reorganisation measure but not to other provisions of the law of the home state affecting the operation of that measure.

In rejecting the appeal, Lord Sumption concluded that the later decision of Banco de Portugal not to transfer the Oak Liability was not an amendment of the earlier decision to make Novo Banco a bridging institution, and nor was it a retransfer of a liability previously transferred. It was a ruling under Portugal's national banking law. The English court therefore had to treat the Oak Liability as never having been transferred to Novo Banco, meaning it was never party to the jurisdiction clause in the facility agreement.

The claimant's alternative case that even if the decision not to transfer the Oak Liability to Novo Banco was recognised in England it should be disregarded as this was only a provisional decision pending a final decision of the Portuguese courts was also rejected. Lord Sumption explained that the decision was not a provisional decision and any other conclusion on the decision would not be consistent with the Directives. It was not the place for an English court to decide what would amount to an appeal in Portugal, and the Directives would be undermined if the acts of a national Resolution Authority were open to challenge in every other member state simply because they were open to challenge in the home state.

Reference to the Court of Justice of the European Union was refused.

Comment

Whilst similar facts may not regularly occur, this judgment acknowledges and affirms the application of the Directives. The judgment demonstrates that the emergency powers given to authorities in a home state will triumph over private law rights in these circumstances. Moving forwards, it will be important to remember that a party's rights could be affected by reorganisation measures taken under foreign law which will then be recognised and enforced in that party's home state.

Orexim Trading Limited v Mahavir Port and Terminal Private Limited [2018] EWCA Civ 1660 (Lewison, Gross, and Leggatt LJJ, 13 July 2018)

Lottie Pyper, Barrister, South Square, London, UK

Synopsis

In *Orexim Trading Limited v Mahavir Port and Terminal Private Limited* [2018] EWCA Civ 1660 the Court of Appeal considered the scope of paragraph 3.1(20)(a) of Practice Direction 6B, which applies to claims brought 'under an enactment which allows proceedings to be brought', where those provisions are not covered by any other 'gateway' in paragraph 3.1. The Court of Appeal found that paragraph 3.1(20)(a) theoretically applies to all statutes with extra-territorial effect, including section 423 of the Insolvency Act 1986. However, in order to obtain permission to serve out, the section 423 claim must have a sufficient connection to England and Wales.

Introduction

Paragraph 3.1 of Practice Direction 6B sets out the jurisdictional gateways for permitting service out of the jurisdiction. Following the Court of Appeal's decision in *Orexim Trading Limited v Mahavir Port and Terminal Private Limited* [2018] EWCA Civ 1660, the court has power to permit service out of the jurisdiction in respect of any claim brought under a statute that permits proceedings to be brought extraterritorially.

The relevant statute in *Orexim* was section 423 of the Insolvency Act 1986. Although it is well-established that section 423 has extra-territorial effect, where such a claim has a foreign element, there must be a sufficient connection between the defendant and England and Wales. In *Orexim* the court was not satisfied that there was a sufficient connection, and accordingly permission to serve out of the jurisdiction was refused.

Factual background in *Orexim*

The facts relevant to the Court of Appeal's decision are limited to those relating to jurisdiction. The claimant, Orexim Trading Ltd ('Orexim Trading') was a Maltese company. Orexim Trading had brought a section 423 claim in relation to an Indian flagged vessel, contending that the sale of that vessel by Mahavir Port and Terminal Private Ltd ('Mahavir') to Singmalloyd Marine (S) Pte Ltd ('Singmalloyd') and subsequent on sale to Zen Shipping and Ports India Private Ltd ('Zen') should be set aside. Mahavir and Zen were Indian companies. Singmalloyd was a Singaporean company.

On 19 December 2013 Orexim Trading had entered into a charterparty with Mahavir. The charterparty provided that any disputes were to be arbitrated in India.

A number of disputes arose between the parties, leading to court proceedings in India and Ukraine. On 15 May 2014 Orexim Trading and Mahavir (and another party, Atlantis ME FZE), entered into a settlement agreement. The settlement agreement was subject to English law and contained an English jurisdiction clause.

Under the settlement agreement, Orexim agreed to release the vessel from arrest and withdraw certain criminal proceedings against Mahavir. Mahavir agreed to procure that USD 7.39m be paid to Orexim. Orexim had only been paid USD 466,365 and, therefore, Mahavir's obligations under the settlement agreement remained unfulfilled.

Orexim subsequently discovered that the vessel had already been sold by Mahavir to Singmalloyd pursuant to a memorandum of sale dated 4 June 2013. It sought to reverse that transaction and the subsequent on sale by bringing a claim under section 423 of the Insolvency Act 1986 against Mahavir and Zen.

The Civil Procedure Rules

Ordinarily the claimant must obtain the court's permission in order to serve a claim form out of the jurisdictions (unless the location of service is in Scotland or Northern Ireland (CPR r6.32) or the claim falls under certain European legislation (CPR r6.33)). The court has power to grant such permission if any of the 'gateways' in paragraph 3.1 of Practice Direction 6B apply (CPR r6.36). The gateway relied on in *Orexim* was paragraph 3.1(20)(a) (hereafter referred to as 'gateway 20(a)') which provides that permission to serve a claim form out of the jurisdiction may be granted where the claim is made

> 'under an enactment which allows proceedings to be brought and those proceedings are not covered by any of the other grounds referred to in this paragraph.'

In addition to satisfying one of the gateways in paragraph 3.1, the claimant must also satisfy the court that the claim has a reasonable prospect of success (CPR r6.37(1)) and that England and Wales is the 'proper place' to bring the claim (CPR r6.37(3)).

The extra-territorial effect of section 423 of the Insolvency Act 1986

Section 423 of the Insolvency Act 1986 enables the court to reverse or grant relief in respect of transactions made at an undervalue for the purpose of defrauding creditors. Although this provision appears in the Insolvency Act, its scope is not limited to insolvency proceedings: claims may be brought by a victim of the transaction at any time. Since *Re Paramount Airways Ltd* [1993] Ch 223, it has been accepted that section 423 has extra-territorial effect to the extent that it confers power on the court to make orders against persons or property outside England and Wales, but that the exercise of this power is subject to there being a sufficient connection with the jurisdiction. In considering whether such a connection exists, the court will consider all the circumstances of the section 423 claim.

The construction of gateway 20(a)

As observed by Lewison LJ in *Orexim*, since section 423 has extra-territorial effect, one might expect that the procedural rules would enable the court to exercise its power under that section. In order to determine whether or not section 423 fell within gateway 20(a) Lewison LJ began by consider the scope of the gateway itself. He observed that, as a matter of construction, '*an enactment which allows proceedings to be brought*' must mean an enactment which allows proceedings to be brought against persons not within England and Wales (at [33]). Subject to this, there was no other limitation arising from the wording of the gateway.

In considering whether taking a broad approach to gateway 20(a) was appropriate, Lewison LJ emphasised that, in light of the increasingly global and digital world economy, asserting extra-territorial jurisdiction was no longer regarded as 'exorbitant.' He said (at [35]):

> 'Untrammelled by authority, it seems to me that the natural construction of [gateway 20(a)] is that if, as a matter of construction, the enactment in question allows proceedings to be brought against persons not within England and Wales, then the court has power to allow those proceedings to be served abroad. Whether it should exercise that power is a different question.'

However, at first instance in *Orexim*, HHJ Waksman QC had declined to grant permission to serve out of the jurisdiction on the basis that section 423 did not fall within gateway 20(a). In reaching his decision, the judge followed *Re Harrods (Buenos Aires) Ltd* [1992] Ch 72 and held that *Erste Group Bank AG (London) v JSC (VMZ Red October)* [2013] EWHC 2926 (Comm), [2014] BPIR 81 had been wrongly decided.

Lewison LJ disagreed. Following the approach of Flaux J in *Erste Group*, he found that section 423 did fall within gateway 20(a) (at [45]). Whereas HHJ Waksman regarded gateway 20(a) as a partial successor to RSC Ord. 11 r1(2), the statutory provision considered in *Re Harrods*, Lewison LJ drew a comparison between the wording of that provision and CPR 6.33. Accordingly, the 'obvious inference' was that gateway 20(a) was intended to operate in different circumstances (at [47]). Further, the consequences of a claim falling within RSC Ord. 11 r1(2) and gateway 20(a) were radically different. A claim that fell within RSC Or 11 r1(2) could be served out of the jurisdiction without the Court's permission. By contrast, the consequence of a claim falling within gateway 20(a) is that the court must still consider whether or not to grant permission. Accordingly, Lewison LJ concluded that section 423 fell within the scope of gateway 20(a). This conclusion is consistent with the decisions in *Erste Group* and *Paramount Airways*.

Orexim has provided welcome clarity regarding claims brought under section 423. More generally, it has confirmed that gateway 20(a) includes all statutes that allow proceedings to be brought against parties located outside of England and Wales that are not otherwise caught by paragraph 3.1 of Practice Direction 6B.

Sufficient connection

The next issue to consider in *Orexim* was sufficient connection. Following *Paramount Airways*, Lewison LJ emphasised that where a claim under section 423 has a foreign element, there is a further requirement that there be a sufficient connection between the defendant and England and Wales (at [55]). Although in some cases this question might not be capable of being resolved before trial, this would not invariably be the case. The question of 'sufficient connection' was also relevant to satisfying CPR 6.37(1): if there was not a sufficient connection, the section 423 claim would have no reasonable prospects of success, so permission to serve out of the jurisdiction would not be granted.

Lewison LJ held that, on the facts in *Orexim* there was not a sufficient connection with England and Wales, and there was no need to wait until trial to resolve that question (at [59]). None of the parties, the vessel or either of the transactions involving the vessel had any connection to England and Wales. The connection with England and Wales relied on by Orexim was the settlement agreement, which was governed by English law had an English jurisdiction clause. However the fact that the settlement agreement post-dated 4 June 2013, the date on which the vessel was or purported to have been sold, fatally undermined the alleged connection with England and Wales. The relevant question was whether the section 423 claim itself had any connection with England and Wales. The fact that the section 423 claim had been brought with the purpose of enforcing a claim that Orexim had under the settlement agreement was not relevant to the question of jurisdiction.

Further, since there was no sufficient connection with the jurisdiction, there was no basis for concluding that England and Wales was the 'proper place' to be the claim, as required by CPR 6.37(3)).

Comment

Orexim has confirmed that paragraph 3.1 of Practice Direction 6B includes all statutes that apply extra-territorially, including section 423 of the Insolvency Act 1986. The decision also underlines the importance of judicial discretion where broad powers are available. However, it is perhaps notable that in both *Erste Group* and *Orexim* itself, permission to serve the section 423 claim out of the jurisdiction was not granted. It is therefore clear that, as a result of the broad approach taken to the scope of gateway 20(a), the courts will adopt a robust approach towards ensuring that each of the CPR requirements are met before granting permission to serve out of the jurisdiction under that gateway.

Carlos Sevilleja Garcia v Marex Financial Limited [2018] EWCA Civ 1468

Stefanie Wilkins, Barrister, South Square, London, UK

Synopsis

In *Sevilleja Garcia v Marex Financial Limited* [2018] EWCA Civ 1468, the Court of Appeal considered the scope of the rule against reflective loss, concluding unambiguously that the rule extends to preventing claims brought by creditors of a company, and is not limited to claims brought by shareholders. Further, the Court clarified the extremely limited nature of the exception to the rule, namely that an exception will be recognised only where the conduct of the wrongdoing defendant has made it legally impossible for the company, or another acting on its behalf, to bring the claim.

Introduction and overview

In *Sevilleja Garcia v Marex Financial Limited* [2018] EWCA Civ 1468 ('*Garcia*'), the Court of Appeal considered whether an unsecured creditor of a company who was not also a shareholder would be prevented from bringing their claim by the operation of the rule against reflective loss.

It has long been accepted that where a company suffers loss at the hands of a third party which results in a diminution of the value of its shares, a shareholder cannot sue that third party for the loss in the value of its shareholding. Only the company can pursue a claim for its loss. The loss suffered by a shareholder in such circumstances is treated as indirect, and only a 'reflection' of the loss suffered by the proper claimant, the company. What has been less certain is whether it precludes only claims by shareholders as such, or whether it extends to others, in particular creditors.

The Court of Appeal considered the proper scope of the rule against reflective loss. In doing so, they identified the policy justifications for the rule, thus providing clarity and guidance as to how future cases might be decided. Further, the Court identified clearly the scope of the exception to the rule against reflective loss, and confirmed the extremely limited scope of the rule.

Factual and procedural background

Marex was the claimant at first instance. In 2013, Marex had brought claims against two companies ('the Companies'), through which Mr Sevilleja conducted foreign exchange trading. Marex had succeeded in obtaining judgment against the Companies in an amount of USD 5 million, and shortly thereafter obtained a freezing order (on 14 August 2013). However, when the assets of the Companies were disclosed, it became apparent that the value of those assets was less than USD 5,000.

Marex asserted that between the delivery of the draft judgment (on 26 July 2013) and 12 August 2013, Mr Sevilleja had dishonestly caused the Companies to transfer some USD 9.5 million from its bank accounts to his personal control. It therefore sought to commence proceedings against Mr Sevilleja seeking damages against him for the torts of (i) knowingly inducing and procuring the Companies, of which he was the ultimate beneficial owner, to act in wrongful violation of Marex's rights under the judgment it had received in 2013, and (ii) intentionally causing loss to Marex by unlawful means.

The judgment at first instance concerned Marex's service of Mr Sevilleja, which had been effected out of the jurisdiction. Mr Sevilleja applied to set aside the service, on the basis that there was no claim in law against him. The question for the court was whether Marex, as claimant, had a good arguable case (also described in the judgments at first instance and appeal as whether Marex had 'the better argument'). For the purpose of resolving that legal question, it was assumed that the facts were as Marex alleged them to be. Mr Justice Knowles concluded that Marex had the better of the argument that the two torts had been committed, and no permission to appeal was granted in respect of that finding.

However, Mr Sevilleja also contended that the rule against reflective loss barred Marex's claim. The judge rejected this contention, and it was this aspect of the judgment which was subject to appeal.

The scope of the rule against reflective loss

In the Court of Appeal, Flaux LJ delivered the leading judgment, with which Lewison and Lindblom LJJ agreed. The Court considered that the case was an appropriate vehicle for considering the scope of the rule against reflective loss, which was uncertain insofar as it extended to creditors (see [12]).

Having reviewed the existing authorities concerning the rule against reflective loss, Flaux LJ observed that it had been used to prevent not only claims brought by shareholders in their capacity as such, but also claims by shareholders in their capacity as creditors; as the rule had developed, it had *not* been limited to claims for the diminution in the value of a shareholding. In some of these cases, there had been obiter remarks supporting the application of the rule to creditors who were not shareholders.

In considering whether the rule ought to be extended to prevent claims by creditors claiming as such, his Lordship identified that the existing case law had recognised four considerations for the rule against reflective loss. These were (see [32]):

- preventing double recovery – that is, preventing both the shareholder and the company from making a claim against the defendant in respect of the same loss;
- the principle of causation – if a company chose not to pursue a claim against a wrongdoer, then the better view was that any loss to a shareholder was caused by that decision, and not by the acts of the wrongdoer;
- the public policy in avoiding conflicts of interests by those in control of the company – if a shareholder were permitted to go behind a settlement which had been negotiated by the directors of the company, then a conflict might arise between the interests and duties of the directors; and
- the interest in preserving company autonomy, and in protecting the position of minority shareholders and creditors.

There is an additional practical consideration: if a shareholder were able to claim against the defendant irrespective of the company's position, then the defendant would have little incentive to settle a claim with the company, because the shareholder would be able to proceed against the defendant in respect of any outstanding loss.

Thus, his Lordship observed that the rationale for the rule was *not* limited to any 'unity of economic interest between a company and its shareholders'. Given the wider justification for the rule, his Lordship concluded that there was no principled basis for distinguishing between creditors on the basis of whether or not they held shares. For example, it would be illogical for a claim by a shareholder creditor to be barred in circumstances where it would be permitted if they were to sell their shares (see [33]).

Flaux LJ regarded as particularly persuasive the need to protect creditors of companies. His Lordship explained that permitting a claim by a creditor in respect of an allegation of asset-stripping – such as in the case at bar – would 'bypass and subvert the *pari passu* principle', because if the creditor were able to pursue the wrongdoer, they would be fully compensated for their loss, whereas the proceeds of any claim by a liquidator would be distributed amongst the general body of creditors (see [37]).

Accordingly, Flaux LJ concluded that (see [38]):

> 'The artificial distinction between shareholder creditors and non-shareholder creditors is anomalous and, in my judgment, the rule should apply to all creditors of the company in cases of reflective loss such as the present, the considerations which justify the rule being equally applicable to all creditors.'

The limited scope of the exception

The second question for the Court was whether the exception identified in *Giles v Rhind* [2002] EWCA Civ 1428 applied. In that case, a company had commenced proceedings against a former director who had diverted its business to another company. The company entered administrative receivership, and the defendant director applied for security for costs. Because the company could not provide security, the action was discontinued on terms which included that the company was precluded from commencing a further action against the defendant. The claimant – who was another director, and shareholder – then commenced proceedings against the defendant director. It was held on appeal that the claim was not precluded in circumstances where it was the defendant's own conduct which had disabled the company from bringing its own claim.

Flaux LJ in *Garcia* observed that this exception had proved to be controversial, and that there had only been one other case in which a claimant had successfully relied on *Giles v Rhind* (see [49]-[50]). Counsel for Garcia submitted that the exception was extremely limited, namely to cases in which the defendant's wrong had made it impossible for the company to bring the claim. It was said that the present case did not fall within the exception, because Marex could have taken various steps to procure that the company bring a claim, such as providing the liquidator with funds. Conversely, counsel for Marex contended that the exception applied wherever a claim by the company was 'legally or factually impossible', including where the company was impecunious (see [54]-[55]).

Flaux LJ accepted the former view. His Lordship concluded that the exception in *Giles v Rhind* applied only in the very limited circumstances in which the defendant's wrongdoing was 'directly causative of the impossibility the company faces in bringing the claim'. For the purpose of the exception, impossibility was *legal* impossibility, in the sense that it 'no longer [had] a cause of action and it is impossible for it to bring a claim or for a claim to be brought in its name by a third party'. So if a company could be put in funds to commence proceedings, or if it could assign its cause of action, the exception would not apply (see [56]-[58]).

Accordingly, because Marex could not establish that a claim by the company would be impossible, in this limited sense, its claim was precluded by the rule against reflective loss.

Conclusion

The judgment of the Court of Appeal introduces some welcome certainty to an area which had been uncertain. In light of the pre-existing law, it would have been anomalous to preclude claims by creditors only where they were also shareholders of the company in question. One may question, however, the limited nature of the exception. Where a wrongdoer has, in practical terms, disabled a company from bringing proceedings – for example, by rendering the company impecunious – one might question the justice of permitting that conduct to go unremedied, in the absence of a willing funder or assignee of the company's claim. Nevertheless, given the clear statement of principle in *Garcia*, any challenge the scope of the rule against reflective loss, or indeed the exceptions thereto, must be for the Supreme Court.

Burlington Loan Management and others v Lomas and others (as the joint administrators of Lehman Brothers International (Europe) (in administration)) [2017] EWCA Civ 1462

Madeleine Jones, Barrister, South Square, London, UK

Synopsis

The Court of Appeal has clarified a number of issues relating to the calculation of statutory interest under r. 2.88(7) of the Insolvency Rules 1986.

Introduction

On 24 October 2017, the Court of Appeal (Gloster LJ, Patten LJ and Lord Briggs JSC), handed down judgment in the appeal one tranche of the so-called Waterfall litigation, dealing with the proper distribution of funds in the solvent administration of Lehman Brothers International (Europe) ('LBIE').

LBIE was the UK subsidiary of Lehman Brothers Holdings Inc., the fourth largest investment bank in the United States, which filed for Chapter 11 bankruptcy protection on 15 September 2008. Following its US parent's collapse, LBIE was put into administration, also on 15 September 2008. However, the English bank had never been balance sheet insolvent and its Joint Administrators eventually found themselves charged with a surplus of around £7 billion. In this unprecedented situation, the Joint of Administrators applied to the Court for directions in relation to a number of matters relating to the distribution of the surplus to creditors.

The rules governing the distribution were largely contained in the Insolvency Rules 1986 (the '1986 Rules'), which have now been superseded by the Insolvency Rules 2016 (the '2016 Rules'). However, the 2016 Rules largely reorganized and restated the 1986 Rules, so the principles stated by the Court in this judgment remain relevant.

The Court of Appeal in this case were initially to consider appeals from each case in the second set of first instance hearings in the Waterfall litigation: Waterfall IIA, B and C. However, the issues from A and B largely fell away, and so the appeal dealt with questions on appeal from Waterfall IIC. These questions all related to the entitlement of creditors who, due to the surplus, were to receive the full principal amounts of their claims and to interest on these principal sums.

Creditors' entitlement to interest in an administration

The creditors' entitlement to interest on the amounts they claimed came from rule 2.88 in the 1986 Rules (this is now substantially reproduced at r. 14.23 in the 2016 Rules; ss. 189(2) and 328(4) of the Insolvency Act 1986 provide for the payment of interest on claims in windings up and bankruptcies, respectively).

So far as relevant, r. 2.88 of the 1986 Rules provided as follows:

> '(1) Where a debt proved in the administration bears interest, that interest is provable as part of the debt except in so far as it is payable in respect of any period after the company entered administration or, if the administration was immediately preceded by a winding up, any period after the date that the company went into liquidation.
>
> ...
>
> (6) The rate of interest to be claimed under paragraphs (3) and (4) is the rate specified in section 17 of the Judgments Act 1838 on the date when the company entered administration.
>
> (7) Any surplus remaining after payment of the debts proved shall, before being applied for any purpose, be applied in paying interest on those debts in respect of the periods during which they have been outstanding since the company entered administration.
>
> ...
>
> (9) The rate of interest payable under paragraph (7) is whichever is the greater of the rate specified under paragraph (6) or the rate applicable to the debt apart from the administration.'

The Appeal dealt with a number of issues relating to the interpretation of these sub-rules.

Bower v Maris

The first issue concerned the calculation of interest awarded under r. 2.88(7). In *Bower v Marris* (1841) Cr & Ph 351 the Court of Chancery had held that, in circumstances where there was a surplus in a bankrupt's estate, dividends on a claim in the bankruptcy were to be applied *first* to the statutory interest due and thereafter to the principal amount claimed.

The Court of Appeal were asked to decide whether this rule applied in the instant administration, or whether the dividends should be applied to the principal sums claimed first.

At first instance, David Richards J had held that the dividends were to be applied to the principal sums first, that is, not in accordance with the rule in *Bower v Marris*, on the bases that allocation first to interest was incompatible with the statutory scheme for proof of debts and payment of statutory interest and that allocation first to principal better reflected both the language of r. 2.88(7) in its context and the recommendations of the Cork Committee.

Two of the appellants challenged this finding on the following bases: allocation to interest first is normal commercial conduct, it has historically been the approach of the courts in administrations, the *Bower v Marris* approach was applied in bankruptcies at least until the Bankruptcy Act 1883, *Bower v Marris* had been followed in cases concerning corporate insolvencies until 1986, the approach had not been abolished, either in the 1986 Rules, or in the *travaux préparatoires* preceding the 1986 insolvency legislation, attribution of dividends first to outstanding interest better ensures that contributories do not receive that which, apart from the insolvency, would have been paid to creditors, than the application of dividends to principal, *Bower v Marris* has been widely applied in other common law jurisdictions, and the judgment of the Supreme Court in *Waterfall I* (2017] 2 WLR 1497) affirmed the vitality of judge-made rules within the insolvency code, where compatible with the statutory scheme and necessary to do justice.

The Court rejected all these arguments, finding that David Richards J had been correct in his construction of r. 2.88(7), and that this rule, being clear, left no rule for the development of judge-made law. The Court found that the words of r. 2.88(7), alongside the provisions at rr. 2.88(8) and (9), provide 'a complete and clear code for the award of statutory interest on provable debts.' (at [26]). Rule 2.88(7) takes as its starting point the assumption that principal debts will already have been paid off, since there could be no surplus until they had been paid: 'The requirement that there should be a surplus out of which statutory interest is paid means that the aggregate of principal and pre-administration interest will for each creditor be a specific, known figure, ascertained during the course of the administration, prior to the calculation and payment of any statutory interest.' (at [27]).

Re-opening the question of the order of payment of principal and interest could lead to a scenario in which interest having been paid, there was not enough left to cover all the principal due (at [28]). This approach would also be incompatible with the rules at rr. 2.88(1) to (6) (ibid). The rule in *Bower v Marris* was developed to fill a lacuna, at a time when there was no express statutory provision for interest on proved debts (at [32]). None of the authorities showing the application of the rule had any application to the instant circumstances, where there was a clear statutory answer to the question of the application of dividends (at [34]). Although it was correct that the *Bower v Marris* approach made distribution to contributories rather than creditors less likely, a similar argument had failed to persuade the Supreme Court in *Waterfall I* that creditors were entitled to claim the value lost by creditors due to currency fluctuations between the date of the entry into administration and the date at which the claims were due to be satisfied (currency conversion claims) (at [36]).

Compounding under rule 2.88(9)

The second issue related to the compounding of interest. Where the rate under r. 2.88(9) is a compounding rate, does accrued statutory interest continue to compound following the payment in full of the principal amount by way of dividends? David Richards J had answered this question in the negative at first instance, and the Court of Appeal upheld this finding. Again, the first instance judge had treated this as a question of construction: in his view r. 2.88(9) made clear that statutory interest was only payable where the principal amount remained outstanding.

The Court of Appeal agreed with David Richards J. It said that the essence of compounding is that interest in arrears at the end of a particular period is added to the amount upon which interest is then payable in the subsequent period. The concept of arrears of interest arising after the payment of dividends sits uneasily with the basis for the payment of statutory interest, as expressed in rr.2.88(1) to (6). There is no room for the concept of interest, let along compound interests, being payable in respect of any period, after the payment of the final dividend.

Compensation for late payment of statutory interest

This ground of appeal concerned whether a creditor should be compensated for receiving interest sometime after a surplus arose in the administration, and therefore sometime after interest became payable under r. 2.88. Clearly, there is no express provision for such compensation in the rule; the appellants relied on a common law entitlement to such interest. David Richards J had rejected the existence of such an entitlement, on the basis that there was no stipulation in r. 2.88 as to *when* interest should be paid, so that the question a of a delay in payment did not arise, and that the rule makes no provision for the payment of interest on statutory interest due. In the absence of such a provision, he said, there was no jurisdiction to order interest, or any other monetary compensation for delay in payment, to be paid, because it could not be said that a duty to make payment by a certain time had been breached.

The Court of Appeal upheld David Richards J's ruling on this issue as well, for the same reasons. It was rightly submitted by the appellants that there is a common law entitlement to interest on a late paid debt. However, in this matter, there was no suggestion that the Administrators had behaved improperly by not paying creditors their dividends earlier. The basis for paying interest was therefore absent.

Interest on contingent debts

Contingent claims are provable in an administration and dividends payable upon them, even if the contingency has not occurred at the date of proof or the date of the dividend. However, it was unclear if interest is payable under r. 2.88 in respect of a period during which the debt remained contingent.

At first instance, David Richards J found that interest was payable on contingent claims, because distribution in an administration is made pari passu on the basis of proved debts, not the underlying claims, and interest is awarded in respect of proved debts too; some parts of r. 2.88 used the word 'debt' to refer to the underlying claim but the reference in r. 2.88(7) is to proved debts; this is consistent with the treatment of statutory interest on future debts and with the pari passu principle itself, which is applied as far as possible from a single date (in this case, the date of entry into administration).

The Appellant contended that where a contingency occurred late, the judge's interpretaton meant that interest would be paid in respect of a period when the debt was not in any ordinary sense interest bearing, and that this violated the pari passu principle.

However, the Court of Appeal upheld David Richards J's conclusion on this issue as well, again for the reasons given by him. The Court also noted that period during which statutory interest is payable is the same for all debts, including future and contingent ones. Debts which are still contingent at the date of the dividend are discounted. Under the appellant's proposed interpretation of r. 2.88(7), such debts would be both discounted and deprived of interest. The Court also considered that the view of the majority of the Supreme Court in Waterfall I, that the statutory process of proof entirely replaces and discharges the previous contractual liability, supported this conclusion.

Foreign judgment rates of interest

David Richards J held that here a creditor obtained a foreign judgment before the onset of the administration any interest rate applicable to that foreign judgment would fall within the phrase 'the rate applicable to the debt apart from the administration' in rule 2.88(9).

Could the 'rate applicable to the debt apart from the administration' in rule 2.88(9) include: (a) a foreign judgment rate of interest applicable to a foreign judgment obtained after the date of administration, or (b) a foreign judgment rate of interest which would have become applicable to the debt if the creditor had obtained a foreign judgment, when it did not in fact do so?

David Richards J had found that neither the rate at (a) or (b) was capable of falling under the sub-rule. The rate at (b) was rejected because the rule contemplated actual rather than hypothetical interest rates. Again, the Court of Appeal 'found it difficult to improve upon the judge's analysis' here.

The judge rejected the rate at (a) because pari passu distribution requires a universal cut-off date for claims, which precluded in his view the possibility that rates applied by judgments obtained after the cut-off date could be applied by statute. The Court of Appeal also agreed with this conclusion.

Contractual interest rate due only after close-out

The question of whether a contractual rate of interest applicable only after a close-out triggered by a creditor after the date of the administration is to be taken into account under rule 2.88(9) was treated both by Hildyard J in Waterfall IIC, who found that such contractual interest did fall under the rule.

The Appellants on this issue pointed out that Hildyard J's conclusion appeared to be incompatible with David Richards J's reasoning on the question of interest under post-cut-off date foreign judgments. Why should contractual interest arising upon the occurrence of an event after the cut-off date fall under the rule, when interest under foreign judgments obtained after the cut-off date did not?

However, the Court of Appeal held there was no tension between the two rulings, particularly in light of David Richards J's supplemental ruling in *LBI HF v Karen Denise Millen* [2016] EWHC 2132 (Ch) in which he found that where under a pre-existing contract, no interest was due on the date of administration but a rate (higher than the Judgments Act rate) was provided for on a later date, or the period between the date of administration and the contractual start-date for the payment of interest, the alternative rate under rule 2.88(9) was nil. Upon the contractual start date, the contractual rate applied. Then the two rates had to be combined to produce an overall average, which would be the rate payable under 2.88(7), if it exceeded the Judgments Act rate.

Given this, the correct approach to r. 2.88(9) is to examine what rights to interest existed as at the administration date – including rights to interest upon the occurrence of a given contingency or otherwise in the future. It is then necessary to apply these rates to the periods to which they would have applied if the administration had not occurred, and work out whether on average, they produce a rate for the whole period which exceeds the Judgments Act rate, for the purposes of r. 2.88(9).

This also means that 'Rule 2.88(9) constitutes a clear but limited departure from the emerging principle (fortified by the majority of the Supreme Court in *Waterfall I* [2017] 2 WLR 1497) that the process of proof of debt and dividend in insolvency, including administration, replaces and extinguishes creditors' previous contractual rights.' [77]

Thus, on this issue too, the Court of Appeal upheld the finding of David Richards J in *Waterfall IIB* and also of Hildyard J in *Waterfall IIC*.

Lehman Brothers Australia Limited (in liquidation) v Anthony Victor Lomas, Steven Anthony Pearson, Russell Downs, Julian Guy Parr (The Joint Administrators of Lehman Brothers International (Europe) (in administration)) [2018] EWHC 2783 (Ch), 24 October 2018, Hildyard J

Lottie Pyper, Barrister, South Square, London, UK

Synopsis

In this case Hildyard J held that neither the rule in *Ex Parte James* (1873-74) LR 9 Ch App 609 nor paragraph 74 of Schedule B1 of the Insolvency Act 1986 justified the Court interfering in a contract which had been freely entered into by the parties. This was so even where both parties agreed that there had been a mistake in the calculation of the sum owed by the respondent, Lehman Brothers International (Europe), to the applicant, Lehman Brothers Australia. The jurisdiction conferred by the rule in *Ex Parte James* was limited to circumstances in which it would be unconscionable for officeholders to uphold their legal rights, and relief under paragraph 74 of Schedule B1 was restricted to situations in which officeholders proposed to act in a discriminatory manner between creditors. Since neither applied in the instant case, the application was dismissed.

Introduction

This application concerned the scope of the Court's discretion to direct its officeholders under the rule in *Ex Parte James* (1873-74) LR 9 Ch App 609 and/or paragraph 74 of Schedule B1 to the Insolvency Act 1986. The question was whether the administrators of Lehman Brothers International (Europe) ('LBIE') should be directed to admit a claim from Lehman Brothers Australia ('LBA') in an amount greater than the amount contractually agreed between the parties. The parties had entered into a contract which, on its face, finally determined certain claims between them. Over two years later, it emerged that the sum arrived at had been miscalculated due to an innocent mistake overlooked by both parties. LBIE submitted that the amount stated in the contract was conclusive as to the amount that it owed. LBA accepted that the contract was binding, but submitted that the Court should direct LBIE not to rely on its contractual rights therein. Hildyard J declined to make any direction under either *Ex Parte James* or paragraph 74, holding that, in the circumstances, neither enabled the Court to interfere in the contractually binding arrangements. He discussed the previous authorities for both rules in some detail, and, in doing so, sought to clarify the scope of each. In his view 'neither paragraph 74 nor the rule in Ex Parte James should be treated as a magic wand, and that outside the context of obviously unjust reliance on defects or gaps in the law and/or the abuse or perverse use of power both must be deployed with caution, insofar as available at all' ([81]).

Background

In order to assist with the efficient administration of LBIE's estate, its administrators entered into numerous bilateral contracts, which determined the size of the claim which that creditor was entitled to make against LBIE. These were called 'Claims Determination Deeds' and their purpose was to provide finality and certainty for LBIE and its creditors. Over 2,300 such contracts were agreed by the administrators.

The Claims Determination Deed between LBA and LBIE was dated 12 March 2014 and provided that, in respect of the claims covered by the agreement, LBA was entitled to claim £23,533,508 from LBIE's estate. This amount was paid in full on 30 April 2014. Several years later, following investigations by a prospective purchaser of LBIE's residual claims against LBA, it emerged that the Claims Determination Deed had contained a calculation error. The value of a bond owed to LBA by LBIE was erroneously recorded as being in Australian Dollars rather than in Euros. But for the error, LBA would have been entitled to claim £25,028,091. Both parties acknowledged that this was an innocent mistake.

The question in this application was whether the administrators of LBIE should be directed to admit a claim by LBA in the amount that it would have been entitled to if the mistake has not been made.

The rule in *Ex Parte James*

The rule in *Ex Parte James* enables the Court to direct an officer of the court not to rely on his strict legal rights in circumstances where doing so would be unequitable and cause the insolvent estate to be unjustly enriched. The central tension in the case law considered by Hildyard J was whether the touchstone for the Court's jurisdiction under *Ex Parte James* is unfairness to the creditor, or whether it is necessary that the officeholder's reliance on strict legal rights would be dishonourable. Adopting the same approach as in his recent judgment in *Heis v Financial Services Compensation Scheme Limited* [2018] EWHC 1372 (Ch),[1] Hildyard J held that the touchstone was dishonourable behaviour by the officeholder. In particular, he considered the Court of Appeal's decision in *Re Wigzell* [1921] 2 K.B. 835 to be binding, and therefore held that (at [61]):

> 'the discretionary jurisdiction which the rule expresses to prevent the enforcement of legal right when it would be contrary to 'natural justice' was not to be used (in the words of Salter J in *Re Wigzell*) "unless the result of enforcing the law is such that, in the opinion of the Court, it would be pronounced to be obviously unjust by all right-minded men."
>
> In other words, in the context the phrase 'contrary to natural justice' connotes more than subjective unfairness: it connotes that what is proposed would be such that undoubtedly a "high-minded" and "honourable" man (per Lord Sterndale MR and Scrutton LJ in *Re Wigzell* at pages 851 and 862 respectively) would not do it because it would be "dishonourable and not high-minded" (ibid.)'

In rejecting the unfairness test, Hildyard J departed from the view expressed by David Richards J in *Re LBIE (Waterfall IIB)* [2015] BPIR 1162. Although, as a result of his other findings, reliance on *Ex Parte James* was not necessary in that case, David Richards J discussed the scope of the rule *obiter dicta.* He relied particularly on *Re Clark* [1975] 1 WLR 559, where Walton J described the rule as operating where it would be 'unfair for a trustee to take full advantage of his legal rights' (p563). Commenting on *Re Clark,* David Richards J said (at [180]):

> 'It might be said that Walton J used the word "unfair" as synonymous with dishonourable or even dishonest, but I very much doubt it. Walton J was not a judge known for a lack of precision in his use of language and his repeated use of the word unfair in his judgment demonstrates in my view the concept which he had in mind.'

As a result, David Richards J concluded that if it had been necessary to rely on the rule in *Ex Parte James,* he would have directed the officeholders not to enforce certain contracts on the basis that the alternative would have been unfair to the relevant creditors.

Hildyard J had no hesitation departing from David Richard J's comments in Waterfall IIB, firstly because he considered them to be in the nature of *obiter dicta* and therefore not binding, and secondly because he considered that both Walton J in *Re Clark* and David Richards J had failed to follow the binding judgement of the Court of Appeal's in *Re Wigzell.* Rather than enabling the Court to interfere in consensual arrangements that could be subsequently characterised as unfair to one party, Hildyard J emphasised that the jurisdiction of the Court under the rule in *Ex Parte James* turned on the behaviour of officeholders. In other words, the rule should operate so as to enable the Court to prevent the officeholder from being forced to choose between enforcing his legal rights and thereby securing an unfair advantage to the estate, and acting honourably with respect to one creditor, but arguably falling short of his duty to the rest ([58]).

Hildyard J concluded that in the present case he did not have jurisdiction under the rule in *Ex Parte James.* Whilst enforcing the contractual arrangement might be subjectively regarded as unfair, it did not constitute dishonourable behaviour by the officeholder. Hildyard J went on to hold that, even if he had found jurisdiction under the rule, he would have declined to exercise it on the basis that the agreement between LBA and LBIE was binding and enforceable, and its terms were designed to provide finality between the parties.

Paragraph 74 of Schedule B1

Paragraph 74 of Schedule B1 enables the Court to grant relief where:

> '(a) the administrator is acting or has acted so as unfairly to harm the interests of the applicant (whether alone or in common with some or all other members or creditors), or
>
> (b) the administrator proposes to act in a way which would unfairly harm the interests of the applicant (whether alone or in common with some or all other members or creditors).'

In this case, LBA relied on subparagraph (b), claiming that it would be unfair for LBIE to enforce the terms of

Notes

1 Although Hildyard J's conclusions on construction in that judgment were overturned by the Court of Appeal ([2018] B.P.I.R. 1142) his conclusions on *Ex Parte James* and paragraph 74 of Schedule B1 were not challenged.

the Claims Determination Deed given that the mistake had emerged.

As with the rule in *Ex Parte James,* paragraph 74 is 'capable of subjecting the exercise of legal right to an ultimately subjective standard' (*Heis* at [143], cited at [58]). However, whereas *Ex Parte James* operates to prevent an officeholder from being bound to act dishonourably in promulgating the unjust enrichment of the insolvent estate, paragraph 74 enables a creditor to seek protection from discriminatory behaviour of the officeholder.

In considering the meaning of 'unfair harm', Hildyard J cited *Re Lehman Brothers International (Europe) (in administration, Four Private Investment Funds v Lomas)* [2009] BCC 632. He emphasised that in this context, 'unfair harm' meant an exercise of powers by the officeholder which '(a) causes or would cause disadvantage to that creditor; (b) cannot be justified by reference to the interests of the creditors as a whole or to achieving the objective of the relevant insolvency process; and/or which (c) is discriminatory in such effect' ([78]). In the instant case, there was no unfair harm caused to LBA: the contract was part of a number of contracts designed to give finality to creditors, it had been freely entered into between the parties, and the mistake was an innocent one. It was not 'discriminatory' for the administrators of LBIE to enforce their rights under the agreement, and LBA would not, therefore, suffer any unfair harm.

Conclusion

In general terms, Hildyard J's judgment seeks to confine the rule in *Ex Parte James* and paragraph 74 to circumstances where the behaviour of the officeholder is or is threatened to be dishonourable and discriminatory respectively.

More particularly, it is clear that Hildyard J did not feel it would be appropriate for the Court to direct its officeholders not to enforce contractual arrangements in circumstances where, absent an insolvency process, there would have been no remedy for LBA. In this context, it was relevant that LBA had not sought to argue that the contract should be rectified on the ground of common mistake, and indeed appeared to concede that that remedy was not available to them. In Hildyard J's view there is a bright line between the Court exercising its direction to control the behaviour of an officeholder in his capacity as such, and interfering in consensual contractual arrangements reached between the company and an individual creditor.

In both this judgment and his previous decision in *Heis,* Hildyard J sought to discourage reliance *Ex Parte James* and paragraph 74 in circumstances one party is, with hindsight, dissatisfied with an agreement reached. Whilst this is a sensible limitation, it is possible that parties may continue to test the scope of both rules, at least until the matter falls for consideration by the Court of Appeal.

Wiemer & Trachte GmbH v Tadzher [2018] EUECJ C-296/17 (14 November 2018)

Rose Lagram-Taylor, Barrister, South Square, London, UK

Synopsis

The Court of Justice of the EU ruled that Article 3(1) of the Insolvency Regulation should be interpreted as providing exclusive jurisdiction to the Member State in which insolvency proceedings are opened in relation to actions to set aside the disposals of assets from the insolvent estate.

Introduction

On 14 November 2018, the Court of Justice of the EU issued a preliminary ruling principally concerning the interpretation of Article 3 of Council Regulation No 1346/2000 of 29 May 2000 on Insolvency Proceedings (the 'Insolvency Regulation'). The request for the ruling had been made by the Supreme Court of Cessation of Bulgaria under Article 267 of the Treaty on the Functioning of the European Union. It was made within the context of proceedings between Wiemer & Trachte GmbH ('Wiemer'), a company in liquidation, and Mr Zhan Oved Tadzher ('Tadzher') concerning the repayment of a sum of money which had been transferred from Wiemer to Tadzher without the consent of Wiemer's provisional liquidator.

Background

The underlying dispute involved Wiemer, a limited liability company registered in Dortmund, Germany. By a decision of 10 May 2004 the Sofia City Court of Bulgaria ordered that a branch of Wiemer be entered into the Bulgarian Commercial Register. By an order of 3 April 2007, the local court in Dortmund, in the context of opening insolvency proceedings, designated a provisional liquidator over Wiemer, and ruled that no disposals of assets by Wiemer could take effect without the consent of that liquidator. The order was entered in the German Commercial Register. A further order made on 21 May 2007 and also entered into the Register placed a general prohibition on Wiemer disposing of its assets. A third and final order was made on 1 June 2007 which made Wiemer's assets the subject of insolvency proceedings. This was registered on 5 June 2007.

Following the making and registering of the Dortmund court orders, certain sums of money were transferred from Weimer's Bulgarian account by the managing director of Wiemer's Bulgarian branch to Tadzher. The purpose of these sums were said to be (i) a declaration of travel expenses, and (ii) an advance on business expenses. Upon learning of the transfer, an action was brought by Wiemer against Tadzher for the repayment of those sums plus interest before the Sofia City Court of Bulgaria. It was claimed that the transfers to Tadzher were invalid because they had taken place after the insolvency proceedings were opened. However, Tadzher contended that the Sofia City Court lacked jurisdiction to hear the case in the main proceedings, and in any event the sum of money representing an advance had not been used and had already been repaid to Wiemer.

The lack of jurisdiction argument was rejected by both the Sofia City Court, and the Bulgarian Court of Appeal. Further the Supreme Court of Bulgaria considered that the appeal brought before it on a point of law was inadmissible and that the Court of Appeal's order recognising the jurisdiction of the Sofia City Court to decide the case on the merits had acquired the force of *res judicata*. Accordingly, upon returning to the Sofia City Court the action was upheld on the merits. Tadzher once again appealed, and the Court of Appeal set aside the judgment of the lower court, dismissing the request for the repayment of the sums paid to Tadzher as unfounded and unsubstantiated. This led to Wiemer appealing on a point of law to the Supreme Court, claiming that Article 24 of Regulation No 1346/2000 was not applicable to the dispute in the main proceedings, such that Tadzher could claim to have been unaware of the opening of the insolvency proceedings. Upon this, the Supreme Court decided to stay the proceedings and refer certain questions to the Court of Justice for a preliminary ruling.

Issues

The primary question with which the Court of Justice had to grapple was:

> 'Is Article 3(1) of the Insolvency Regulation to be interpreted as meaning that the jurisdiction of the courts of the Member State within the territory of which insolvency proceedings have been opened to hear and determine an action to set a transaction aside by virtue of the debtor's insolvency which has been brought against a defendant whose registered office or habitual residence is in another Member State is exclusive, or in the case of Article 18(2) of the Insolvency Regulation is the liquidator empowered to bring an action to set aside before a court in the Member State within the territory of which the defendant has his registered office or habitual residence, where the action to set aside brought by the liquidator is based on a disposal of moveable assets carried out in the other Member State?'

Relevantly, Article 3(1) provides:

> 'The courts of the Member State within the territory of which the centre of a debtor's main interest is situated shall have jurisdiction to open insolvency proceedings. In the case of a company or legal person, the place of the registered office shall be presumed to be the centre of its main interests in the absence of proof to the contrary.'

Article 3(2) goes on to state:

> 'Where the centre of a debtor's main interests is situated within the territory of a Member State, the courts of another Member State shall have jurisdiction to open insolvency proceedings against that debtor only if he possesses an establishment within the territory of that other Member State. The effects of those proceedings shall be restricted to the assets of the debtor situated in the territory of the latter Member State'

As to Article 18:

> '(1) The liquidator appointed by a court which has jurisdiction pursuant to Article 3(1) may exercise all the powers conferred on him by the law of the State of the opening of proceedings in another Member State, as long as no other insolvency proceedings have been opened there nor any preservation measure to the contrary has been taken there further to a request for the opening of insolvency proceedings in that State. He may in particular remove the debtor's assets from the territory of the Member State in which they are situated, subject to Articles 5 and 7.
>
> (2) The liquidator appointed by a court which has jurisdiction pursuant to Article 3(2) may in any other Member State claim through the courts or out of court that moveable property was removed from the territory of the State of the opening of proceedings to the territory of that other Member State after the opening of the insolvency proceedings. He may also bring any action to set aside which is in the interests of the creditors.'

Decision

As set out in the decision of the Court of Justice, the Bulgarian Supreme Court were essentially asking whether Article 3(1) of the Insolvency Regulation should be interpreted as (i) meaning the jurisdiction of the courts of the Member State in which insolvency proceedings had been opened to hear and determine an action to set a transaction aside by virtue of the debtor's insolvency which had been brought against a defendant whose registered office of habitual residence was in another Member State is exclusive, or (ii) meaning that the liquidator may also bring such an application to set aside before a court of the Member State in which the defendant had his registered office or habitual residence.

In reaching an answer to this question, the Court of Justice determined that it was necessary to also consider Recital 6 of the Insolvency Regulation. This states:

> 'In accordance with the principle of proportionality this Regulation should be confined to provisions governing jurisdiction for opening insolvency proceedings and judgments which are delivered directly on the basis of the insolvency proceedings and are closely connected with such proceedings. In addition, this Regulation should contain provisions regarding the recognition of those judgments and the applicable law which also satisfy that principle.'

On the basis of this Recital, the Court concluded that the objective of the legislature must therefore be interpreted as meaning that Article 3(1) also confers on the courts of the Member State which have jurisdiction to open insolvency proceedings, international jurisdiction to hear and determine actions which derive directly from those proceedings, and those which are closely connected with them.

As to whether actions to set a transaction aside could be assumed to derive directly from insolvency proceedings or be closely connected with those proceedings, it was accepted that the Court had previously held that such actions did fall within the scope of Article 3(1), as the aim of setting aside the transaction was to add to the assets of that transaction to the insolent estate (see *Seagon v Deko Marty Belgium NV*, C-339/07, EU: C:2009:83).

With regard to whether the jurisdiction conferred on the courts of the Member State where the insolvency proceedings were opened was exclusive, or whether the liquidator had the option to pursue a defendant in another Member State where the defendant had its registered office or was habitually resident, the court held there was no such option. This was in line with the objective of improving the effectiveness and efficiency of insolvency proceedings which have cross-border effects, alongside avoiding the promotion of forum shopping, whereby a party may otherwise look to transfer assets or judicial proceedings from one Member State to another in order to obtain a more favourable legal position (again see *Seagon v Deko Marty Belgium NV*). It was held that allowing more than one court to exercise jurisdiction as regards actions to set a transaction aside by virtue of insolvency brought in various Member States would undermine the pursuit of this objective.

The Court of Justice also concluded that Article 18(2) of the Insolvency Regulation could not call into question the exclusive nature of the international jurisdiction of the courts referred to in Article 3(2). Although Article 18(2) did envisage that actions for the benefit of the insolvent estate could be brought in other member states in the case of secondary proceedings, the same considerations did not apply to main proceedings. This is because secondary proceedings are inherently limited to assets within the jurisdiction where the secondary proceedings are opened meaning external reach such as an action to set aside in another Member State was appropriate. However main proceedings were not limited in this way.

Accordingly, the answer to the principle question posed by the Bulgarian Supreme Court was that Article 3(1) of the Insolvency Regulation must be interpreted as meaning that the jurisdiction of the courts of the Member State within the territory of which insolvency proceedings have been opened to hear and determine an action to set aside a transaction aside by virtue of the debtor's insolvency which has been brought against a defendant whose registered office or habitual residence is in another Member State is exclusive.

Comment

It is noteworthy that whilst the Court of Justice gave some consideration of Article 18(2) of the Insolvency Regulation, little was given to Article 18(1) and it is difficult to see why Article 18(1) could not be relied on to allow the bringing of proceedings for an action to set aside in a different Member State to that where insolvency proceedings were opened. This is because the wording of Article 18(1) specifically enables a liquidator to exercise the powers conferred by the law of the Member State where proceedings were opened, in another Member State.

Whilst this judgment may create certain difficulties, its impact is likely to be limited given the introduction of Regulation 2015/848 of the European Parliament and of the Council of 20 May 2015 on insolvency proceedings (the 'Recast Insolvency Regulation'), which applies to all insolvencies commencing after 26 June 2017. Unlike the Insolvency Regulation, the Recast Insolvency Regulation acknowledges by Article 6 that it may be appropriate to allow other actions deriving directly from insolvency proceedings and that are closely linked to them to be brought in the Member State where the defendant is domiciled.

Bresco Electrical Services Ltd (in liquidation) v Michael J Lonsdale (Electrical) Ltd; Cannon Corporate Limited v Primus Build Limited [2019] EWCA Civ 27

Lottie Pyper, Barrister, South Square, London, UK

Synopsis

These joined appeals considered the relationship between the construction adjudication process and the insolvency regime. It was held that a contractual right to refer a claim to adjudication is not altered by the entry of one of the parties into insolvency proceedings. However, if the decision of the adjudicator is unlikely to be enforced as a result of the insolvency proceedings, the court may, in its discretion, prevent the adjudication from continuing. Whether or not an adjudication is likely to be enforced will depend on the facts: whereas a claim is likely to be futile if one of the parties is in insolvent liquidation, the position may be different if the insolvency proceedings designed to restore the company to financial health, such as a CVA. More generally, any objection to the jurisdiction of an adjudicator needs to be made promptly and clearly, otherwise the party will be taken to have waived the right to object.

Introduction

The tension in these conjoined appeals was between contractual rights and the insolvency regime. In both cases, the parties had the right to refer any dispute to adjudication. This right arose both out of the bilateral contracts themselves, and from section 108 of the Housing Grants, Construction and Regeneration Act 1996 ('the 1996 Act'), which provides that 'a party to a construction contract has the right to refer a dispute arising out of the contract for adjudication.'

The question in *Bresco Electrical Services Ltd (in liquidation) v Michael J Lonsdale (Electrical) Ltd* was whether an adjudicator had jurisdiction to hear a claim brought by a company in insolvent liquidation, and even if they did, whether there was any practical utility in allowing the adjudication to continue. In *Cannon Corporate Limited v Primus Build Limited*, the facts were slightly different, as Primus Build Limited ('Primus') had already obtained summary judgment against Cannon Corporate Limited ('Cannon') in respect of certain adjudications. It was not in insolvent liquidation, but had entered into a CVA with its creditors. In order to resolve the tension, the Court adopted a pragmatic approach, holding that although any contractual rights were not extinguished be the entry of either party into an insolvency process, there may be circumstances in which the Court can, and should, prohibit the adjudication from continuing on grounds of utility. Accordingly, parties should be mindful not just of their theoretical contractual rights, but also of the practical implications of bringing or continuing the adjudication in the circumstances.

In respect of *Cannon v Primus*, the Court undertook a detailed consideration of the circumstances in which a party may be said to have waived any objection to the jurisdiction of an adjudicator. In summary, unless a reservation of rights is clearly made, the party will be taken to have waived the right to object.

Bresco Electrical Services Ltd (in liquidation) v Michael J Lonsdale (Electrical) Ltd

This case required the Court to consider whether or not an adjudication process started by a company in insolvent liquidation could or should be permitted to continue. Bresco Electrical Services Ltd ('Bresco') sought to commence an adjudication process in relation to a dispute with Michael J Lonsdale (Electrical) Ltd ('Lonsdale') arising out of a building contract. Bresco sought to commence the adjudication in June 2018, over three years after it entered insolvent liquidation in March 2015. At first instance, the court granted Lonsdale an injunction against the continuation of the adjudication, on the ground that the adjudicator had no jurisdiction to hear the claim. The Court of Appeal upheld the injunction, but for different reasons.

In particular, the Court considered other dispute resolution procedures that would have been open to Bresco, including Court proceedings and arbitration. The fundamental difference between those procedures and adjudication is that they would result in a final determination of the issues, whereas any decision arising from an adjudication would only be temporarily binding. On this basis, it was difficult to see how the particular characteristics of adjudication as a process could operate to deprive the adjudicator of jurisdiction to hear the claim.

However, given that Bresco was in insolvent liquidation, any temporary decision made by the adjudicator was unlikely to be enforceable, as it would contravene the pari passu principle. Accordingly, although the right to refer disputes to adjudication remained extant, that right was in fact devoid of any practical utility. In these circumstances, and mindful that it is undesirable to spend time and money on a process that will inevitably be futile, the Court of Appeal upheld the injunction granted by the lower court.

Cannon Corporate Limited v Primus Build Limited

In July 2017, Primus entered into a CVA, which anticipated that all of its creditors would ultimately be paid 100p in the £. The basis for this analysis was that Primus anticipated making significant recoveries against various counterparties. One of those counterparties was Cannon. There were a number of adjudication procedures to determine disputes between Canon and Primus, which culminated in Primus obtaining summary judgment in respect of the adjudication decisions against Canon in the sum of £2.1 million, and Canon failing to obtain a stay of execution. After the hearing, but prior to judgment being handed down by the Court of Appeal, the parties in fact reached a settlement, which resulted in Canon paying that sum to Primus. The Court of Appeal decided to hand down its judgment in any event.

Mirroring the submissions made in *Bresco v Lonsdale*, on appeal Canon sought to argue that the adjudicator did not have jurisdiction to hear the claim. This argument was rejected in any event, but the court also spent some time considering whether or not Canon had already waived any right to object on the grounds of jurisdiction.

The principles regarding waiver were helpfully set out by Lord Justice Coulson at [91] and [92], as follows:

> 'In my view, the purpose of the 1996 Act would be substantially defeated if a responding party could, as a matter of course, reserve its position on jurisdiction in general terms at the start of an adjudication, thereby avoiding any ruling by the adjudicator or the taking of any remedial steps by the referring party; participate fully in the nuts and bolts of the adjudication, either without raising any detailed jurisdiction points, or raising only specific points which were subsequently rejected by the adjudicator (and the court); and then, having lost the adjudication, was allowed to comb through the documents in the hope that a new jurisdiction point might turn up at the summary judgment stage, in order to defeat the enforcement of the adjudicator's decision at the eleventh hour. To that extent, therefore, I consider that the position in adjudication is rather different to that in arbitration…
>
> In my view, informed by that starting-point, the applicable principles on waiver and general reservations in the adjudication context are as follows:
>
> i) If the responding party wishes to challenge the jurisdiction of the adjudicator then it must do so 'appropriately and clearly'. If it does not reserve its position effectively and participates in the adjudication, it will be taken to have waived any jurisdictional objection and will be unable to avoid enforcement on jurisdictional grounds …
>
> ii) It will always be better for a party to reserve its position based on a specific objection or objections: otherwise the adjudicator cannot investigate the point and, if appropriate, decide not to proceed, and the referring party cannot decide for itself whether the objection has merit …
>
> iii) If the specific jurisdictional objections are rejected by the adjudicator (and the court, if the objections are renewed on enforcement), then the objector will be subsequently precluded from raising other jurisdictional grounds which might otherwise have been available to it …
>
> iv) A general reservation of position on jurisdiction is undesirable but may be effective …
>
> Much will turn on the wording of the reservation in each case. However, a general reservation may not be effective if:
>
> i) At the time it was provided, the objector knew or should have known of specific grounds for a jurisdictional objection but failed to articulate them …;
>
> ii) The court concludes that the general reservation was worded in that way simply to try and ensure that all options (including ones not yet even thought of) could be kept open …'

As Canon had not effectively reserved its position, it would not have been able to object on jurisdictional grounds in any event. In any case, the analysis regarding Bresco was equally applicable here, and as such the adjudicator did have jurisdiction to hear the claim.

Ultimately, the key difference between this *Canon v Primus* and *Bresco v Lonsdale* was the insolvency process in question. In *Canon v Primus* the purpose of the CVA was to restore Primus to financial health. Unlike in an insolvent liquidation, the quick resolution offered by adjudication was ideal for this situation, and any award made would not be futile. In this case, therefore, it was appropriate that summary judgment had been granted, and that the stay of execution had been refused.

Conclusion

The practical takeaways from these cases are as follows.

Firstly, it is unwise for a company in any insolvency proceeding that is designed to facilitate the distribution of its assets to commence an adjudication, since the court is likely to prohibit it from continuing. On the other hand, if the insolvency proceedings are designed to restore the company's financial health, it may be both pragmatic and desirable to commence adjudication.

Secondly, parties wishing to object to an adjudication on jurisdictional grounds should do so clearly and specifically, otherwise they will be taken to have waived any objection by participating in the process. At the time of writing, this part of the decision has been relied on in two subsequent High Court decisions, *Donald Install Associates Limited v Kew Holdings Limited* [2019] EWHC 384 (TCC) at [39], and *Ove Arup & Partners International Limited v Coleman Bennett International Consultancy Plc* [2019] EWHC 413 (TCC) at [18].

Re Carluccio's Ltd (in administration) [2020] EWHC 886 (Ch)

Daniel Judd, Barrister, South Square, London, UK

Synopsis

In response to the coronavirus pandemic, the government announced a measure of particular significance for companies in administration. This was the Coronavirus Job Retention Scheme ('the Scheme'), by which the government undertook to underwrite, in large part, the payment by private companies of employee wages, in an effort to reduce the scale of any redundancies resulting from the crisis.

The decision of Snowden J in *Re Carluccio's (in administration)* [2020] EWHC 886 (Ch) ('*Re Carluccio's*'), heard from 6 to 9 April 2020, was the first decision to consider how the use by companies in administration of the Scheme might be reconciled with the statutory regime set out in Schedule B1 to the Insolvency Act 1986 ('Schedule B1'). In *Re Carluccio's*, Snowden J carefully considered the circumstances in which administrators would be treated as 'adopting' employment contracts of the workforce. The judgment provides the clarification that an administrator's act of applying to the Scheme in respect of certain employees, or of paying the wages of certain employees to be furloughed under the Scheme, would cause those employment contracts to be 'adopted' under paragraph 99 of Schedule B1. That, in turn, would provide a proper basis for paying employee salaries out of the company's estate in priority to other creditors, consistently with the requirements of the Insolvency Act 1986, as and when the Scheme funds were paid to the company.

Snowden J's analysis provided the foundation for the further consideration of these issues in *Re Debenhams Retail Limited (in administration)* [2020] EWHC 921 (Ch), heard before Trower J on 15 April 2020, and heard on appeal ([2020] EWCA Civ 600) on 22 April 2020 ('*Re Debenhams*').

Background

The application was brought by the administrators as a matter of some urgency. The availability of the Scheme to the company was a critical consideration. The evidence was that the company had no money with which to pay the existing wages of its employees, and so if the Scheme were not open to the company, the workforce would be made redundant (at [3]). This concerned the administrators because in order to 'mothball' the business, with a view to a prospective sale in order to achieve a better result for creditors than would result from an immediate winding up, the company would need to retain its workforce.

The company could, however, afford to pay employee wages, and retain the workforce, to the extent of the financial assistance provided by the Scheme, where the employees' employment contracts were varied to that end. Otherwise, the administrators would, economically, have had no option but to terminate the employment of the workforce (at [13]).

The administrators were conscious of the 14-day 'safe period', during which the administrators' actions would not be treated as contributing to the adoption of employment contracts. The adoption of those contracts would mean that they qualified for payment as expenses, having 'super-priority', before even the administrators' own remuneration. The administrators' assessment was that the adoption of the original (unvaried) employment contracts would be economically unsustainable for the company, and in this scenario the administrators were concerned about becoming personally liable in respect of the original employment contracts. To avoid this risk, the administrators would be forced to make the workforce redundant.

With this in mind, the administrators had invited employees by letter to consent to the variation of their employment contracts on terms that dovetailed with the available funding provided under the Scheme. The company would only be able to pay employees as and when it received funds from the government under the Scheme. Almost all employees agreed to this variation. A small number of employees either refused to consent to the variation, accepting that they would be made redundant, or failed to respond to the letter.

As a preliminary matter, Snowden J considered that those contracts were validly varied where the employees expressly agreed to the variation (at [45]). It could not be inferred from a failure to respond that the employees concerned had consented to the variation, however Snowden J limited his conclusion on this point to the particular circumstances of the case before him (at [54]).

Snowden J explained that the Scheme did not change the applicable law, and based on the available guidance published online concerning the Scheme (the

'Scheme Guidance'), its structure had not been publicly explained in any great detail (at [15]). The central question became how, if at all, applicable insolvency legislation could accommodate payments under the new Scheme as it had been proposed.

The urgency with which the application had been brought, and the absence of any joined representative employees, or representatives of the government, led Snowden J to question whether it was appropriate to give directions at all (at [7]). However, the administrators did not have the luxury of time, and in the extraordinary circumstances, Snowden J considered that the courts should work constructively and innovatively to respond to the crisis, wherever possible (at [8]-[9]).

Structure and scope of the Scheme

A first question concerned the scope of application of the Scheme as announced by the Chancellor of the Exchequer on 20 March 2020. While the Scheme was principally directed at companies which were not in an insolvency process, the Scheme Guidance referred to the possibility of the Scheme being open to an administration where, for instance, there was a 'reasonable likelihood of rehiring the workers'. That phrase was apt to include, Snowden J considered, a sale of the business and assets of the business. The court therefore accepted that the Scheme was available to the company (at [23]).

This then gave rise to a problem. How could the Scheme operate in the course of an insolvency process? There were techniques open to the government to ensure that money lent or provided to the company would never form part of its estate. The judge noted that the funds could be held on trust as earmarked for particular purposes, referring to *Barclays Bank v Quistclose Investments Limited* [1970] AC 567. But the Scheme as announced contemplated that funds would be paid to the company as income. Those monies would therefore constitute assets of the company in administration, and the applicable provisions, including Schedule B1, would therefore be engaged (at [33]). The consequence was that the administrators would have to justify the payment of employee wages, in priority to other claims against the company, by reference to relevant provisions of insolvency legislation (at [36]).

The basis in insolvency legislation for the priority payment of wages

The two candidate provisions for enabling payments to employees in these circumstances, in priority to the payment of the company's unsecured creditors, were paragraphs 66 and 99 of Schedule B1.

The first was paragraph 66 of Schedule B1, which sets out a general basis for allowing payments outside the normal order of priorities where an administrator 'thinks it likely to assist achievement of the purpose of administration'.

The other candidate was paragraph 99, which dealt with charges and liabilities upon an administrator's vacation of office. Snowden J identified that the adoption of a contract of employment under paragraph 99(5) would mean that any salary due would be payable out of the assets held by the administrators, even in priority to the administrators' own remuneration, which already has priority over the claims of other creditors (at [39]).

Which provision should apply? Paragraph 66, Snowden J observed, was drafted in wide terms, and used for payments other than in accordance with the normal order of priorities. Nevertheless, the judge considered that paragraph 99 was the more apt provision here, being specifically designed to deal with the obligations of administrators to pay wages and salary in an administration. The general provision had to give way to the specific provision (at [56]).

The above analysis would be revisited in the High Court and the Court of Appeal in *Re Debenhams*. In the Court of Appeal, David Richards LJ opined that paragraph 66 of Schedule B1 was the more obvious source of authority, given that paragraph 99 is stated to operate only where a person ceases to be an administrator (at [67]). This was not an essential part of Snowden J's decision in *Re Carluccio's*. But as Trower J had noted at first instance in *Re Debenhams*, it was possible to view paragraph 99 not only as the source of the obligation to pay employee wages as a super-priority expense, but, by extension, as authority for an administrator's ability to do so before leaving office (at [39]-[41]).

Paramount and the 'adoption' of employment contracts

Snowden J then turned to the leading authority on the 'adoption' of employment contracts in the context of paragraph 99(5), which was the decision of the House of Lords in *Powdrill v Watson & Anor (Paramount Airways Ltd)* [1995] 2 AC 394 ('*Paramount*') (at [57]-[68]). In that case, the administrators had continued to pay the wages of pilots while they continued to seek a buyer over the course of four months. The administrators asserted, however, that the contracts of employment of the pilots would not be adopted. The efforts to find a buyer ultimately failed, the pilots' employment was terminated, and the pilots claimed that their employment contracts had been adopted, entitling them to the super-priority payment of their contractual salary and other employment-related benefits.

Lord Browne-Wilkinson had explained (at 440-441) that new provisions had been introduced into the Insolvency Act 1986 to correct the mischief revealed by *Nicoll v Cutts* [1985] BCLC 322, the effect of which was that an employee who had rendered services during a receivership or administration was unable to recover any payment for their work where the employment contract was not adopted. Parliament's response, however, had the practical consequence that office-holders had only a short window within which to decide whether to adopt contracts of employment (which risked exposing the administrators to large personal liabilities) or avoiding the risk altogether by making employees redundant.

Snowden J then recorded Lord Browne-Wilkinson's comments that the mere continuation of employment did not inexorably lead to the conclusion that the contract of employment had been adopted. Rather, 'adoption' connoted some conduct by the administrator or receiver which amounted to an election to treat the continued contract of employment as giving rise to a separate liability in the administration or receivership (*Paramount*, at 448-449). A second element of Lord Browne-Wilkinson's speech was his conclusion that, as Snowden J put it: '*adoption was an all-or-nothing concept*' (at [67]). Either the whole employment contract was adopted, or there was no adoption at all.

The question then turned to how those dicta applied to the furlough arrangements under the Scheme.

Rejection of the 'no services' argument

The Scheme did not contemplate that employees would provide services to the insolvent company. In fact, on the contrary, the terms of the furlough prevented employees from rendering services to their employer. Since the purpose of paragraph 99(5) of Schedule B1 was to address the mischief identified in *Nicoll v Cutts*, where services rendered went unremunerated, and given that the furlough arrangements did not give rise to that mischief, it was argued that, therefore, the paragraph had no application. The employees' contracts could not be 'adopted' where no services were to be provided by them.

Snowden J rejected this argument. Parliament deployed the concept of 'adoption' for remedying the mischief of *Nicoll v Cutts*, and did not limit super-priority to cases in which services had actually been rendered (at [71]).

There were, in addition, other reasons why the 'no-services' argument should fail. Even in normal circumstances, Snowden J continued, there were other situations in which it would be appropriate, and commercially important, for an administrator to continue to pay an employee's wages, despite the employee not providing any services. This could be the case where retention of an employee's status as such was valuable, whether in keeping them from a competitor, or retaining the value of a business in advance of a prospective sale. It would be wrong in those circumstances to hold that an employee was not entitled to wages or salary (at [72]).

When would contracts of employment be adopted under the Scheme?

In the circumstances of the coronavirus pandemic, Snowden J emphasised that paragraph 99(5) of Schedule B1 should, if possible, be interpreted to allow the Scheme to take effect, and support both the rescue culture and efforts to address the crisis.

In this respect, Snowden J considered further Lord Browne-Wilkinson's statement in *Paramount* that the mere continuation of a contract did not necessarily lead to its adoption. Some positive conduct was required by the administrator in order to treat salaries as ranking as separate liabilities in the administration. In the light of those comments, 'continuing' the employment contracts after the expiry of the 14-day grace period in paragraph 99(5), by failing to terminate them, did not mean that those contracts had been adopted automatically (at [84]). Snowden J approved the later decision of Laddie J in *Re Antal International Ltd* [2003] 2 BCLC 406, where the employment contracts in question were only discovered by the administrators once the 14-day grace period had expired, and on learning of their existence, the employment contracts were terminated. Those contracts had simply been 'continued' in the meantime, and were not automatically adopted by virtue of the failure to terminate. Snowden J endorsed that conclusion (at [88]).

For an 'adoption' to take place, Snowden J held that the administrators would need to carry out an act that was only explicable on the basis that they were electing to treat the varied contract as giving rise to liabilities which would qualify for super-priority.

In the context of the Scheme, it was sufficient to make an application under the Scheme in respect of any employees to be retained. A payment of the employees' wages under their varied contracts of employment would also qualify. Snowden J added that where any monies that became unexpectedly available to the company were applied to the payment of the wages of furloughed employees, prior to the receipt of funds from the Scheme, this would amount to an adoption of the varied contract. These were actions that were only explicable on the basis that the administrators were electing to treat the varied employment contract as giving rise to liabilities which qualified for super-priority (at [91]).

Snowden J therefore considered that the employment contracts, as varied in order to dovetail with the receipt of funds under the Scheme, could be adopted so as to permit super-priority payments in respect of wages. This meant that payments could properly be made to employees from the company's estate, consistently with insolvency legislation, as and when the funds were received under the Scheme.

The judge's conclusion also meant that the administrators did not have to take the precaution of dismissing employees who did not respond to the invitation to vary their terms of employment. After the expiry of the 14-day grace period, those employment contracts would not be automatically adopted, but would simply 'continue' instead.

ORDER FORM – Please complete

I wish to subscribe to *International Corporate Rescue* from 1 January 2021 – 31 December 2021.

Hardcopy ☐ Online ☐ Hardcopy + Online ☐ (please tick)

I wish to have online access to all Special Issues ☐

I wish to have online access to back catalogue (Volumes 1–17) ☐

My preferred method of payment is:

Cheque ☐ Credit Card ☐ Bank Transfer ☐ Please invoice me ☐ (please tick)

Name . . . .

Address . . . .

. . . .

Postcode / Zip . . . .

For payment by credit card please complete the following details:

American Express ☐ Discover ☐ MasterCard ☐ Visa ☐ (please tick)

Name as it appears on the card: . . . .

Card no. . . . .

Issue Date: . . . . Expiry Date: . . . .

Security Code: . . . .

Signed . . . . ***Date*** . . . .

Payment notes / Cancellation

Returning this form constitutes the subscriber's agreement to subscribe to *International Corporate Rescue* for one year, on the following terms and conditions. Payment is due from each subscriber annually in advance by cheque, credit card (through PayPal), or bank transfer. Although any subscription may be cancelled at any time no refunds are made in any circumstances. A hardcopy subscription is EUR 730 / USD 890 / GBP 520; online: EUR 730 / USD 890 / GBP 520; and hardcopy + online: EUR 840 / USD 1045 / GBP 625. Rates per additional hardcopy or online user are: EUR 165 / USD 220 / GBP 145. If applicable, VAT is charged on online and hardcopy + online subscriptions. Hardcopy-only is zero-rated for VAT purposes. For package subscriptions, VAT is charged on the entire package.

Special Issues. Price for individual Special Issues for subscribers: EUR 125 / USD 175 / GBP 105; for non-subscribers: EUR 165 / USD 225 / GBP 135. Online access to all Special Issues for subscribers: EUR 375 / USD 535 / GBP 315; for non-subscribers: EUR 495 / USD 695 / GBP 420. Online subscription plus access to all Special Issues: EUR 995 / USD 1250 / GBP 740. Hardcopy + online subscription plus access to all Special Issues: EUR 1150 / USD 1450 / GBP 875.

Back Catalogue (Volumes 1–17). Price for single user online access to back catalogue: EUR 815_/ USD 975_/ GBP 750; Online subscription plus access to back catalogue EUR 1545 / USD 1865 / GBP 1270. Hardcopy + online subscription plus access to back catalogue EUR 1655 / USD 2020 / GBP 1375

Please complete and return this form to:
Chase Cambria Company (Publishing) Limited
4 Winifred Close
Arkley
Barnet EN5 3LR
United Kingdom

ChaseCambria
Company Publishing Limited