# Digest


## Virgin Atlantic

Lottie Pyper considers the guidance given on the first restructuring plan under Part 26A of the Companies Act 2006

**Cryptocurrencies: 2020 and beyond**
Robert Amey, with Jonathon Milne of Conyers, Cayman, on recent case law and developments in relation to cryptocurrencies

**Provisional Liquidation and Restructuring: The Cayman Islands and Hong Kong**
Michael Popkin of Campbells, takes a cross-border view

A regular review of news, cases and articles from South Square barristers

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SOUTH SQUARE

# From the editors

**MARCUS HAYWOOD AND WILLIAM WILLSON**

*Welcome to the final edition of the Digest of 2020*

We hope all our readers and their families are well in what remain challenging times. When the last edition of the Digest was published in the summer, the UK had recently emerged from lockdown and restrictions were easing. Now, some four months on, we are again emerging from a second lockdown following a spike in coronavirus cases, particularly in the North of England.

The fallout from COVID-19 continues to have very significant economic costs. Monthly GDP in September 2020 (the latest month for which data is currently available) was 8.2% below the level of February 2020 with the restaurant, entertainment, travel and air transport industries, amongst others, particularly adversely affected.

The Bank of England has estimated that the pandemic will cause persistent economic scarring over the long term, with total economic output about 1.75% lower than would otherwise have been the case by the end of 2023.

In the immediate term, the continuing effect of the pandemic has led, amongst other things, to the extension of a number of the temporary provisions to protect companies which were introduced in the Corporate Insolvency and Governance Act 2020 ('**CIGA**') (which, together with the other changes introduced by CIGA were the subject of detailed consideration in our July *"Special Edition"* of the Digest). A review of these extensions appears later in this issue.

Other uncertainties loom. The transition period following the UK's exit from the European Union will end on 31 December 2020 with (as at time of writing) no deal yet having been reached with the EU. The Governor of the Bank of England, Andrew Bailey, has recently warned that the economic cost of a no-deal Brexit would be bigger in the long term than the damage caused by COVID-19 and that any failure to agree a deal before the Brexit transition expires would cause significant disruption to the UK economy.

However, amongst all the uncertainty, some light appears to be emerging at the end of the tunnel. The results of trials of three COVID-19 vaccines, the University of Oxford/AstraZenica vaccine, the Pfizer/BioNTech vaccine and the Moderna vaccine, have been extremely promising with the Government now hoping that the NHS should be able to inoculate the *"vast majority"* of the people who need the most protection by Easter of next year and vaccination of vulnerable groups set to start as we go to press. We hope that by the time of the next edition of the Digest, a return to normality may not be too far in the horizon.

Closer to home, there has been good news for Chambers, sweeping the board of the Company/Insolvency prizes at the Chambers Bar Awards held virtually on 19 November. South Square was named as Company/Insolvency Set of the Year for the fourth year running. Tom Smith QC was named Company/Insolvency silk of the year and Stephen Robins Company/Insolvency junior of the year. Congratulations to all members and staff, and to Tom and Stephen in particular. A full review of the prizes appears later in the Digest.

This edition also contains a number of topical articles. In our lead article, Lottie Pyper provides a detailed review of the first restructuring plan to be convened and sanctioned under Part 26A of the Companies Act 2006 in relation to Virgin Atlantic Airways. The article considers the guidance given on the operation of Part 26A both at convening hearing by our former Head of Chambers, Mr Justice Trower and at the sanction hearing by Mr Justice Snowden.

Following on from our recent series of articles on cryptocurrencies, a joint article Robert Amey and Jonathan Milne of Conyers Dill & Pearman, Cayman Islands, considers recent case law and developments regarding the

treatment of cryptocurrencies and the legal status of this relatively new and evolving asset class to predict how the Cayman Islands and other jurisdictions may treat crypto assets and deal with disputes relating to them.

Then, in our regular offshore guest article, Michael Popkin of Cambells, Hong Kong considers recent developments in relation to provisional liquidations and restructuring in Hong Kong and the Cayman Islands.

Felicity Toube QC and Hilary Stonefrost, together with Scott Akins and Dr Kai Luck of Norton Rose Fulbright, Australia consider the case for further reform to strengthen business rescue in the UK and Australia, focusing in particular on super-priority debtor-in-possession ("**DIP**") financing and prepack business sales.

For those that missed it, associate member Hon Paul Heath QC, provides an overview of P.R.I.M.E Finance's recent webinar on *"Insolvency and Restructuring in a Pandemic – the Global View from the Boardroom and the Courtroom"*.

Toby Brown and Zoe Nolan of Walkers Cayman consider the recent decision of the Grand Court of the Cayman Island in *Re LATAM Finance Limited* and ask: §*"Is modified universalism alive and well in the Cayman Islands?"*.

And in our regular *"Legal Eye"* piece, Roseanna Darcey takes us through historical backstreets of London with surprisingly modern connections. Meanwhile, associate member Professor Christoph Paulus continues his regular Euroland piece and informs us of recent developments of interest on the continent.

The period since the last edition of the Digest was published has also seen the handing down of judgments in a number of important cases including the decisions of the Supreme Court in *Sevilleja v Marex Financial Ltd* and *Enka Insaat Ve Sanayi AS v OOO Insurance Company Chubb* (in which Robin Dicker QC appeared). A summary of these cases, along with other cases of note, many involving members of Chambers, appear as always in the Case Digests.

Finally, we welcome our newest members – Paul Fradley and Jamil Mustafa, after the successful completion of their pupillage. Biographies of Paul and Jamil appear later in the Digest and both have contributed articles to this edition: Jamil with two articles, one on the Government's recent Pre-Pack review and the other on the Disclosure Pilot Scheme and Paul on the extension of the temporary provisions in the CIGA.

And to keep you busy over the Christmas period, this edition's South Square Challenge is a word search, with a topical coronavirus theme.

In the meantime, until the next edition, we wish all our readers a happy festive period and New Year – which hopefully will be much better than the last!

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

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

It goes without saying that if you have any feedback to give us in relation to the Digest – positive or negative – we would be delighted to hear from you. ■

**Marcus Haywood and William Willson**



# Virgin Atlantic proposes the first restructuring plan under Part 26A of the Companies Act 2006

LOTTIE PYPER

*Just weeks after the Corporate Insolvency and Governance Act 2020 received Royal Assent, Virgin Atlantic Airways Limited proposed the first restructuring plan to be convened and sanctioned under Part 26A of the Companies Act 2006. This article considers the initial guidance given on the operation of Part 26A in the resulting judgments.*

## Introduction

2020 was not a good year for airlines. The restrictions made necessary by the COVID-19 pandemic resulted in passenger demand plummeting in a way that was previously unimaginable. This is clear from turning back to the risk assessment in the Virgin Group's 2018 Annual Accounts, which list the key operational and business risks as being: (1) damage to the brand's reputation, (2) Brexit, (3) regulatory changes, (4) terrorism and other security incidents, (5) technology failure, (6) the failure of a key supplier and (7) industrial action by its workforce. None of these risk factors come anywhere close to anticipating a global pandemic that caused a near shutdown of the entire international travel industry.

Although Part 26A of the Companies Act 2006 ("**CA 2006**") was conceived back in May 2016 and developed following extensive industry consultations, it was introduced as part of the emergency insolvency legislation developed to help businesses navigate the economic devastation wreaked by the COVID-19 pandemic. Part 26A was therefore inserted into the CA 2006 as schedule 9 to the Corporate Insolvency and Governance Act ("**CIGA 2020**"), which was hurried through parliament in May and June 2020 and received Royal Assent on 25 June 2020.

Given this timing, it is unsurprising that the first company to propose a restructuring plan under Part 26A was Virgin Atlantic Airways Limited ("**Virgin Atlantic**" or the "**Company**"), on behalf of the Virgin Group. It is clear that the only reason for Virgin Atlantic to propose a restructuring plan under Part 26A, rather than a scheme of arrangement under Part 26, was to enable the Company to rely on the cross class cram down provisions in section 901G, if the statutory majority was not achieved at each class meeting. Save for the potential uncertainty in relying on a newly-enacted procedure, there was no downside to taking this approach rather than proposing a Part 26 scheme of arrangement. Given the Company's dire financial position, there was no question that it would meet the threshold conditions in section 901A, which is the only additional jurisdictional hurdle.

In the event, the restructuring plan could have been proposed under Part 26 instead. By the time of the convening hearing, the only class that was not guaranteed to meet the statutory majority was the class of 168 trade creditors included in the plan (the "**Trade Plan Creditors**"). In fact, the Trade Plan Creditors voted overwhelmingly in favour of the restructuring plan, with over 99% by value of those present and voting supporting the restructuring plan, with a turnout of 66%. This meant that no application under section 901G was required.

The restructuring plan was convened by Mr Justice Trower on 4 August 2020 and sanctioned by Mr Justice Snowden on 3 September 2020: see *Virgin Atlantic Airways Limited* [2020] EWHC 2191 (Ch) (the "**Convening Judgment**") and [2020] EWHC 2376 (Ch) (the "**Sanction Judgment**") respectively. Although Virgin Atlantic's restructuring plan was uncontested and did not require cross class cram down, these judgments provide some helpful initial guidance on the interpretation of Part 26A. In each case, they followed the established principles under Part 26, including regarding notice, class composition and sanction.

This approach is consistent with the Explanatory Notes to the CIGA 2020. As observed by Snowden J (at paragraph 44):

*"these Explanatory Notes are admissible as an aid to the interpretation without needing to show that the legislation is ambiguous or unclear: see Flora v Wakom (Heathrow) Ltd [2007] 1 WLR 482 at [15]-[16]."*

Both the Convening Judgment (at paragraph 18) and the Sanction Judgment (at paragraph 44) cite paragraph 16 of the Explanatory Notes, which provides as follows:

*"while there are some differences between the new Part 26A and existing Part 26 (for example the ability to bind dissenting classes of creditors and members), the overall commonality between the two Parts is expected to enable the courts to draw on the existing body of Part 26 case law where appropriate."*

Given the conservative nature of both stages of the Virgin Atlantic case, the judges were able to follow the existing body of Part 26 case law almost entirely, save for regarding the threshold conditions in section 901A.

## The Convening Hearing

### Notice of the Convening Hearing

In tandem with the enactment of CIGA 2020, the government introduced a new practice statement dated 26 June 2020, titled *Practice Statement (Companies: Schemes of Arrangement under Part 26 and Part 26A of the Companies Act 2006)* (the "**Practice Statement**"). This incorporates case law developments since the previous practice statement

was published in 2002, as well as making provision for the additional features of Part 26A restructuring plans.

Paragraph 6 of the Practice Statement provides as follows:

*"It is the responsibility of the applicant, by evidence in support of the application or otherwise, to draw to the attention of the court at the hearing for an order that meetings of creditors and/or members be held ("the convening hearing"):*

a. *any issues which may arise as to the constitution of meetings of members or creditors or which otherwise affect the conduct of those meetings;*

b. *any issues as to the existence of the court's jurisdiction to sanction the scheme;*

c. *(in relation to a Part 26A scheme) any issues relevant to the conditions to be satisfied pursuant to section 901A of the 2006 Act and, if an application under section 901C(4) of the 2006 Act is to be made, any issues relevant to that application; and*

d. *any other issue not going to the merits or fairness of the scheme, but which might lead the court to refuse to sanction the scheme."*

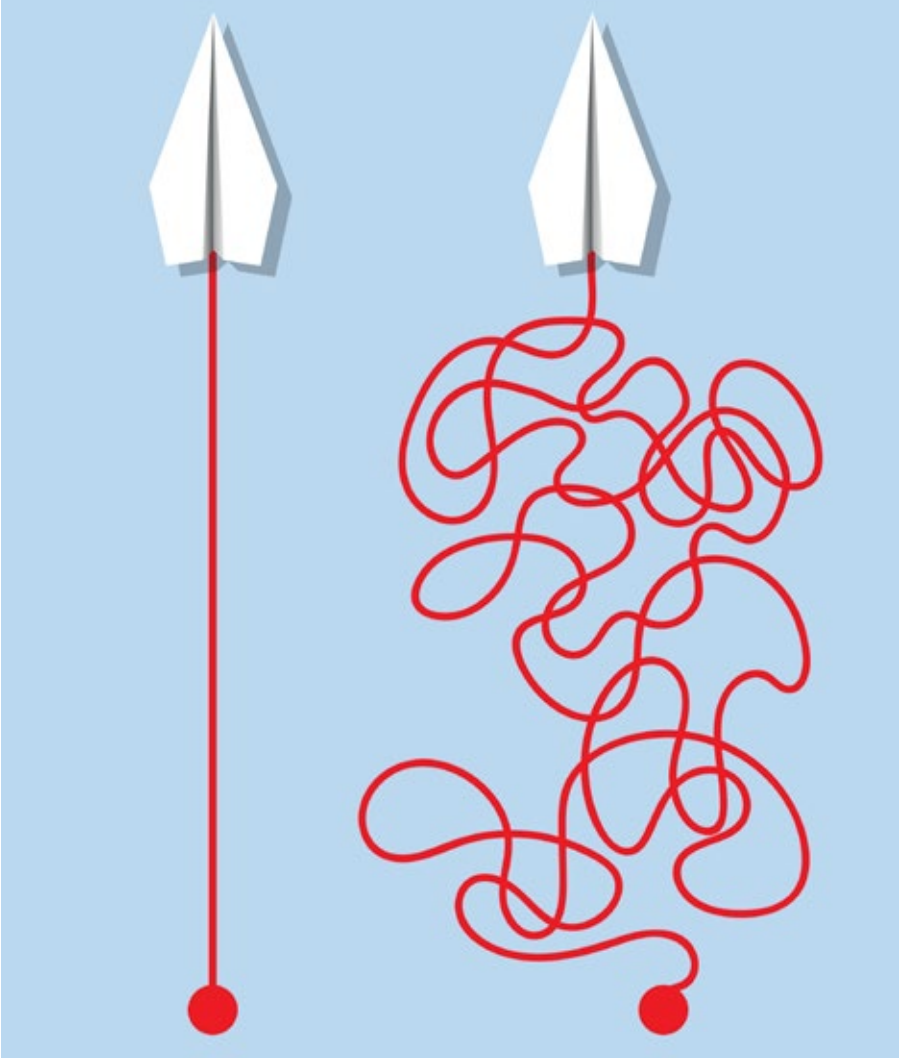
It is well-established that at a Part 26 convening hearing, the role of the court is *"emphatically not"* to consider the merits or fairness of the scheme, which should instead be considered at the sanction hearing: *Re Telewest Communications plc* (No 1) [2004] BCC 342, [14]. At paragraph 35 of the Convening Judgment, Trower J held that paragraph 6(d) of the Practice Statement *"makes clear that the same approach should be adopted at the convening hearing held for the purpose of giving directions to summon meetings of creditors for a Part 26A restructuring plan."*

Paragraphs 7 of the Practice Statement goes on to state that, if any of the issues identified in paragraph 6 are engaged, *"the applicant should, prior to the convening hearing, take all steps reasonably open to them to notify any person affected by the of the following matters:*

*"a. that the scheme is being promoted,*

*b. the purpose which the scheme is designed to achieve and its effect,*

*c. the meetings of creditors and/or members which the applicant considers will be required and their composition,*



*d. the other matters that are to be addressed at the convening hearing, including the issues identified in paragraph 6 above,*

*e. the date and place fixed for the convening hearing,*

*f. that such persons are entitled to attend the convening and sanction hearings, and*

*g. how such persons may make further enquiries about the scheme."*

It is for the applicant to ensure that such notification is given in a concise form and communicated in an appropriate manner. However, paragraph 8 emphasises that this is not an inflexible requirement:

*"Save for the circumstance in which there are good reasons for not giving the notification identified in paragraph 7 above, it should be given to persons affected by the scheme in sufficient time to enable them to consider what is proposed, to take appropriate advice and, if so advised, to attend the convening hearing. What is adequate notice will depend on all the circumstances. The evidence at the convening hearing should explain the steps which have been taken to give the notification and what, if any, response the applicant has had to the notification."*

It is now clear that, following Snowden J in *Re ColourOz Investment 2 LLC* [2020] EWHC 1864 (Ch) at paragraph 47 (the first Part 26 scheme proposed under the new Practice Statement), *"the question of the adequacy of notice of the convening hearing is therefore not affected by the level of support for the scheme from the creditors who have already locked up. It falls to be judged by reference to the position of those who have not locked up and who might wish to oppose the formulation of classes proposed by the company."* Trower J followed this approach in the Convening Judgment, holding that the only creditors with whom the court was concerned were the Trade Plan Creditors, since unlike the other plan creditors, they had not been involved in the restructuring negotiations or invited to enter into support agreements. This made it *"all*

*the more important that the court should give careful consideration to whether the notice actually given to them was sufficient"* (paragraphs 26 to 27).

In this case, Trower J was satisfied that the notice given was adequate.

Firstly, there was detailed evidence as to how the Trade Plan Creditors had been identified.

Secondly, he was satisfied by the Company's evidence that the restructuring was urgent, holding that (at paragraph 32) "[t]*his is not one of those cases in which the court is sceptical as to the genuineness of proposed deadlines. The evidence points to a very real prospect that the Company will go into administration with a substantial loss of value to creditors if the Restructuring Plan is not sanctioned in the early part of September."*

Thirdly, the Trade Plan Creditors were given 21 days to consider the Practice Statement Letter before the Convening Hearing. The Practice Statement Letter was sent to the Plan Creditors on 14 July 2020, which was 21 days before the Convening Hearing. This was followed by an Addendum sent on 20 July 2020, with a number of updates, including moving the date on which Trade Plan Creditors' claims would be valued (the "**Trade Plan Creditor Record Date**").

They were also invited to attend a webinar on 21 July 2020, a recording of which was uploaded online. Although not discussed in the Convening Judgment, the reason why the Trade Plan Creditor Record Date was moved was because of the discussions with Trade Plan Creditors following the circulation of the Practice Statement Letter. A number of them expressed concern about the fact that, if they continued to supply the Company, their claims to be compromised by the Restructuring Plan would continue to increase until the original Record Date in mid-August. In order to address these concerns, the Trade Plan Creditor Record Date was moved to 1.30pm on 14 July 2020, being the time when the original Practice Statement Letter was circulated.

Fourthly, although a number of Trade Plan Creditors had been in touch, none of them had contended that there was inadequate time for them to consider their position prior to the Convening Hearing.

Since Part 26 and Part 26A share the same Practice Statement, the same principles evidently apply to both procedures in this respect.

**Threshold Conditions**

Unlike a Part 26 scheme, a company has to meet certain additional threshold conditions in order to propose a restructuring plan under Part 26A. These are contained in section 901A, which provides as follows:

*"(1) The provisions of the Part apply where conditions A and B are met in relation to a company.*

*(2) Condition A is that the company has encountered, or is likely to encounter, financial difficulties that are affecting, or will or may affect, its ability to carry on business as a going concern.*

*(3) Condition B is that—*

*(a) a compromise or arrangement is proposed between the company and—*

*(i) its creditors, or any class of them, or*

*(ii) its members, or any class of them, and*

*(b) the purpose of the compromise or arrangement is to eliminate, reduce or prevent, or mitigate the effect of, any of the financial difficulties mentioned in subsection (2)."*

No difficulty arose in establishing that Virgin Atlantic was a "company" under section 901A, as it is registered in England.

In terms of Condition A, this was not a borderline case. The difficulties caused by the COVID-19 pandemic resulted in the Company being *"on the brink of collapse"* and, if the restructuring plan was not approved, it was likely to enter administration by mid-September 2020, with a view to winding up the business and selling its assets (paragraph 37).

Condition B was also plainly satisfied. As to the first limb, Trower J held that "*there is no reason to think that the concept of what is capable of amounting to a compromise or arrangement for the purposes of s.901A is any different to the same phrase used in Part 26. Indeed, quite the contrary, there is every reason to think that Parliament has intended the same language should be construed in the same way*" (at paragraph 38). The restructuring plan was clearly a "*compromise or arrangement*", involving a degree of give and take with each class of creditors.

The second limb of Condition B is that the purpose of the compromise or arrangement must be *"to eliminate, reduce or prevent, or mitigate, the effect of any of the company's financial difficulties under condition A."* Trower J held that (at paragraph 39) *"this is broad language which was intended to be expansively construed."* In this case, the only purpose of the Restructuring Plan was to *"mitigate and, if possible, to eliminate"* the financial difficulties caused by the COVID-19 pandemic.

**Class Composition**

Having outlined the existing authorities on class composition for Part 26 schemes of arrangement and the principal differences introduced in Part 26A, Trower J held that *"while the court undoubtedly has power to sanction a restructuring plan in circumstances in which it would not have power to sanction a Part 26 compromise or arrangement, it seems to me that the approach to classifying the other creditors with whom they should be required to consult is broadly the same"* (at paragraph 45).

"Unlike a Part 26 scheme, a company has to meet certain additional threshold conditions under Part 26A"

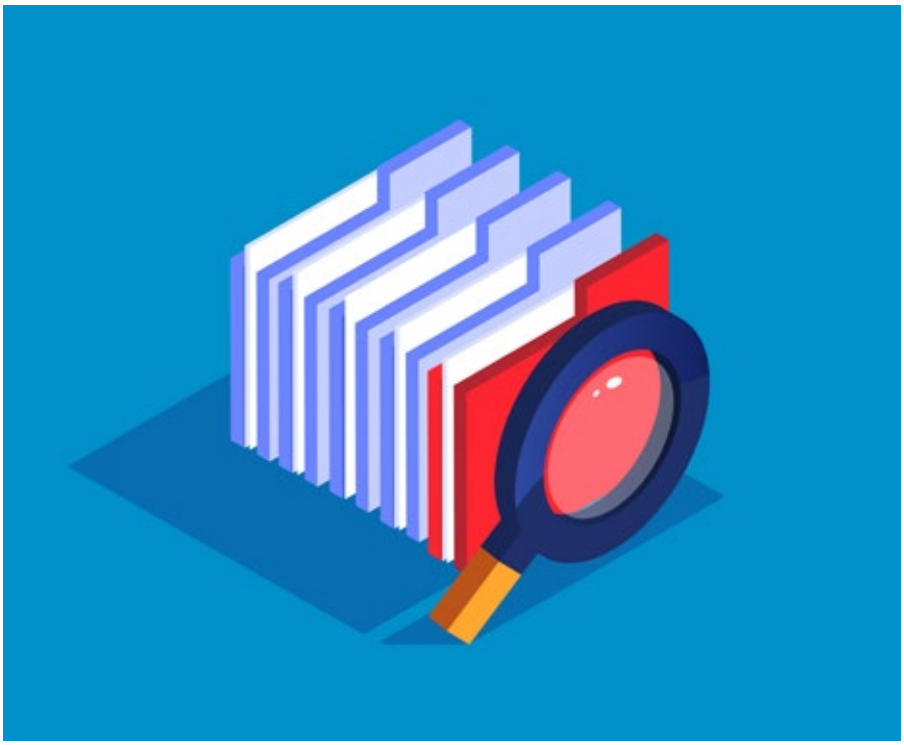
He gave three main reasons for this, whilst noting that there had been no adversarial argument on this point.

Firstly, he observed that purpose of class meetings under Part 26A is the same as class meetings under Part 26, namely to enable those with a genuine economic interest in the company, whose rights will be affected by the restructuring plan, to reach a collective conclusion on whether the proposed restructuring plan should be approved. He noted that in both cases *"Parliament has chosen the same language of compromise and arrangement to describe what must be approved"* (paragraph 46).

Secondly, he held that the established approach under Part 26 of concentrating on rights rather than interests was equally applicable to Part 26A, and in particular *"whether, ignoring any personal or extraneous interest, there is more that unites the relevant creditors than divides them."* In acknowledgement of the fact that the class test under Part 26 has been developed to promote the success of a procedure that does not enable cross class cram down, he also made the following observation: *"having regard to the fact that the cross-class cram down provisions under s.901G, and, in particular, the requirements of section 901G(5), point to the possibility that in some circumstances a company may have an incentive to increase rather than reduce the number of classes in respect of which class meetings need to be called so that it can improve the prospect that at least one class votes to agree it"* (paragraph 47).

Thirdly, he identified a number of specific matters that supported this view (at paragraph 48). Firstly, the language in the relevant parts of sections 901A and 901C CA 2006 is identical to the language in the comparable sections in Part 26, i.e. sections 895 and 896. Secondly, the Explanatory Notes expressly contemplate a commonality of approach being taken. Thirdly, and perhaps most importantly, he observed *"the constitution of classes has long been at the heart of the case law dealing with schemes under Part 26 and its statutory predecessors. It is to be expected that, if a difference in approach was anticipated by Parliament, it would at least have been signalled in some way in the legislation, which is not the case."*

Applying those principles, he was satisfied that the constitution of



classes proposed by Virgin Atlantic were appropriate. Indeed, in this case the existing rights of each class were materially different, and so was their treatment under the restructuring plan. Although the point was not argued before the court, it is likely that it would not have been possible to reduce the number of classes, at least under the existing Part 26 jurisprudence.

By way of summary:

(1) The "**RCF Plan Creditors**" were secured finance creditors with claims under a revolving credit facility. The restructuring plan made certain changes to the facility, including converting it into a term loan and extending the maturity date, as well as making arrangements for the security over one of the secured assets – an aircraft engine – to be released in exchange for security over a bank account.

(2) The "**Operating Lessor Plan Creditors**" were the lessors under certain operating leases for the Company's aircraft. The restructuring plan gave them three options, two of which involved deferring rent payments (on slightly different repayment terms) and the third enabled them to repossess their aircraft. In the event, all of these creditors selected the same deferral option.

(3) The "**Connected Party Plan Creditors**" were connected parties with unsecured claims under various contracts. Under the restructuring plan, for the most part, their existing and future claims were to be exchanged for the same preference shares. The only potential class issue was that one of the Connected Party Plan Creditors would not be required to exchange its future claims under a particular contract – the Delta Air4 Agreement – for preference shares. However, since each of the Connected Party Plan Creditors had already agreed to support the restructuring plan in advance of the hearing, it was not impossible for them all to consult together.

(3) The Trade Plan Creditors were all unsecured creditors of the Company. Their claims would all be altered in the same way under the restructuring plan, in that a haircut of 20% would be applied, and the remainder repaid in a total of nine instalments over two years. This represented a substantially better result than in an administration, which was the most likely alternative.

**International Jurisdiction**

Unsurprisingly, Trower J took the same approach towards international jurisdiction as is usually taken in Part 26 schemes, and adopted what he referred to as the *"usual practice"* (paragraph 59) of assuming that Regulation EU (1215/2012) (the "**Judgments Regulation**") applies without deciding the matter. As there

were a number of plan creditors domiciled in England, including at least one in each class, the court therefore had jurisdiction pursuant to Article 8 of the Judgments Regulation. He was not, however, satisfied that the Company could rely on Article 25, as there was no clear evidence that each of the Trade Plan Creditors had contracted on terms with an English jurisdiction clause.

**Confidentiality**

It has become almost routine for companies disclosing sensitive financial information in their evidence for Part 26 schemes to seek an order that keeps that detail confidential. Given the very candid detail given about Virgin Atlantic's precarious financial position in the Company's evidence, the court was asked to make an order pursuant to CPR 5.4D(2), that notice shall be given to the Company of any application made by a person to obtain a copy of a document from the court file. Trower J held that *"whether or not this has become a standard order in Part 26 schemes, I am satisfied that there is sufficiently commercially sensitive material which has been put before the court to make such an order appropriate in the present case"* (at [67]). He then observed that this order did not preclude anybody from obtaining the documents, but simply required the Company to be given notice of an application to inspect them.

Where a similar order was made in *Noble Group Limited* [2018] EWHC 2911 (Ch), the commercially sensitive information was confined to the company's witness statement and not mentioned in open court or the judgement. Snowden J deliberately skirted over the details at paragraph 177 of his judgment, commenting on the tight timetable for the implementation of the restructuring: *"the pressure that this approach created was compounded by evidence from Mr Brough, the detail of which I have ordered should be kept confidential for the time being, but which I can nevertheless say warned of dire consequences for the company and its creditors if the timetable set by the SIC was not met."*

By contrast, in Virgin Atlantic, the commercially sensitive information was repeated in both written and oral submissions as well as summarised in the Convening Judgment itself. Hours after the hearing concluded, quotations from the hearing had been published in numerous online news publications: see for example:

(1) https://www.law360.com/articles/1298146/virgin-atlantic-gets-ok-to-take-covid-19-refinancing-to-vote

(2) https://www.travelweekly.co.uk/articles/381761/virgin-atlantic-could-run-out-of-cash-by-end-of-september-without-12bn-bailout

(3) https://www.thisismoney.co.uk/wires/pa/article-8592061/Virgin-Atlantic-run-money-end-September.html

(4) https://metro.co.uk/2020/08/04/virgin-atlantic-run-money-altogether-next-month-13083397/

(5) https://uk.finance.yahoo.com/news/coronavirus-virgin-atlantic-rescue-restructuring-close-flights-airlines-091229553.html

It can be seen even from these website domains that the details of the Company's precarious financial position was not kept confidential for long. This casts doubt on whether the order pursuant to CPR 5.4D(2) had any practical utility at all.

## The Sanction Hearing

**Outcome of the Plan Meetings**

Due to restrictions caused by the ongoing COVID-19 pandemic, and following Trower J's guidance in *Re Castle Trust Direct plc* [2020] 969 Ch (in particular paragraphs 42 and 43), the class meetings took place by Zoom conference on 25 August 2020. The restructuring plan was approved at all four meetings. 100% in value and number of the RCF Plan Creditors, Operating Lessor Plan Creditors and Connected Party Plan Creditors voted in favour, with a turnout of 100% at each meeting. 99.24% in value of the Trade Plan Creditors voted in favour, with a turnout of 66.05%. Two Trade Plan Creditors holding 0.39% by value voted against and three Trade Plan Creditors holding 0.37% by value abstained from voting.

In these circumstances, the Company sought for the restructuring plan to be sanctioned under section 901F.

As a practical point, during the hearing Snowden J indicated that although the statutory majority in Part 26A does not include a numerosity requirement, it would nevertheless assist the court for the chairperson's report and the evidence to contain details about the number of plan creditors who voted at the plan meetings and how they voted.

**A warning against 100% consent**

Snowden J began by noting that (at paragraph 45) *"it is clear that the court has a general discretion whether to sanction a restructuring plan under Part 26A. It is also envisaged that the authorities under Part 26 may, where appropriate, assist the court in deciding how to exercise its discretion under Part 26A."* Since all of the classes of plan creditors had approved the plan, the court was in a similar position to a Part 26 sanction hearing and *"accordingly, I shall simply follow the tried and tested approach to the exercise of discretion which has been established under Part 26"* (paragraph 46).

However, he also addressed the potential difficulty caused by the fact that three of the four classes had, prior to the convening order being made, already agreed to vote in favour of the restructuring plan. The compromises with those creditors could therefore have been implemented consensually. Indeed, when the Practice Statement Letter was sent out, there was an additional class of plan creditors, comprising of the lessors and finance parties in respect of various finance leases. By the time of the convening hearing, those creditors had been removed from the restructuring plan, as 100% consent had been obtained.

In light of this, Snowden J noted that (at paragraph 48) *"under Part 26, the court would not ordinarily entertain an application to convene scheme meetings or sanction a scheme of arrangement where it was known in advance that all creditors have consented or would be prepared to consent to a variation of their rights against the company. As such, although very high majorities are sometimes locked up in advance to support a scheme, it is not normal practice to include classes in a Part 26 scheme where 100% of the relevant creditors are known to be willing to consent."*

In this regard, there is precedent for the court convening a Part 26 scheme

> *If creditors who rank pari passu with scheme or plan creditors are being treated more favourably outside the scheme or plan, this should be fully explained to the creditors who are being dealt with under the scheme or plan, so that they can assess whether they are being treated unfairly*

where 100% support has been obtained from all of the creditors: see *Re NN2 Newco Limited; Politus BV* [2019] EWHC 1917 (Ch), where Norris J made an order convening meetings in respect of the scheme proposed by Politus BV, notwithstanding that all of the scheme creditors had agreed to support the scheme by the time that the convening order was made. However, he noted that if Politus still wished to implement its restructuring by way of a scheme it would be for the judge at the sanction hearing to decide *"whether, if all Politus Lenders are agreed, it is a proper exercise of discretion to sanction the scheme"* (at paragraph 25). In the event, Politus abandoned the scheme before the scheme meetings.

As a practical matter, future applicants under Part 26A should take care to ensure that less than 100% of at least one consenting class formally agree to support the restructuring plan in advance. This will avoid any risk that the court considers using fully consenting classes to cram down a dissenting class is an inappropriate use of its discretion.

**The approach to sanction**

Snowden J began by summarising the established four-stage test for Part 26 sanction hearings, which is follows (paragraphs 51 and 52):

(1) Whether the statute has been complied with.

(2) Whether the class was fairly represented at the meeting, and whether the majority was coercing the minority in order to promote interests adverse to the class which they purport to represent.

(3) Whether the scheme is a fair scheme which a creditor could reasonably approve.

(4) Whether there is any blot or defect in the scheme.

In this case, three of the four stages were clearly satisfied. The provisions of the statute had been complied with; the high level of support for both the restructuring plan and the broader recapitalisation, including by the Trade Plan Creditors, suggested that the compromise offered was fair; and the court was not aware of any "blot" or defect in the restructuring plan.

However, Snowden J gave more detailed attention to the second stage of the test, in order to address the question of whether the class of Trade Plan Creditors was properly constituted. As alluded to above, four categories of the Company's suppliers were not included in the Restructuring Plan (the "**Excluded Trade Creditors**"), as follows (see the Convening Judgment at paragraph 11):

(1) Creditors whose claims were less than £50,000 as at 12 June 2020. Including these creditors in the plan was considered to be financially inefficient, given that the logistical difficulties and additional expense it would have generated were considered disproportionate when compared to the total value of these claims.

(2) Public bodies and insurance companies who were owed liabilities, the non-payment of which would jeopardise the ability of the Company to carry on business.

(3) Other suppliers whose continuing goodwill was essential to the continuation of the Company's business.

(4) Suppliers who the Company had already reached agreement to compromise their claims at a level equal to or below the level provided by the restructuring plan.

Although there was no doubt that companies have the ability to choose which of their creditors to include in a scheme under Part 26 and, therefore, Part 26A (following in particular *SEA Assets v PT Garuda* [2001] EWCA Civ 1696), Snowden J emphasised that the selection of creditors had implications for the exercise of the court's discretion (at paragraph 42). In order for the classes to be fairly constituted, the creditors must have been properly consulted. This requires the creditors to have been given both sufficient time for consideration and sufficient information to make a reasonable judgment about whether the proposal is in their commercial interests or not. The information required includes both information about what the creditors are likely to get under the scheme as opposed to absent the scheme, and in addition *"if creditors who rank pari passu with scheme or plan creditors are being treated more favourably outside the scheme or plan, this should be fully explained to the creditors who are being dealt with under the scheme or plan, so that they can assess whether they are being treated unfairly"* (paragraph 63).

In this case, the exclusion of the Excluded Trade Creditors was not unfair. In particular, there was a reasonable commercial justification for excluding creditors with the power to jeopardise the Company's ability to carry on business (categories 2 and 3 above), for the same reasons given in *Garuda* itself. There was also a reasonable justification for excluding the creditors who were owed less than £50,000, since including them in the restructuring plan would have increased the number of Trade Plan Creditors by around 1,000 in exchange for a debt reduction of about £1 million (category 1 above) (see paragraphs 65 and 66). As Snowden J did not specifically consider the position of category 4 creditors, it seems evident


that he considered there was no unfairness in excluding creditors who had already agreed to a haircut equal to or greater than that imposed by the restructuring plan. He was also satisfied that sufficient information had been given about the exclusion of the Excluded Trade Creditors in the explanatory statement. Therefore, this limb of the test was also satisfied.

Finally, there was no doubt that, if sanctioned, the restructuring plan was likely to have a substantial effect (paragraphs 71 to 75).

## Conclusion

In a case such as Virgin Atlantic, where the restructuring plan could, in hindsight, also have been proposed as a Part 26 scheme, adopting a consistent approach was both logical and appropriate. However, there will no doubt be future cases which test the limits of applying the existing scheme jurisprudence to Part 26A restructuring plans. At the moment, the classic principles of class composition enable a company to artificially manufacture a consenting class, in order to engage section 901G. The class composition in Virgin Atlantic dipped a toe in this water since, by the time of the Convening Hearing all of the classes other than the Trade Plan Creditors had already received 100% support, and therefore could have been implemented outside of the restructuring plan. It will be interesting to see how far the court is happy to tolerate this in cases where section 901G is engaged.

Most striking, however, is the fact that the *Buckley* test cannot be applied so directly when the court is considering whether to sanction a restructuring plan under section 901G. Clearly, imposing a restructuring plan on a dissenting class requires the court to depart from the established principle that creditors, rather than the court, are best placed to judge what is in their commercial interests, at least on a class by class basis. Until a new fairness test is formulated, there remains considerable uncertainty about the circumstances in which the court will exercise this new discretion. ■

# Cryptocurrencies: *2020 and beyond*

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As the global leader in alternative investment funds, and one of the most innovative financial centres in the world, it is unsurprising that the Cayman Islands has quickly become a popular destination for cryptocurrency vehicles with initial coin offerings (ICOs).

There are several other reasons why Cayman is an attractive jurisdiction for FinTech business, including the fact that it offers tax neutrality, a stable political system, judicial ties to the United Kingdom and support via sophisticated professional services firms.

There is always a balancing act between adopting a pro-industry approach to exciting new business and maintaining the highest standards of governance. Cayman, like the rest of world, is considering how best to regulate and place controls on the cryptocurrency space.

In this article, we consider recent case law and developments regarding the treatment of this FinTech business and the legal status of this relatively new and evolving asset class, to predict how the Cayman Islands and other jurisdictions may treat crypto assets and deal with disputes as they arise.

## Brief History of the development of cryptocurrencies

Almost 12 years ago now, a white paper entitled *"Bitcoin: A Peer-to-Peer Electronic Cash System"* was published under the moniker Satoshi Nakamoto. Prior to that watershed moment, other Blockchain pioneers had tried to create digital currencies with more limited success.

By 2010, cryptocurrency exchanges were cropping up. Shortly after that, more coins and crypto assets were created under a variety of brand names. The market was relatively sophisticated by 2015, when Ethereum arrived on the scene, and ICOs began taking place. Fast forward to 2020 and there are literally thousands of unique digital currencies.

There is now a wide-ranging investor base for digital assets and many retail stores are accepting cryptocurrencies as a method of payment. With the advent of dedicated ATMs and mainstream use of Blockchain technology, it appears that cryptocurrencies (in one form or another) are here to stay.

Accordingly, as Bitcoin and its competitors become more embedded in our daily lives, there is an increased focus on regulation and a desire to determine the legal status of this relatively new and evolving asset class. However, that focus and desire creates a number of issues from a philosophical standpoint. Many early adopters of Bitcoin and other cryptocurrencies were attracted to the ideology of cryptocurrencies rather than the financial benefits. It is no coincidence that Bitcoin gained traction and support following the Global Financial Crisis, when anger and apathy were at an all-time high.

The Bitcoin white paper contains this statement: *"The root problem with conventional currencies is all the trust that's required to make it work. The central bank must be trusted not to debase the currency, but the history of fiat currencies is full of breaches of that trust."*

It is against that ideological background that the judiciary, regulators, legislature and industry stakeholders must consider how to apply existing principles (if possible) and also develop a satisfactory regulatory regime in respect of cryptocurrencies and related digital assets.

## Latest developments: is cryptocurrency property?

An issue which has arisen repeatedly in the recent past and will continue to arise is, whether Bitcoin and other cryptocurrencies should be treated as property in the eyes of the law. The answer to this question has profound consequences and has been the subject of a number of decisions. For example, how can misappropriated assets be recovered and remedies sought to trace them, if the asset is not property and therefore there is no proprietary interest to protect? As will be seen, the position is not as straightforward as it initially appears.

The spectrum of academic opinion on certain fundamental, threshold questions is broad:

- Is cryptocurrency personal property? If not a form of personal property (as it is neither a chose in possession nor a chose in action), is it a new hybrid category of personal property, a "virtual chose in possession"?

- Is cryptocurrency money? Although it lacks certain of the fundamental characteristics, it may soon become a form of money. Therefore, can it be classed as property in that sense?

It is generally accepted that a bitcoin, to pick a particular type of cryptocurrency, cannot be a chose in action – not least because the holding of a bitcoin gives the holder no rights against any other person. Furthermore, a bitcoin is not a chose in possession because, in the absence of statutory intervention, one cannot take possession of an intangible (such as a block added to a chain on a digital system).

It is settled law, at Court of Appeal level in England, that choses in action and choses in possession are the only two categories of personal property (see *Your Response Ltd v. Datateam Business Media Ltd* [2014] EWCA Civ 281). So this poses quite a problem regarding how bitcoin and other crypto assets should be, and whether they can be, classed as property.

This does not mean that the holding of a bitcoin could not in principle be a type of personal property at common law. It could be viewed as being *"other intangible property"*. Different crypto assets have different fundamental features however, so a further problem is how to define different types of asset under one definition of *"crypto assets"*.

We consider below how the courts have been dealing with the issue of how to treat cryptocurrency.

**English Interim Injunction Cases**

The issue first arose, in England, on applications for interim injunctions.

In *Vorotyntseva v Money-4 Ltd* [2018] EWHC 2596 (Ch), the claimant alleged that the defendant cryptocurrency exchange had misappropriated her cryptocurrency (in that case, Bitcoin and Ethereum), and sought a proprietary injunction pending trial, preventing the defendant from dissipating the cryptocurrency which had allegedly been misappropriated. The injunction was granted and continued following an *inter partes* hearing.

Although the decision lends support to the proposition that English law will treat cryptocurrency as property (such that a proprietary injunction may be granted to preserve it pending trial), it appears that the point was not actually argued.

In *AA v Persons Unknown* [2020] 4 WLR 35, hackers had installed ransomware on a victim's computer systems, rendering those systems unusable. The hackers demanded US$1.2 million to reverse the effect of the ransomware, although they subsequently accepted US$950,000 instead. Payment was made in Bitcoin. Subsequently, the victim's insurer (AA), which had funded the ransom payment, instructed investigators to trace the destination of the Bitcoin payment. The payment was traced to an account with the Bitfinex exchange. (As an aside, the facts of the case provide a useful reminder that Bitcoin payments are not, contrary to popular belief, wholly anonymous or untraceable.)

Having identified the destination of the Bitcoin, the insurer sought a proprietary and/or freezing injunction against the hackers (the *'Persons Unknown'*). Although the *'Persons Unknown'* could not be identified, the benefit of an injunction would be that Bitfinex would be obliged to freeze the relevant account.

The court considered whether Bitcoin could fall within the definition of *'property'*, such that it was amenable to a proprietary injunction. After considering authorities on the nature of property in English law[1], Bryan J concluded that *"crypto currencies are a form of property capable of being the subject of a proprietary injunction"*.

Although this decision lends considerable support to the proposition that English law will treat cryptocurrency as property, the judgment is subject to two serious limitations:

1. Including the decision in *Vorotyntseva v Money-4 Ltd*, the first instance judgment (although not the appeal judgment) in *B2C2 v Quoine* (discussed further below) and the UK jurisdiction Task Force Legal statement on crypto assets and smart contracts (discussed further below).

(1) The application was made ex parte, and accordingly no contrary argument was considered by the court.

(2) The court only needed to be satisfied, at the interim injunction stage, that "*there is at least a serious issue to be tried*" (para.63). Accordingly, even if there had been full argument, it would be dangerous to rely upon this decision as conclusive proof that English law recognises Bitcoin as a form of property.

**Singaporean Judgements B2C2 v. Quoine [2020] SGCA (I) 2**

In *B2C2 v. Quoine* [2020] SGCA (I) 2, Quoine operated a cryptocurrency exchange, on which B2C2 was an investor. Trading occurred automatically through computer algorithms. Due to a coding error, B2C2 sold cryptocurrency to Quoine for 250 times its actual value. Quoine unilaterally reversed the relevant trade and B2C2 sued.

At trial, the High Court allowed B2C2's claim for breach of contract and breach of trust. However, it had apparently been conceded that cryptocurrency was a form of property, and the court heard no argument on the point.

On appeal, the Court of Appeal reversed the trial Judge's findings on breach of trust and declined to determine whether cryptocurrency could be property. Menon CJ referred to the UK Jurisdiction Taskforce Legal statement (discussed below) and concluded:

*"There may be much to commend the view that cryptocurrencies should be capable of assimilation into the general concepts of property. There are, however, difficult questions as to the type of property that is involved. It is not necessary for us to come to a final position on this question in the present case."*

**New Zealand Cryptopia [2020] NZHC 728**

*Cryptopia* [2020] NZHC 728 appears to be the only decision anywhere in the common law world where the proprietary status of Bitcoin was fully argued and ruled upon. To understand the judgment, it is necessary to explain how the issue arose.

Cryptopia was a cryptocurrency exchange. It had started as a small-scale operation but had grown as the price of Bitcoin increased. By the time it entered liquidation, it held cryptocurrency worth NZ$170 million (over US$100 million). Its Terms and Conditions had changed over time and were expressed in language which was *"not ideal"*, but the latest version referred to Cryptopia holding assets *"on trust"* for investors.

Investors would deposit their own cryptocurrency (eg Bitcoin) into a '*wallet*' owned by Cryptopia, and could then exchange their cryptocurrency for another (eg Ethereum). Investors' deposits were pooled by currency (ie, all Bitcoin deposits would be in one wallet, all Ethereum deposits in another wallet etc). Some, but not all, of the wallets were hacked, and crypto assets were misappropriated.

Investors in the accounts which had not been hacked argued that they had a proprietary right to receive the full value of their deposits. By contrast, investors in the accounts which had been hacked would be better off if investors were treated as having a purely *personal* right (rather than a proprietary right), because that would result in all the crypto assets being pooled and shared among all the investors.

It therefore became necessary to determine whether investors had a proprietary right to the crypto assets held in their account. Having heard full argument, Glendall J considered at para.69:

*"I reach the conclusion that the cryptocurrencies here situated in Cryptopia's exchange are a species of intangible personal property and clearly an identifiable thing of value. Without question they are capable of being the subject matter of a trust."*

This first instance judgment lends the strongest support yet for the proposition that the common law treats crypto assets as a form of intangible property. However, with respect, it is possible to make various criticisms of the reasoning:

(1) There does not appear to have been any expert evidence on the nature of the various cryptocurrencies in issue, and the Judge appears to have treated them all alike. There were apparently *"several"* different cryptocurrencies misappropriated from Cryptopia (para.13), but the judgment does not tell us what they all were (Bitcoin and Ethereum are mentioned, but there were apparently others). The judgment does not analyse the technical characteristics of these various cryptocurrencies, and how those characteristics might inform the question whether they should be treated as property. The only attempt in the judgment to explain the technical nature of crypto assets is at para.21 of the judgment, where Glendall J quoted from the UK Jurisdiction Taskforce Legal statement. That quotation simply makes clear that there is a wide range of different crypto assets, each with their own peculiar features. This is an important point. However one defines the concept of 'property', the question whether any given crypto-token satisfies that definition will depend on the characteristics of the relevant token. Given the wide range of instruments which carry the label 'crypto asset', it is likely that some will fall within the definition, and some will not. The judgment makes no effort to distinguish between the different categories.

(2) Linked to this, part of the Judge's reasoning included what he described as "*public policy arguments*" (see paras 129-132). The Judge considered that *"honest commercial developments may very well be hindered by a failure of the general law to recognise crypto assets as property"* and that *"Cryptocurrencies have also become popular with honest people as a method of effecting payments and of investing. The traditional banking sector is itself widely reported to be already using block chain technology and to be planning to create trading platforms for cryptocurrencies."* The correctness of this statement (which does not appear to have been based on any expert evidence) is highly doubtful. The sole basis for the finding is an article from Bloomberg which, with respect to the Judge, says nothing of the sort. If supposed

public policy arguments are to be used as a justification for developing the law in a novel way, it is desirable that such decisions are made on the basis of proper evidence as to the social and commercial consequences, rather than a single news article.

(3) The absence of expert evidence as to how different cryptocurrencies work appears to have led the Judge to draw inaccurate comparisons between crypto-tokens and traditional bank deposits. At para.127 of his judgment, the Judge considered that crypto-coins are *"comparable to the electronic records of a bank"* and that the private key used to transfer crypto-coins was like *"a PIN on an electronic bank account"*. This is, with respect, a misunderstanding of how most cryptocurrencies work. In the case of electronic bank records, the electronic ledger is simply a record of a chose in action that the customer has against the bank (where the account is in credit) or that the bank has against the customer (where the account is overdrawn). It is that chose in action which is the *'property'* held by the depositor. It is certainly possible to devise a crypto-token which has 'real- world' legal rights attached to it (a sort of virtual bearer share or bearer bond), and there would be a strong case for treating such a token as an item of property. However, the same reasoning cannot be applied to Bitcoin and other similar crypto assets, which do not have any *'real-world'* legal rights attached.

The UK Jurisdiction Taskforce Legal Statement recognised that the rationale and design of crypto assets may create some practical hurdles to legal intervention but *"that does not mean that crypto assets are outside the law"*. The judiciary, in different parts of the common law world, have followed that line of thinking and the cases summarised above are worthy of deeper analysis.

## Other Guidance

### Cayman Islands Regulatory Regime

On 25 May 2020, the Cayman Islands legislative assembly passed the Virtual Asset (Service Providers) Law 2020 (the *"Law"*). The Law provides a licensing regime for providers of a *"virtual asset service"*. *"Virtual asset service"* is widely defined, including the issuance, exchange, transfer or custody of virtual assets, as well as *"participation in, and provision of, financial services related to a virtual asset issuance or the sale of a virtual asset"*.

Section 4 of the Law provides that any person carrying on or purporting to carry on a *"virtual asset service"* must be registered or licensed (or to have received a waiver from such requirements) in accordance with the Law.

The Law aims to maintain certain standards in respect of licence-holders by requiring the employment of personnel with the necessary skills, appropriate capital adequacy and cybersecurity measures and accounting systems (section 8). Virtual asset service providers must be owned and operated by fit and proper persons, and must comply with anti-money-laundering, data protection and other regulatory requirements (section 9).

Other requirements are imposed on those offering virtual asset custody services (section 10), virtual asset trading platforms (section 11), and issuance of virtual assets on the licence-holder's own behalf (section 12).

Of particular interest is Part 3 of the Law (section 17) onwards, which provides for sandbox licences for a period of up to one year in respect of new and innovative technologies. The Law aims to strike a balance between protecting the public by the imposition of regulatory requirements and encouraging legitimate technological innovation.

The Cayman Islands Monetary Authority is given power to enforce the regime and non-compliance with its requirements can result in a fine and imprisonment. Companies which fail to comply may be wound up (section 34).

### The UK Jurisdiction Taskforce Legal Statement

As discussed above, a committee of experts prepared a legal statement in relation to the status of both smart contracts and cryptocurrencies under English law. Despite the fact that it is not legally binding, judges throughout the common law world have already referred to and relied upon it in reaching interlocutory and final decisions. The legal statement carries substantial weight due to the make-up of the UK Jurisdiction Taskforce, which included Sir Geoffrey Vos (Chancellor of the English High Court) and other distinguished lawyers.[2]

In summary, according to the authors:

(1) Crypto assets have the legal indicia of property, and should be treated as property, even though such assets are intangible, and may work on a decentralized ledger.

(2) The private key grants practical control over the asset, which is one of the indicia of property.

(3) Crypto assets are subject to the protection of English law with respect to insolvency, succession, theft and fraud.

(4) As there is no physical possession of crypto assets, there can be no *"bailment"* of crypto assets, or pledge or lien granted over crypto assets. On that note, crypto assets do not constitute documents of title or negotiable instruments.

2. The foreword to the legal statement makes clear that it reflects the views of the drafting team (four English barristers in private practice), rather than the members of the Taskforce generally. Nonetheless, Sir Geoffrey's involvement has conferred a certain degree of respectability on the legal statement.

(5) It may be possible that "some types of security" may be applied to crypto assets.

It is worth noting that the statement was produced at the behest of the LawTech Delivery Panel, which is an industry-led group that is tasked with supporting the digital transformation of the UK legal services sector. It is also drafted from a rather partisan starting point (i.e. *"Crypto assets and smart contracts undoubtedly represent the future"* and that *"perceived legal uncertainty was the reason for some lack of confidence amongst market participants and investors"*).

**Comment**

The combination of legal guidance, regulation and common law judgments handed down to date, suggest that the default position is that crypto assets will be treated as property. However, not all crypto assets are created equal. Therefore, it will be important for clients and their advisers to analyse the specific nature of the asset and the way it is held/used to determine whether it might fall within the traditional legal definition of property.

Given that Cayman is a world-leader in this space; it is likely that it will be at the forefront of shaping the legal and regulatory regime for crypto assets in the near future. Watch this space. ■

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Since this article was first published, the Crytopia liquidator has started to prepare a distribution model for returning coins held on express trust to beneficial owners (i.e. beneficial owners will receive Crypto as opposed to cash or some other form of property).

# Provisional Liquidation and Restructuring:

## *The Cayman Islands and Hong Kong*

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*As is well known, other than schemes of arrangement Hong Kong has no legislation that provides for corporate debt restructuring or rehabilitation. This unsatisfactory state of affairs has been the subject of much adverse comment for two decades now is brought into unforgiving focus by the economic problems that Covid-19 is causing. It makes it all the more important that the courts of Hong Kong and the Special Administrative Region's practitioners rise to the challenges we now face to find, within the flexibility of the common law, mechanisms to address the financial problems companies face. It is fortunate that great strides have been made in this regard in recent years as illustrated by the authorities referred to earlier in this decision. That having been said it is clearly desirable that some steps are taken immediately to improve the legislative position. Immediate (by which I mean the kind of alacrity shown in other major financial centres around the World in the last couple of months) amendment to section 193 of the Ordinance to provide expressly for provisional liquidators to be given restructuring powers is desirable.*[1]



1. 5 May 2020, Mr Justice Harris, High Court of Hong Kong Special Administrative Region in *The Joint and Several Provisional Liquidators of China Oil Gangran Energy Group Holdings Limited (in provisional liquidation in the Cayman Islands)* [2020] HKCFI 825 at [9].

## Restructuring Reform

With the quote set out above, Mr Justice Harris, the Companies Court judge of the Hong Kong High Court, Court of First Instance, shone a spotlight yet again on a vexing issue that has persisted for many years in Hong Kong and in many offshore jurisdictions: the lack of any legislated, purpose-built corporate restructuring regime other than schemes of arrangement. This is in contrast to, for example, the United States' Chapter 11 process, the administration regimes in the UK and Australia and the new restructuring regime introduced in Singapore in 2017. Legislative reform in the area of restructuring and cross border insolvency has been mooted in Hong Kong for decades, with the Law Reform Commission having made recommendations to implement corporate restructuring legislation as far back as 1996. A similar push towards implementing a new corporate restructuring regime that operates outside of the context of liquidation has been gathering steam in the Cayman Islands for several years. Those efforts have most recently culminated in proposals that would allow Cayman companies to formally restructure their debts outside of a formal insolvency process under the supervision of a qualified insolvency practitioner acting in the capacity of a 'restructuring officer'. The restructuring officer would fill a role similar to that of a 'soft touch' (or 'light touch') provisional liquidator but without the stigma (and potential triggering of *ipso facto* clauses) that is attached to the liquidation process. There would be a stand-alone moratorium imposed to protect the company from creditor action during the period of the restructuring. When, or if, the current proposals might be formalised and put to the Cayman Islands Legislative Assembly for

consideration remains uncertain, but the Cayman profession remains eternally optimistic that reforms will be progressed in the relatively near future.

## 'Soft Touch' Provisional Liquidations in Offshore Jurisdictions

In the meantime, the Cayman Islands will continue to implement corporate restructurings through the use of schemes of arrangement, supported by 'soft touch' provisional liquidations. Bermuda largely follows the same process for the restructuring of companies in its jurisdiction. The scheme of arrangement regimes in both the Cayman Islands and Bermuda are largely modelled on the provisions of Part 26 of the UK Companies Act 2006 and the general processes and procedures for putting a scheme into place will therefore be familiar to English practitioners. English scheme case law is highly persuasive in the offshore jurisdictions and will be followed unless there are any particular local aspects that would justify divergence, which would be quite unusual.

It is possible for a well organised and pre-planned restructuring to be completed relatively quickly in the Cayman Islands, where the time from the filing of a scheme petition to the granting of court sanction of a scheme of arrangement can be as little as 12 weeks. Where, however, the scheme is complex, recognition of the scheme or parallel schemes are required to be implemented in other jurisdictions, or there is active and vocal dissent by creditor groups, the restructuring process can easily run its course over a much longer period. The breathing room offered by a provisional liquidation moratorium on claims during that period is therefore invaluable.

During the period where a restructuring proposal is being developed and promoted by the company, a practice has developed in the Cayman Islands and Bermuda (and more recently in the British Virgin Islands, as seen in the 2019 *Constellation* decision[2]) to seek the appointment of 'soft touch' provisional liquidators.

The High Court of the British Virgin Islands described 'soft touch' provisional liquidation in its decision in *Constellation* (at [3]) as follows:

*The essence of a 'soft touch' provisional liquidation is that a company remains under the day to day control of the directors, but is protected against actions by individual creditors. The purpose is to give the Group the opportunity to restructure its debts, or otherwise achieve a better outcome for creditors than would be achieved by liquidation. It may be appropriate where there is no alleged wrongdoing of the directors.*

The powers of 'soft touch' provisional liquidators are determined by the terms of the appointment order made by the Court and therefore each case will operate along a spectrum of debtor control.


At one end of the spectrum are cases where the directors' powers are suspended for the duration of the provisional liquidation and the provisional liquidators have full control of the restructuring process (for example, in the Cayman restructuring of *LDK Solar*[3]), which arguably is not actually 'soft touch' at all. At the other end of the spectrum are cases where the provisional liquidators' role and powers are expressly limited to the monitoring and supervision of the company's directors as the directors develop and promote a restructuring (for example, in the Cayman restructuring of *Arcapita Investment Holdings Limited*[4]), which is more akin to a traditional debtor-in-possession regime. The Court appointment order, and the powers granted to the provisional liquidators, will be typically be tailored to meet the requirements of the particular case.

The advantages that 'soft touch' provisional liquidations bring to a restructuring derive primarily from the statutory moratorium that is imposed on creditor action following the appointment of provisional liquidators (although secured creditors continue to be entitled to enforce their security). While provisional liquidators are appointed, no suit, action or other proceeding may be continued or commenced against the company except with leave of the Court and subject to such terms and the Court

2. *Re Constellation Overseas Ltd, Lone Star Offshore Ltd, Gold Star Equities Ltd, Olinda Star Ltd, Snover International Inc and Alpha Star Equities Ltd* BHIHC(COM) 2018/0206, 0207, 0208, 0210 and 0212.

3. FSD 14 of 2014.

4. FSD 45 of 2012].

may impose. This allows a distressed company time to develop and promote a restructuring plan, which will most frequently take the form of a scheme of arrangement.

## Access to Restructuring Provisional Liquidation in the Cayman Islands

In order to access the provisional liquidation regime, a winding up petition must first be presented in respect of the company. This can often present a serious public relations challenge where the company conducts business in jurisdictions that are unfamiliar with the provisional liquidation process and its use in restructurings. It can be challenging to reassure directors, shareholders and creditors that the filing of a winding up petition is a necessary gateway to an eventual corporate restructuring, and not the beginning of a process that will lead to the eventual dissolution of the company. The winding up petition also risks triggering contractual defaults, impacting on the value of assets that might be sold as part of the restructuring and causing reputational damage with customers that the company may wish to retain. These issues are some of the strong drivers for the implementation of a corporate restructuring regime that stands outside of the liquidation process.

The Courts in both the Cayman Islands and Bermuda are accustomed to the appointment of 'soft touch' provisional liquidators for restructuring purposes. In the Cayman Islands, section 104(3) of the Companies Law expressly permits a company to apply ex parte for the appointment of provisional liquidators (at any time after the presentation of a winding up petition but before the making of a winding up order) if (1) the company is or is likely to become insolvent and (2) the company intends to present a compromise or arrangement to its creditors. In Bermuda, the power to appoint provisional liquidators for restructuring purposes was confirmed in the 1999 decision of Ward CJ (as he then was) in *Re ICO Global Communications (Holdings) Ltd*,[5] a case where the jurisdiction of the Bermuda Court to make a 'soft touch' provisional liquidation order was challenged, where he concluded:

*"I am satisfied that the Court is given a wide discretion and had jurisdiction under section 170 of the Companies Act and Rule 23 of the Companies (Winding Up) Rules 1982 to make such an Order. Under it the directors of the Company remained in office with continuing management powers subject to the supervision of the joint provisional liquidators and of the Bermuda Court."*

Where an order is made to appoint provisional liquidators, the Court will usually adjourn any extant winding up petitions to facilitate the restructuring. As recently confirmed in *Re Sun Cheong Creative Development Holdings Limited*,[6] the Cayman Islands Grand Court's discretion to appoint provisional liquidators to facilitate a corporate restructuring is broad and flexible. The Chief Justice in that case noted that there is no prescriptive list of factors to be taken into consideration by the Court when exercising that discretion, but cited (at [37]) the following as matters to which the Court may have regard:

*"(1) The express wishes of creditors (though the Court should be cautious not to "count up the claims of supporting and opposing creditors"): Segal J in Re Grant T G Gold Holdings;*[7]

*(2) Whether the refinancing is likely to be more beneficial than a winding up order: Re Fruit of the Loom Ltd;*[8]

*(3) That there is a real prospect of refinancing and/or a sale as a going concern being effected for the benefit of the general body of creditors: Re Fruit of the Loom Ltd; and*

*(4) The considered views of the board as to the best way forward: Re CW Group Holdings Limited.*[9]

In the Cayman Islands, there is an additional hurdle that a company seeking to take advantage of provisional liquidation as part of its restructuring strategy must overcome. The 2015 decision in *Re China Shanshui Cement Group Limited*[10] made it clear that the relevant provision

5. [1999] Bda LR 69 at [6].

6. Unreported, Smellie CJ, 20 October 2020, Cause No. 169 of 2020 (ASCJ).

7. Unreported, Segal J, 21 August 2016, Cause No. FSD 84 of 2016 (NAS)) at [6(f) (iv)].

8. Unreported, Smellie CJ, 26 September 2000, Cause No. FSD 823 of 1999 (ASCJ).

9. Unreported, Parker J, 3 August 2018, Cause No. FSD 113 and 122 of 2018 (RPJ).

10. [2015 (2) CILR 255].

of the Cayman Islands Companies Law[11] requires a winding up petition to be presented by one of the company, its creditors, its contributories or (for regulated businesses) the Cayman Islands Monetary Authority. There is no current legislative authority for a company's directors to cause a winding up petition to be presented unless they have been explicitly granted that power in the company's Articles of Association or have obtained prior authorisation to do so by a resolution of the company's shareholders.

Where that is an issue, a practical work-around has been to have a 'friendly' creditor present the winding up petition, rather than the company. This approach was approved by the Cayman Grand Court in the decision of *Re CHC Group Ltd*[12]. In that case, the company was seeking to have provisional liquidators appointed in order to assist with the implementation of its US Chapter 11 restructuring plan. The company's directors, recognising that following the decision in *China Shanshui* they could not cause the company to petition for its own winding up without shareholder approval, arranged for a related, 'friendly' creditor to present a winding up petition and then immediately caused the company to
file its own application for the appointment of 'soft touch' provisional liquidators under section 104(3). The Court granted the company's application. The reasoning in *CHC Group* has since been followed in *Re CW Group Holdings Limited* at [30] where the Judge stated:

*"There is no dispute that the company may act, as it does here [in making an application for 'soft touch' provisional liquidators under section 104(3) following presentation of a winding up petition by a creditor], through its board of directors without the sanction of a resolution of shareholders passed in general meeting".*

Neither of the decisions in *CHC Group* and *CW Group* addressed the provisions of Order 4, rule 6(1) of the Cayman Islands Winding Up Rules 2008 (as amended) which state: *"Whenever a winding up petition is presented by the company itself the company may apply by summons for an order for the appointment of a provisional liquidator on the grounds contained in section 104(3) of the Law"*. On its face, this would arguably appear to limit the ability of a company to seek orders appointing 'soft touch' provisional liquidators to cases where the company had filed the underlying winding up petition itself – which then squarely revives the original *China Shanshui* difficulties discussed above. It is not apparent from the judgments in either case whether the Court's attention was drawn to this rule, and so there remains the possibility that the 'friendly creditor' work around may in future be subject to challenge.

## Access to Restructuring Provisional Liquidation in Hong Kong

Hong Kong has its own difficulties for companies wishing to use provisional liquidation for restructuring purposes. These stem from the impact of the decision of the Hong Kong Court of Appeal in *Re Legend International Resorts Ltd*[13]. That decision held that the statutory power to appoint provisional liquidators under s193 of the Hong Kong Companies Ordinance (Cap 32) may not be exercised for the sole purpose of restructuring a company's debt. While provisional liquidators in Hong Kong may be granted the power to promote a restructuring, for an appointment to be made in the first place the traditional protective grounds of provisional liquidation must be engaged – that is, the petitioner must establish that the assets of the company are in jeopardy and the appointment of provisional liquidators is necessary to preserve the status quo pending a determination of an extant winding up petition.[14]

Prior to the Legend decision, the Hong Kong Court regularly used provisional liquidation as a tool to assist in corporate rescues, as it continues to be used today in the offshore jurisdictions. Since the *Re Legend* decision, the Hong Kong Court has affirmed on numerous occasions that, notwithstanding the fact that it has no free-standing jurisdiction to appoint restructuring provisional liquidators, it does have jurisdiction at common law to recognise and assist restructuring provisional liquidators appointed by foreign Courts.[15]

This has led to the rather odd situation where in practice 'soft touch' provisional liquidations for restructuring purposes are regularly recognised and assisted by the Hong Kong court, but exclusively in respect of companies incorporated outside of Hong Kong (most often in the Cayman Islands or Bermuda). While odd, this does serve a very practical purpose in Hong Kong, where over 52% of the 2,071 companies listed on the Main Board of the Hong Kong Stock Exchange are incorporated in the Cayman Islands or Bermuda, as are over 91% of the 378 companies on the Growth Enterprise Market of the exchange (all figures as at the end of 2019).

Justice Harris recently commented on the situation in his August 2020 decision in *Agritrade Resources*[16] stating:

*"The proliferation of applications for recognition and assistance in recent years in Hong Kong is largely to be explained by a combination of factors: the corporate structure of many Chinese business groups, the lack of any relevant corporate restructuring legislation in Hong Kong and the impact of the Court of Appeal's decision in Re Legend International Resorts Ltd. Chinese business groups' principal business activities normally take place in the Mainland, but the group*

11. Section 94.

12. Unreported, McMillan J, 24 January 2017, Cause No. FSD 5 of 2017 (RMJ).

13. [2006] 2 HKLRD 192.

14. *Re China Solar Energy Holdings Ltd* [2018] HKCFI 555.

15. See the recent examples of: *Re Z-Obee Holdings Ltd* [2017] HKCFI 2204; *Re the Joint Provisional Liquidators of Hsin Chong Group Holdings Ltd (provisional liquidators appointed) (for restructuring purposes only)* [2019] HKCFI 805; *Re the Joint Provisional Liquidators of Moody Technology Holdings Ltd (in provisional liquidation for restructuring purposes)* [2020] HKCFI 416; *Re China Oil Gangran Energy Group Holdings Limited (in provisional liquidation in the Cayman Islands)* [2020] HKCFI 825; *Re the Joint Provisional Liquidators of Agritrade Resources Ltd (in provisional liquidation in Bermuda)* [2020] HKCFI 1967; *Re the Joint and Several Provisional Liquidators of Rare Earth Magnesium Technology Group Holdings Ltd (in provisional liquidation in Bermuda)* [2020] HKCFI 2260.

16. *Re the Joint Provisional Liquidators of Agritrade Resources Ltd (in provisional liquidation in Bermuda)* [2020] HKCFI 1967 at [4] and [5].

> …I hope that in future this is what will occur and this decision is shown to judges in offshore jurisdictions

*holding company is based in Hong Kong, commonly listed here and incorporated in an offshore jurisdiction. Recognition and assistance has come to be used in one of two situations. The* ***first*** *is to avoid arguments over jurisdiction that can arises if a winding-up petition is presented in Hong Kong. The* ***second*** *involves the use of soft-touch provisional liquidation in the jurisdiction of incorporation, which has come to be used as a technique to overcome the limitations in Hong Kong's own system. As will be apparent from this summary the applications are not driven by events occurring in the offshore jurisdictions. They are driven by events occurring in Hong Kong and the Mainland and techniques developed in Hong Kong.*

*Particularly in the case of the second category I have aimed to establish a process, which provides for quick, cost effective and, so far as possible, uncontroversial recognition and assistance. I have made clear in a number of decisions and also talks to the profession that it is important that the procedures and standard orders that have been developed are used. I have suggested that so far as possible, for example, the letters of request are drafted to be consistent with the Hong Kong procedure and order.... I hope that in future this is what will occur and this decision is shown to judges in offshore jurisdictions in order that they understand the Hong Kong court's approach."*

The principles on which the Hong Kong Court will grant recognition and assistance to foreign insolvency proceedings are well settled and were recently reiterated by the Court in *CEFC Shanghai International Group Limited*.[17] Recognition will be granted if:

(1) the foreign insolvency proceeding is a collective insolvency proceeding (which will include provisional liquidations); and

(2) the foreign insolvency proceeding is opened in the company's country of incorporation.

The eligibility criteria do not require the foreign insolvency proceeding to be capable of being opened in Hong Kong.

The assistance that the Hong Kong Court may grant extends to allowing the foreign provisional liquidators to pursue restructuring options in Hong Kong.[18] Thus the foreign provisional liquidators, once recognised, will be able to undertake actions in Hong Kong that are largely unavailable

17. [2020] HKCFI 167 at [8].

18. *Re Z-Obee Holdings Ltd* [2017] HKCFI 2204.

19. *Re the Joint Provisional Liquidators of Moody Technology Holdings Ltd (in provisional liquidation for restructuring purposes)* [2020] HKCFI 416 at [27] and [28].

to locally appointed provisional liquidators (unless their original appointment satisfies the requirements for a traditional protectionary provisional liquidation).

Earlier this year, the Hong Kong Court commented on this situation, stating in *Moody Technology*:[19]

*"Therefore, foreign provisional liquidators recognised in Hong Kong will not be acting as, acting in the capacity of, or having the status of provisional liquidators appointed by Hong Kong Courts. It follows that the fact that Hong Kong Courts may not appoint domestic soft-touch provisional liquidators cannot constitute a bar to recognising and assisting foreign soft-touch provisional liquidators.*

*To say that recognising foreign soft-touch provisional liquidators would be to bypass and circumvent the Hong Kong domestic provisional liquidation regime would be to misunderstand the true notion of recognition."*

While the Hong Kong Court has left no doubt of its willingness to accede to letters of request issued by foreign courts for the recognition and assistance of foreign restructuring provisional liquidations, in the *Agritrade Resources*[20] and *Rare Earth Magnesium Technology*[21] decisions of August and September 2020 Justice Harris has made it clear that the Court expects applicants to adhere to the streamlined recognition process that has been established and, unless reasonable justification can be shown, to use the standard form of recognition orders that have been approved.

In *Agritrade*, Justice Harris refused to grant a recognition order in the form sought by the applicants on the ground that it was materially different from the standard form. In *Rare Earth Magnesium*, Justice Harris was persuaded to grant orders for the recognition and assistance of 'soft touch' restructuring provisional liquidators that varied from the standard form to address the fact, by virtue of the limited powers granted to the provisional liquidators by the Bermuda Court, a number of the traditional powers granted in the recognition order would only be exercisable with the consent of the company.

In each of the decisions in *Agritrade* and *Rare Earth Magnesium* Justice Harris has appended a copy of the form of order for recognition and assistance that was made. Foreign practitioners would be well advised to take note and to be prepared to offer cogent reasons for any variation to the standard order that they may wish to seek. The Hong Kong Court will expect that any letter of request seeking its assistance will have been prepared with the form of standard order in front of mind.

As Justice Harris noted in the quote that began this article, great strides have been made in recent years by offshore and Hong Kong practitioners and Courts to creatively use the common law cross-border recognition tools at their disposal to compensate for the inability of the Hong Kong Court to appoint provisional liquidators for restructuring purposes alone. By availing themselves of the long standing 'soft touch' provisional liquidation regimes in the offshore jurisdictions, companies incorporated in those offshore jurisdictions have been able to effectively implement corporate and financial restructurings in Hong Kong that would not have otherwise been possible. That effectiveness, however, has its limits and both Hong Kong and the Cayman Islands would benefit from the kinds of corporate restructuring legislative reforms that are being called for in those jurisdictions. ■

20. *Re the Joint Provisional Liquidators of Agritrade Resources Ltd (in provisional liquidation in Bermuda)* [2020] HKCFI 1967.

21. *Re the Joint and Several Provisional Liquidators of Rare Earth Magnesium Technology Group Holdings Ltd (in provisional liquidation in Bermuda)* [2020] HKCFI 2260.

# The Case for Further Reform to Strengthen Business Rescue in the UK and Australia:

## *A comparative approach*

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## Overview

It is a fundamental policy tenet of the insolvency systems in both the United Kingdom and Australia that insolvency laws should be structured to help 'save' and restructure companies and businesses which, despite current financial distress, are viable and have a reasonable prospect of a return to successful trade.

This policy can be traced back to the 1982 CorkReport in the United Kingdom,[1] the recommendations of which became the foundation of the *Insolvency Act 1986* (UK) ("**Insolvency Act**"), and the 1988 Harmer Report in Australia,[2] which largely adopted the recommendations of the Cork Report and led to the subsequent corporate law reform program culminating in the passage of the *Corporationst Act 2001* (Cth) ("**Corporations Act**").

Yet, despite the policy underpinning and the stated objectives of the Insolvency Act and the Corporations Act, in practice the achievement of corporate and business rescue for viable entities has been relatively limited. Notably, in both the United Kingdom and Australia, there has continued to be a lack of cooperation and collectivist action by creditors following the insolvency of a corporate debtor, with creditors typically preferring an individual enforcement approach (if possible), notwithstanding the progress made to advance informal restructuring under the London Approach principles that have gone on to shape informal workouts across the United Kingdom, Europe and Asia over the last decade.

This article commences by examining the recent reforms made by the *Corporate Insolvency and Governance Act 2020* (UK) ("**CIGA**"), which go some way towards advancing the prospect of corporate and business rescue in the United Kingdom, and noting the absence of similar mechanisms other than *ipso facto* enforcement prohibitions in Australia.

The article then focuses on two other areas of law reform that have an important role to play in cultivating a stronger business rescue culture in the United Kingdom and Australia: super-priority debtor-in-possession ("**DIP**") financing and pre-pack business sales.

## The CIGA Reforms

It is expected that the CIGA, which came into force on 26 June 2020, will play an important role in instilling a stronger rescue culture in the United Kingdom.

In particular, the CIGA introduces a new standalone pre-formal insolvency Part A1 moratorium, binding on secured and unsecured creditors as well as landlords for an initial 20 business day period,[3] where an 'eligible' insolvent entity (there is a broad list of excluded companies) requests the moratorium and, in the opinion of an independent monitor, the moratorium will likely result in the rescue of the entity as a going concern. The enforcement moratorium is designed to support informal rescue by preventing major secured creditors, suppliers and landlords from enforcing their strict rights and withdrawing critical assets that may be used by the distressed entity to return to viable trade in the long-term, an outcome in the best interests of all creditors. The moratorium was introduced as a temporary measure for a period which ended on 30 September 2020; this period has now been extended to 30 March 2021.[4]

Further, the CIGA introduces a new standalone Restructuring Plan, a formal rescue process contained in Part 26A of the *Companies Act 2006* (UK). Unlike the existing limitations of both a company voluntary arrangement ("**CVA**") (which is not binding on secured creditors without their consent) and a scheme of arrangement (which requires the approval of 75 per cent in value and a majority in number of each class of creditors), the new Restructuring Plan introduces a 'cross-class cram down'. This permits the court to approve a compromise or arrangement against the wishes of one or more classes of creditors, subject to certain conditions:

a. Condition A – members of the dissenting class would not be any worse off in the Restructuring Plan than they would be in the event of the relevant alternative to the Restructuring Plan (typically this will be liquidation, but could also be an alternative proposal); and

b. Condition B – the Restructuring Plan has been approved by 75 per cent in value of at least one class of creditors (or members), who would receive a payment or have a genuine economic interest in the company in the event of the relevant alternative.

The cross-class cram down is critical to prevent a single (usually out of the money) class of creditors from undermining a viable rescue attempt in the interests of all creditors.

Broader prohibitions on the enforcement of ipso facto contractual rights during formal insolvency are also introduced as part of the CIGA reforms. Together with the Part A1 moratorium, these new processes and rules aim to help preserve an entity's going concern value while a restructuring attempt is negotiated or a source of new funding is negotiated.

In contrast, in Australia, while there are existing ipso facto enforcement prohibitions similar to those introduced under the CIGA,[5] there is no enforcement moratorium available for an insolvent entity prior to the initiation of formal insolvency proceedings. There is also no cross-

1. Report of the Review Committee on Insolvency Law and Practice, Cmnd 8558, 1982.

2. General Insolvency Inquiry, ALRC Report 45, 13 December 1988.

3. This initial period is extendable for a further 20 business days by directors, for up to a year with creditor consent, or for longer with court approval.

4. CIGA, Schedule 4, section 1 set the original period. The Corporate Insolvency and Governance Act 2020 (Coronavirus) (Extension of Relevant Period Regulations 2020, which came into force on 29 September 2020, extended the period.

5. Corporations Act, sections 415D, 434J and 451E.

class cram down mechanism under a deed of company arrangement ("**DOCA**") executed by a company following a period of voluntary administration ("**VA**") or under a creditors' scheme of arrangement. While the court can order dissenting secured creditors, owners and landlords to be bound to a DOCA, such an order is conditional on those entities receiving 'adequate protection',[6] a concept borrowed from the United States Chapter 11 process, and the court accordingly has far less discretion than that afforded to United Kingdom courts under the Restructuring Plan cross-class cram down test. For a creditors' scheme of arrangement, a scheme, as with a CVA in the United Kingdom, cannot even reach the court approval stage unless it is approved by 75% in value and the majority in number of each class of creditors voting on the scheme.

There is currently strong support within the insolvency industry in Australia for a pre-formal insolvency enforcement moratorium and a cross-class cram down mechanism applicable during formal insolvency proceedings, whether under a DOCA, a creditors' scheme of arrangement or an entirely new rescue procedure as implemented by the CIGA, to be introduced under the Corporations Act. The Australian Government intends to consider structural corporate and insolvency law reforms as part of its economic recovery model for Australia in 2020 and 2021, following the expiry of interim relief measures such as the six month moratorium on insolvent trading liability for directors (similar to the moratorium introduced in that regard in the United Kingdom as part of the CIGA reforms).

## The Need for Futher Reform - DIP Financing and Pre-Packs

Two other areas of focus for insolvency law reform in Australia are a dedicated court-sanctioned process for super-priority DIP financing during VA and a legislative process to permit pre-positioned sales (or 'pre-packs') for distressed businesses. Both reforms would materially contribute to a greater likelihood of the rescue of viable entities, an outcome that depends on access to critical working capital (in the form of new financing) and also flexible processes that support a going concern sale with the benefit of pre-insolvency positioning work (subject to suitable safeguards to protect the interests of employees and creditors).

DIP financing was not included as part of the CIGA reforms. And while, unlike in Australia, pre-packs are a common occurrence in the United Kingdom (resulting, at least in part, from more relaxed independence requirements for insolvency practitioners), debate continues in the United Kingdom about the utility of the existing self-regulated pre-pack model. It is interesting to note that the CIGA has revived the power, originally contained in the *Small Business, Enterprise and Employment Act 2015* (UK), enabling the Government to introduce regulations restricting the scope of pre-packs on or before 30 June 2021, a point returned to below.

6. Corporations Act, sections 444F(3) and 444F(5).

## DIP Financing

Working capital is the lifeblood of any business. Insolvency, necessarily, results in endemic illiquidity. For entities that have a realistic prospect of resumed long-term trade under a viable business plan, new funding is indispensable to a successful restructuring. Depending on their level of exposure, existing creditors may often be reluctant to advance new money, and in any case any decision to provide additional funding is idiosyncratic and based on a creditor's broader loan and investment portfolio. DIP finance, with super-priority status for new lenders, provides an incentive that underpins an active rescue financing market and thereby supports a stronger rescue culture.

DIP financing is a common practice in the United States as part of the insolvency rescue framework in Chapter 11 of the Bankruptcy Code. There are a number of priority options for new funding under Chapter 11.

First, a debtor may, following a Chapter 11 filing, obtain additional unsecured credit as an administrative expense, so that it ranks alongside other such expenses as a first priority payment out of the debtor's unsecured property.[7] When obtained outside the ordinary course of business, as is invariably the case in the context of a restructuring attempt under Chapter 11, court approval is required.[8] Importantly, a creditor advancing funds on this basis does not obtain priority overany existing secured creditors.

Secondly, if a debtor cannot obtain funding on that basis, the court may authorise a debtor to obtain DIP funding that either receives priority over all administrative expenses, is secured by a lien over the debtor's unencumbered property or otherwise a junior lien (subordinate to existing security interests) over encumbered property.[9]

And finally, if a lender is not willing to provide funding on either of those bases, the court may order that the lender is entitled to a lien that is senior or equal to existing security interests over the debtor's encumbered property.[10] However, such an order is conditional on the secured creditors who are to be 'primed' by the grant of this super-priority security interest in favour of the new lender receiving 'adequate protection'. That protection may consist of replacement security, guaranteed principal and loan repayments (typically at the interest rate applicable prior to the Chapter 11 filing) or may otherwise be deemed to exist if existing secured creditors are 'over-secured' with a sufficient equity cushion with respect to their loans.

The United States DIP financing model was adopted in Singapore in March 2017 under a new scheme of arrangement rescue process introduced by the *Companies (Amendment) Act 2017*.

In the United Kingdom and Australia, while new funding provided during a period of administration, due to an administrator's personal liability for new borrowing, ranks as an expense of the administration (receiving priority over the administrator's remuneration, floating charge realisations and unsecured debts), there is no mechanism for the court to provide a new lender with super-priority status, with repayment of the funds advanced ranking ahead of existing fixed charge debts.

Rather, any such arrangement depends on private negotiation between existing lenders as part of a refinancing arrangement to support a rescue attempt. The dominant individual creditor enforcement culture in Australia has meantthat such an outcome has been a rarity in practice. That has also been the case in the United Kingdom, notwithstanding a more active creditor cooperation experience to which the CIGA will give further impetus.

One option in Australia is for an administrator to apply to the court under section 447A of the Corporations Act for an order modifying the usual legislative provisions concerning creditors' rights during a period of voluntary administration. Potentially, an order could include the conferral of super-priority status on a creditor advancing new funds in support of the primary aim of voluntary administration to save the company, or as much of its business as possible, in the event of insolvency.[11]

Since the outbreak of COVID-19, the courts have shown a greater willingness to make broad-based orders under section 447A relieving administrators from personal liability for rental and loan payments and deferring the enforcement rights of creditors in an attempt to enhance the prospect of the successful restructure of entities that are shown, in evidence provided to the court, to have a reasonable likelihood of viable trade. Most recently, orders of that kind have been issued in various proceedings involving the restructure of Australia's second major airline, Virgin Australia.[12]

Yet section 447A provides only an ad hoc mechanism for orders to be made in an individual insolvency, and there is no specific facilitative provision to permit DIP finance with the benefit of a set of criteria similar to that adopted under Chapter 11 of the Bankruptcy Code. Ordering super-priority DIP finance would still be a big leap for a court, even in the context of the widespread economic and financial impact of COVID-19 across so many industries, and even if ordered in an individual matter, one-off cases examples are no substitute for clear, certain legislative criteria that reduces costs and improves efficiency and certainty in the interests of insolvency practitioners and creditors.

7. Corporations Act, sections 444F(3) and 444F(5).

8. Bankruptcy Code, section 364(b).

9. Bankruptcy Code, section 364(c).

10. Bankruptcy Code, section 364(d)(1).

11. Corporations Act, section 435A.

12. See, for example, *Re Virgin Australia Holdings (No 1) [2020] FCA 571*; *Re Virgin Australia Holdings Ltd (Administrators Appointed) (No 2)* [2020] FCA 717; *Re Virgin Australia Holdings Ltd (Administrators Appointed) (No 3)* [2020] FCA 726; and *Re Virgin Australia Holdings Ltd (Administrators Appointed) (No 4)* [2020] FCA 927.

> *A pre-pack, in essence, involves the informal negotiation of the sale of the business of a financially distressed company with involvement from the company's directors and an insolvency practitioner*

In the United Kingdom, absent any specific legislative regime for DIP financing, the only existing option is for an administrator to enter into a new contract having super-priority under paragraph 99(4) of Schedule B1 of the Insolvency Act. Although liabilities pursuant to new contracts do not gain priority over fixed charge holders, they do rank above floating charge holders by virtue of paragraph 99(3) of Schedule B1. In appropriate cases, it is possible for that super-priority to include a roll-up of pre-administration debt, provided the roll-up can be regarded as an expense 'properly incurred' within the meaning of rule 3.51(2) of the Insolvency Rules 2016 (UK), and provided further that it is a liability restated under the new contract, entered into as a result of a 'positive and conscious act' of the administrator.[13] This is in effect a limited 'back door' DIP financing process in the United Kingdom.

## Pre-Packs

A pre-pack, in essence, involves the informal negotiation of the sale of the business of a financially distressed company with involvement from the company's directors and an insolvency practitioner, followed by the appointment of that same practitioner as the company's administrator and the implementation of the previously negotiated sale by the administrator.

A pre-pack can improve efficiency and substantially lower the costs that would be incurred in a protracted administration process, while also cutting short the delay that risks secured creditors, landlords and major suppliers enforcing their rights during administration (subject to the limited scope of the existing enforcement moratoria in both the United Kingdom and Australia) in a manner that renders a rescue attempt impossible.

A successful going concern sale also ensures the optimal investment of capital in value-creating, viable businesses in the interests of broader economic efficiency. However, fairness concerns arise from the potential for a sale to be made to related parties, as well as a possible conflict of interest which may arise due to the completion of a quick sale upon appointment without proper investigation of possible breaches of duty by directors that have appointed a 'friendly administrator'.

In July 2013, the United Kingdom Government commissioned a review into the pre-pack process. *The Graham Review into Pre-Pack Administration* ("**Graham Review**") was completed in June 2014, and found that pre-packs enhance the prospect of rescuing viable businesses, thereby preserving jobs, while avoiding the substantial cost of formal insolvency measures.[14] However, to ensure appropriate transparency and a robust sale process maximising the return achieved for the sale of the business, the Graham Review recommended:

a. the creation of a 'pre-pack pool' consisting of a pool of independent experts, with purchasers of a business having a connection with the existing controllers able to, on a voluntary basis, approach the pool to give an opinion about the sale (the pre-pack pool was subsequently established by the United Kingdom Government on 2 November 2015);

b. the ability for connected purchasers, again on a purely voluntary basis, to complete a 'viability review' of the business; and

c. a self-regulation model, under which insolvency practitioners would be required to conduct a pre-pack sale in accordance with six principles of good marketing and to commission an independent valuation, with compliance to be monitored by recognised professional bodies.[15]

The Graham Review also recommended that the United Kingdom Government 'consider legislating' if these recommendations did not have the 'desired impact'.[16] As noted above, a reserve power was created to enable the Secretary of State to introduce such legislation, in its discretion, under the *Small Business, Enterprise and Employment Act 2015* (UK). There was an

13. *Laverty v British Gas Trading Ltd* [2015] 1 BCLC 295 at [64].

14. Graham Review, 6-7.

15. Graham Review, 10.

16. Graham Review, 10.

original sunset date of 25 May 2020 applying to this reserve power that has now been extended until 30 June 2021 as part of the *CIGA* reforms. The reserve power has not, since its original introduction, been resorted to by the Secretary of State.

Views differed widely on the effectiveness of the United Kingdom pool process. Some took the view that it is enough to comply with the provisions of SIP 16, which sets out the principles and took standards with which an insolvency practitioner must comply when dealing with a pre-pack sale. Others took the view that the mere availability of the pre-pack pool, and even more so its use, is vital to keep pre-packs under scrutiny, and to ensure that they are effective.

In particular, a pool member is able to offer an opinion on the purchase of a business and/or its assets with a connected party (within the meaning of section 435 of the Insolvency Act). The benefit of approval by the pool is that it is an imprimatur of reasonableness, of sorts. That said, the pool member has no powers. He or she will issue an opinion on the reasonableness of the grounds of the proposed pre-pack sale, but will not determine whether the sale can proceed. The pool member can issue one of three opinions (nothing found to suggest that the grounds for the proposed pre-pack are unreasonable, evidence provided has been limited in some areas but otherwise nothing has been found to suggest that the grounds for the proposed pre-pack are unreasonable, or there is a lack of evidence to support a statement that the grounds for the proposed pre-pack are reasonable). No reasons for a decision are given and there is no basis on which to appeal the decision of a pool member. The administrator can, of course, supplement the evidence after the submission to the pool, and in any event the decision remains with the administrator to determine whether the sale is reasonable or not as an incident of the administrator's ordinary powers and duties under the Insolvency Act andat general law.

Only about 10 per cent of eligible cases are referred to the pool. This relatively low take up probably resulted from the general view that insolvency practitioners were happy to take views on pre-packs without the extra comfort of a pool opinion. However, on 8 October 2020 the Government stepped in. It has now proposed new regulations to ensure that more cases are referred to the pool. The draft regulations propose a new regulatory framework that will apply in any case where there is a disposal in administration of all or a substantial part of a company's assets. In such a case, an administrator will be unable to dispose of property of a company to a person connected with the company within the first eight weeks of the administration without either the approval of creditors or an independent written opinion. The connected party purchaser will be required to obtain the written opinion. The provider of the opinion is required to be independent of the connected party purchaser, the company, and the administrator and is required to meet certain eligibility requirements. The administrator must have no reason to believe that the opinion provider is not independent of the connected party or does not meet the eligibility requirements. The opinion provider will provide a written report to state that either the case is made for the disposal or that the case is not made. A connected party purchaser may obtain more than one report. An administrator must consider a report from an opinion provider. Where a report states that the case is not made for the disposal, an administrator can still proceed with the disposal but will be required to provide a statement setting out the reasons for doing so. An administrator will be required to send a copy of the report(s) to creditors of the company and to Companies House. It is intended that these new regulations will come into force as soon as possible, and in any event before June 2021.

In addition to the draft regulations, the Government has made it clear that it intends to work with the industry to provide guidance and update SIP 16 to provide more information to creditors. In particular, the Government has

identified a wish to ensure that there is greater adherence to the principles of marketing (or that where no marketing has been undertaken that this is fully explained by the administrator and any explanation probed by the regulator where necessary). The Government also wishes to ensure that there is a continued increase in compliance with the reporting requirements under SIP16. It even has its eye on viability reports, asking why they are not being completed and how this could be improved. If that voluntary guidance is not adhered to, and if the quality of the information provided to creditors and the transparency of pre-pack sales in administration does not noticeably increase, the Government has already indicated that it will consider whether supplementary legislative changes are necessary.

So much change, cost, and additional compliance requirements are therefore on their way in the UK. Whether this is really needed is another question. The reality is that creditors are often critical of a pre-pack. But that does not mean that pre-packs are by their very nature suspicious or wrong. Proper compliance with SIP 16 and effective insolvency practitioner oversight and integrity should really be sufficient. However, it seems clear that such a route will no longer be countenanced. Increased legislative control is plainly on its way.

In Australia, pre-packs have been a rare occurrence in practice. This is primarily due to strict independence requirements, with the traditional approach taken by the courts that administrators cannot have any actual or perceived conflict of interest, and any substantial involvement with a company and its directors prior to administration unlikely to meet that standard.[17]

Nevertheless, in a 2017 decision, *Re Korda; Ten Network Holdings Ltd (Administrators Appointed) (Receivers and Managers Appointed)*[18] (‘***Ten Network***’), the Federal Court of Australia held that substantial prior involvement is not, of itself, cause for a reasonable apprehension of bias on the part of an administrator. Rather, if substantial involvement in pre-positioning work enhances value for creditors, through reduced costs and a fair sale price, and appropriate safeguards are put in place such as full disclosure of the pre-positioning work undertaken and the costs involved, as well as the possible court-ordered appointment of a special purpose administrator to investigate the primary administrator’s conduct and the circumstances of the sale (as occurred in *Ten Network* itself), a court may be willing to find that the independence requirements are met.

However, the decision in *Ten Network* was made in the context not of a ‘traditional’ pre-pack (completed without the involvement of creditors and with the counter-party already identified by the time of the administration) but rather a ‘planned insolvency’ in which the pre-positioning work involved an informal restructure attempt with broad-based negotiations with substantial creditors, before formal insolvency proceedings were commenced only when those negotiations broke down. Justice O’Callaghan expressly noted that ‘it would be difficult to imagine a situation where an insolvency practitioner would be permitted to take an appointment’ following involvement in a traditional pre-pack.[19]

Accordingly, there continues to be a lack of confidence from administrators to attempt a pre-pack in Australia.

A pre-positioned sale framework, based on a model proposed by the Australian Restructuring, Insolvency and Turnaround Association (‘**ARITA**’), under which an advisor involved in the pre-positioning work could not be subsequently appointed as a company’s administrator and the sale negotiated would be subject to statutory review,[20] was endorsed by the Australian Productivity Commission in 2015[21] but was not introduced by the Australian Government. This is the model that has most industry support in Australia and is likely to be the Government’s first preference in the structural reform process in 2020 to 2021.

17. See, for example, *Commonwealth v Irving* (1996) 144 ALR 172; *Domino Hire Pty Ltd v Pioneer Park Pty Ltd* [2000] NSWSC 1046.

18. (2017) 252 FCR 519.

19. *Ten Network*, 526.

20. Australian Restructuring, Insolvency and Turnaround Association, Policy Positions, February 2015, Policy 15-11 (Pre-Positioned Sales), 17.

21. Australian Government, Productivity Commission, *Business Set-Up, Transfer and Closure*, Final Report, 7 December 2015, 37.

## Conclusion

With the expected influx of new insolvency matters globally in the remainder of 2020 and in 2021, there is a need for insolvency laws that balance fairness for creditors with efficiency and flexibility. A key priority in that regard is having an insolvency system that maximises the prospect of a distressed company or business that is viable, notwithstanding current financial distress, being restructured so that it can continue to trade in the long-term for the benefit of all creditors, as well as shareholders and the broader community.

The CIGA reforms have positioned the United Kingdom as a leader of flexible and effective informal and formal restructuring processes, and these reforms are already serving as a best practice model in the law reform process in other jurisdictions across the world, including Australia and in the Asia-Pacific.

An additional measure, currently absent from the insolvency regimes in both the United Kingdom and Australia, that would enhance the prospect of corporate and business rescue for viable entities is a DIP super-priority financing system modelled on the United States Chapter 11 process (which was also recently adopted in Singapore). Given the difficulty of obtaining new financing in a distressed asset scenario, a DIP financing regime would help to incentivise new working capital critical to the success of a rescue attempt. Further, Australia would benefit from a pre-pack regime – already an established feature of the insolvency process in the United Kingdom – to improve the cost-effectiveness, timeliness and viability of a rescue attempt. However, while the United Kingdom is likely to continue its existing self-regulated model pursuant to the provisions of SIP 16 and the voluntary pre-pack pool process, rather than introduce mandatory regulatory measures, in Australia the long-held industry and court mistrust over the pre-pack process will likely see a mandatory compliance model introduced if pre-packs are included within the scope of the Australian Government's structural reform process in 2020 to 2021.At a minimum, that model will likely prevent a practitioner involved in the pre-pack sale process from accepting a subsequent appointmentas administrator, as well as require a sale to be subjected to a mandatory review. On that basis, the contrast in the regulatory approaches to pre-packs in the United Kingdom and Australia will not change soon. ■

*[Scott Atkins is Partner, Chair and Head of Risk Advisory, Norton Rose Fulbright and Vice-President of INSOL International]*

*[Dr Kai Luck is Executive Counsel and Director of Strategic Insights, Norton Rose Fulbright]*

# New Tenants *at South Square*

## Jamil Mustafa

Before coming to the Bar, Jamil graduated with a First Class degree in Government and History from the London School of Economics and Political Science. He was then awarded a Master of Philosophy degree in American History with Distinction from the University of Cambridge, where he ranked first in his class. Subsequently, Jamil obtained a Distinction on the Graduate Diploma in Law from City, assisted by a Lord Bowen Scholarship from Lincoln's Inn. He then completed the Bar Course, as a Lord Denning Scholar of Lincoln's Inn, receiving an Outstanding grade. In the §year before commencing pupillage, Jamil studied the Bachelor of Civil Law at the University of Oxford, graduating with a Distinction.

Over the course of his pupillage, Jamil gained exposure to all of Chambers' core areas of practice, including insolvency and restructuring, banking and finance, commercial litigation and arbitration, company law, and civil fraud. He was supervised by Stephen Robins, Marcus Haywood, William Willson, Adam Al-Attar, Henry Phillips, Alexander Riddiford and Toby Brown.

As a pupil, Jamil assisted on a variety of matters spanning Chambers' areas of practice, including the subordinated debt litigation arising out of the collapse of Lehman Brothers *(In re LB Holdings Intermediate 2 Limited (in administration)*); a potential application under Part 2 of the Banking Act 2009; litigation concerning securitisation structures (for example, *Business Mortgage Finance 6 Plc v Roundstone Technologies Ltd*); a dispute between the investors and administrators of a medical research company *(Re Fortuna Fix Ltd (in administration)*); and a multi-million pound classic car finance dispute. ■

## Paul Fradley

Paul Fradley graduated with a First Class degree in Jurisprudence from the University of Oxford, ranking second in his year and winning six University prizes. He subsequently completed the Bachelor of Civil Law (BCL) at the University of Oxford, in receipt of a number of scholarships, and graduated with a Distinction. He was called to the Bar by Gray's Inn as a recipient of the Inn's most prestigious scholarships for both the Bar Course and Pupillage (the Bedingfield and Reid Scholarships).

Before joining South Square, Paul tutored Undergraduates in the Law of Trusts at both St Anne's and University Colleges, Oxford between 2018 and 2019. During the Bar Course he was awarded the Norman Tapp Memorial Prize for Advocacy by Gray's Inn.

As a pupil, Paul gained exposure to all of Chambers' core areas of practice, including corporate insolvency and restructuring, bankruptcy, banking and finance, commercial litigation, offshore, company law and trusts. He was supervised by Stephen Robins, Marcus Haywood, Alexander Riddiford, Adam Al-Attar, William Willson, Henry Phillips, and Matthew Abraham.

During pupillage, Paul assisted on a number of major matters. These included the administration of Thomas Cook, a transaction at an undervalue claim in *Re Hirji*, a claim for wrongful trading (*Manolete v Ellis*), a pending Court of Appeal decision on the scope of the Ralli Bros principle, and litigation on the ISDA Master Agreement arising out of the administration of Lehman Brothers. Paul also worked on a number of offshore matters including the drafting of particulars for a major conspiracy claim in the Cayman Islands and advising on privilege issues in Cayman proceedings.

Paul will be taking part in the Judicial Assistant scheme in the High Court between January and March 2021, where he will be based in the Chancery Division. ■

# Insolvency and Restructuring in a Pandemic – *the Global View from the Boardroom and the Courtroom*

HON. PAUL HEATH QC

On 14 October 2020 (or the early hours of 15 October 2020 for me) P.R.I.M.E Finance presented a webinar entitled *"Insolvency and Restructuring in a Pandemic – the Global View from the Boardroom and the Courtroom"*. The purpose of the webinar was to identify ways in which the business community and Judges had adapted to dealing with insolvency and restructuring issues during the Covid-19 pandemic.

The panel was moderated by Hon Judge Elizabeth Stong of the US Bankruptcy Court. Mr Justice Nick Segal of the Grand Court of the Cayman Islands, James H M Sprayregen, Restructuring Partner at Kirkland & Ellis LPP, and I made up the panel. James Sprayregen spoke about the impact of the pandemic on the business community, his predictions for the future, and his perception of how courts were dealing with insolvency issues arising out of it. Mr Justice Segal explained the procedures and practices that the courts in the Cayman Islands, and in England and Wales, had put into place to deal with applications in circumstances where it was not possible for counsel, parties or witnesses to attend at court. My role was to speak about how court processes had been adapted in the Asia/Pacific region and to suggest other ways in which business needs might be met through alternative dispute resolution.

James Sprayregen recalled that the impact of the pandemic really struck him on 12 March 2020, when the NBA was shut down. He characterised the first stage of the lockdown in the United States as one involving a wave of induced bankruptcy and restructuring, amounting to a culling of the weakest businesses, primarily in the retail and energy areas. Those business would, he suggested, have gone into bankruptcy anyway. He saw the second stage as commencing when a large stimulus package was passed by the United States Congress. This provided much needed liquidity and enabled businesses to survive, albeit by increasing their debt. The likelihood of heavily leveraged businesses failing next year was discussed. Mr Sprayregen suggested that many may not go out of business but were likely to be subject to change of control transactions, where old equity may be eliminated and some junior and/or senior debt converted.

The question was posed: Is there a stage 3? Mr Sprayregen pointed to the inability to trade in a zero cash environment over a prolonged period as a reason for believing it was likely that greater number of bankruptcy cases would be filed. That assessment was based on the premise that things would not get *"incredibly worse"*. Sadly, as we all know, since 14 October 2020, the number of Covid-19 cases and deaths resulting have increased markedly, both in the United States and Europe.

Mr Justice Segal noted the court delays that had been caused by virus related issues. That had led to a greater number of applications for extensions of time and adjournments. He pointed to the conduct of court business shifting to remote hearings, whether by telephone, video-link or on the papers. A number of decisions of the English Courts were advanced as useful precedents for the conduct of remote hearings. He added that, when restructuring was involved, Court ordered meetings were often scheduled on a remote basis.

The Judge spoke also of the difficulties in maintaining an open justice regime in circumstances where courts were not open for the public to attend. The prompt dispatch of urgent insolvency and restructuring business has to be balanced against the ability of all stakeholders to participate in it. That is not an easy balancing exercise.

As with the Cayman Islands, where Mr Justice Segal presides over many hearings by audio-visual link from London, a similar approach has been taken in other Asia/Pacific jurisdictions; for example Australia and Singapore. That seems to have worked well, and practitioners and Judges have adapted well to the new environment.

Telephone hearings involving short banco argument have been common in New Zealand since (at least) the mid-1990s. During the early stages of the pandemic, most New Zealand Court hearings were conducted by audio-visual link. I spoke of my own experience in Bankside Chambers in Auckland, from where two members of the Court of Appeal of the island nation of Samoa presided over an appellate hearing in which the third member of the court was in Samoa, together with counsel. The hearings proceeded without difficulty. After counsel completed submissions, the Judges were able to deliberate over the same audio-visual link platform.

Undoubtedly, the time will come (probably some time next year) when the courts are overwhelmed by cases and have difficulty in resolving them with sufficient expedition. I spoke of the circumstances in which arbitration or mediation might be used to resolve such cases. Felicity Toube QC and I are co-chairs of INSOL International's Mediation Colloquium which has considered these issues, and I explored some of those options with the audience.

I mentioned a recent innovation in New Zealand, involving the Farm Debt Mediation Act 2019, which came into force on 1 July 2020. New Zealand is a country that is dependent upon agricultural exports. There are many large farms, generally sheep or dairy, as well as orchards and vineyards of various types. They constitute some of the country's biggest businesses. Under the Farm Debt Mediation Act it is a prerequisite to the lender enforcing a security that a mediation take place first. I spoke of a case in which I was involved as mediator. The amount of debt owed to the banks was in excess of $50 million. Subsequent to the webinar, that mediation took place. A successful outcome was achieved. I think both lenders and debtor were surprised at how useful the process was.

Through Judge Stong's expert moderation, the seminar was able to deliver on its promise of providing insight into the way in which business is viewing the court's responses to the pandemic, the view of how that is being done from the Bench, and some options as to alternative ways in which disputes could be resolved. ■

*The webinar is available to be viewed on P.R.I.M.E. Finance's website at:*
https://us02web.zoom.us/rec/play/b_aN62s9s5A0jIUcDJTRXKSJfmgxHO8aUi05AmlUTzS8Eh8lbeYf_6CkEMZ8kwp2yTlBbiTs7GZM6Bjs.EblKCJCTvV7DTmBb

# CHAMBERS BAR AWARDS 2020

## A triple win for South Square

We were absolutely delighted to be named as Company/Insolvency Set of the Year for the fourth year running at the 'virtual' Chambers Bar Awards held on Thursday 19 November 2020.

Not only that, Tom Smith QC was named Company/Insolvency silk of the year and Stephen Robins Company/Insolvency junior of the year. We are tremendously grateful to all our clients and friends for your ongoing support.

**TOM SMITH QC**
Company/Insolvency
Silk of the Year

*"He has an incredible work ethic, is very approachable and is a super, super person to work with"*

**STEPHEN ROBINS**
Company/Insolvency
Junior of the Year

*"He has a deeply impressive, encyclopaedic knowledge of insolvency law and he's also a robust and effective advocate"*

SOUTH SQUARE

COMPANY/
INSOLVENCY
SET OF THE YEAR

Chambers
Winner
UK Bar
2020

# Case Digest Editorial

**Clara Johnson**

Although the country has remained under restrictions, and has been locked down for a second time, the wheels of justice keep turning. As the cases digested below demonstrate, the courts at all levels have delivered a plethora of important decisions over the past few months, in which many Members of Chambers have appeared.

Perhaps the most ground-breaking of all is the Supreme Court's decision in *Sevilleja v Marex Financial Ltd* [2020] UKSC 31. The case is digested by Edoardo Lupi in the Company Law section below, but deserves particular mention here. This case concerned the principle of reflective loss. The question for the Supreme Court was whether the principle should survive, and if so, to what extent. The choice was between abandoning the last 40 years of law, which started with the decision in *Prudential Insurance Co Limited v Newman Industries Limited (No 2)* [1982] Ch 204 or only the last 20 years, namely, the judgment of Lord Millett in *Johnson v Gore-Wood & Co* [2002] 2 AC 1 and what followed from there. The majority decided to retain the principle, as it had been articulated in *Prudential Insurance* and developed in the judgment of Lord Bingham in Johnson v Gore-Wood, and consigned to history the judgment of Lord Millett. The facts of *Marex* starkly demonstrate why a review of the law of reflective loss was required. Mr Sevilleja was the owner of two BVI companies involved in foreign exchange trading (the 'Companies'). Marex was a creditor of the Companies and successfully brought proceedings against them in the Commercial Court. Upon receiving the draft judgment, Mr Sevilleja arranged for virtually all funds held by the Companies to be transferred to him. The Companies were unable to satisfy the judgment and were subsequently wound up. A liquidator was appointed and funded by Mr Sevilleja, but failed to take any steps to investigate the payment of the Companies' funds to Mr Sevilleja. Marex subsequently brought proceedings against Mr Sevilleja seeking damages for inducing the violation of Marex's rights and for unintentionally causing loss by unlawful means. Mr Sevilleja argued that certain of the amounts claimed could not be recovered because they were merely reflective of the loss suffered by the Companies and that the reflective loss principle applied to claims by creditors (not just shareholders), relying on *Gardner v Parker* [2004] 2 BCLC 554 (which in turn relied on Lord Millett's speech in *Johnson v Gore Wood*).

The majority (Lord Reed PSC, Lord Hodge DPSC, Lady Black and Lord Lloyd-Jones JJSC) held that the speech of Lord Bingham in *Johnson v Gore Wood* was consistent with Prudential but that Lord Millett had wrongly based his reasoning on the rule against double recovery – a principle of much wider application. This was problematic because that rule is premised on recognising that a shareholder's loss exists, but does not permit it to be recovered, whereas the rule in *Prudential* is premised on the basis that the shareholder has not suffered any loss at all. This had led to erroneous extension of the principle to apply to creditors. The rule does not apply to creditors but only to shareholders and only where the loss suffered is the diminution in the value of their shareholding or the dividends received. The appeal was allowed and *Gardner v Parker* was overruled.

The minority (Lord Kitchin, Lord Sales JJSC and Baroness Hale) agreed with the majority on the result but in his speech, Lord Sales reasoned that the 'bright line' favoured by the majority may favour simplicity but may work an injustice in some cases where the shareholder does suffer a loss which is different from the loss suffered by the company. A shareholder should not be prevented from pursuing a valid claim but where

there is the risk of double recovery, this should be addressed by case management or subrogation.

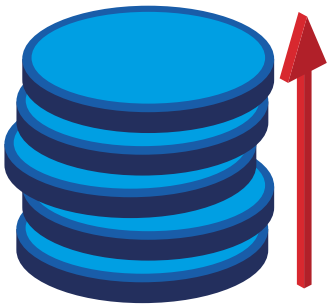
Whilst the 'bright line' rule does provide a strong measure of clarity and certainty, there is likely to be continuing debate around the scope of the rule. The principle will not apply where the shareholder's loss is 'separate and distinct' to the company's loss (a principle developed by Lord Bingham in Johnson v Gore Wood). However, the distinction between the company's loss and the shareholder's loss may be very fine and there will inevitably be litigation around the precise scope of this exclusionary rule.

A further important decision is *Virgin Atlantic Airways Limited* [2020] EWHC 2191 and [2020] EWHC 2376 (in which David Allison QC, Ryan Perkins and Lottie Pyper appeared) digested by Ryan Perkins and Daniel Judd in the Corporate Insolvency section below (and subject to a full analysis by Lottie Pyper also in this Edition). This is the first decision under Part 26A of the Companies Act 2006 and will be an important reference point for future cases. The decision of the Supreme Court in *Michael J Lonsdale (Electrical) Ltd v Bresco Electrical Serivces Limited* [2020] UKSC 25 is also digested here, a decision concerned the inter-relationship of the mandatory insolvency set-off under the insolvency rules and the construction adjudication regime, which the Court held were not incompatible. Also digested in the Corporate Insolvency section are the two decisions in *Re Sunbird Business Services* [2020] EWHC 2493 and [2020] EWHC 2860 (in which Henry Phillips appeared). Snowden J refused to sanction a scheme of arrangement, despite it having been approved by the requisite majorities of scheme creditors. A second application was subsequently made in respect of new scheme (which was granted).

A further important decision in the field of arbitration is *Enka Insaat Ve Sanayi AS v OOO Insurance Company Chubb* [2020] UK SC 38 (in which Robin Dicker QC appeared) set out in the Commercial Litigation section below. This will undoubtedly be a leading authority on the principles for ascertaining the proper law of an arbitration agreement and the role of the court of the seat of the arbitration in granting anti-suit injunctions.

There are several other interesting cases digested here, which are all well worth a read. ■

# Case Digests



## Banking and Finance

**Digested by Stefanie Wilkins**

### Lamesa Investments Limited v Cynergy Bank Limited

**[2020] EWCA Civ 821 (Sir Geoffrey Vos, Males and Arnold LJJ) 30 June 2020**

*Facility agreement – Sanctions against lender – Repayments of interest*

The Court of Appeal's judgment concerned the interpretation of a facility agreement by which Cynergy had borrowed funds from Lamesa, and was obliged to pay interest at half-yearly intervals. Lamesa's ultimate owner was an individual who, after the facility agreement was executed, became the subject of US sanctions, with the result that Lamesa itself became a blocked person within the meaning of the US legislation. The effect of that designation was that persons dealing with it became subject to the US sanctions legislation.

Clause 9.1 of the facility agreement provided that Cynergy would not be in default in failing to pay interest if *"during the 14 days after [Lamesa's notice requiring payment] it satisfies [Lamesa] that such sums were not paid in order to comply with any mandatory provision of law, regulation or order of any court of competent jurisdiction"*. The Chancellor (who delivered the leading judgment) considered that the purpose of the provision was to strike a balance between the lender's interest in timely payment, and the borrower's desire not to contravene some other legal obligation. The question for the Court was whether Lamesa's failure to pay interest fell within the scope of Clause 9.1.

Applying uncontroversial principles of contractual interpretation, the Chancellor emphasised three aspects of the context: Clause 9.1 was in standard terms; its terms mirrored the EU Blocking Regulation, which treated that wording as applicable to US sanctions legislation (and the parties must have known that); and US secondary sanctions would have been one potential problem at the relevant time. Further, his Lordship observed that if Clause 9.1, in referring to *'mandatory provision[s] of law'*, referred only to direct prohibitions against payments by the borrower, it would have virtually no effect. Accordingly, the Court concluded that the proviso in Clause 9.1 was applicable to US secondary sanctions legislation.■

### Aegean Baltic Bank SA v Renzlor Shipping Ltd

**[2020] EWHC 2851 (Comm) (Adrian Beltrami QC, sitting as a Judge of the High Court) 30 October 2020**

*Settlement of insurance claims – Duty owed by assignee of claims under security documents*

The Claimant bank made available to the Defendant shipowner a loan to finance expenses associated with the vessel. The related security documents provided that, in the event of a default under the loan, the bank was entitled to require that all polices relating to the insurance of the vessel be delivered to its brokers, and to recover any claims; there was also a power of attorney in favour of the bank. Following damage to the vessel, the bank negotiated a settlement on an insurance policy.

One of the issues at trial was whether the bank owed any duties to the defendant in the exercise of those rights. It was said by the defendant that such a duty arose at law and/or equity. Conversely, the bank argued that, in light of the breadth of its powers under the security documents, there could be no implied duty, and no room for a duty of care at law or equity.

The Court drew an analogy with the position of a mortgagor of real property, who must exercise their powers in good faith, and in exercising a power of sale, must take reasonable care to secure the true market value. This was a duty that permitted the mortgagor to have regard to its own interest, and could be altered by contract. In the current case, therefore, there was no need to imply a term into the contract; rather, such a duty arose because the bank was, by virtue of the security documents, placed into a position analogous to that of a mortgagor. ■

## In re Industrial North West LLP (in administration)

**[2020] EWHC 3052 (Ch) (Mark Anderson QC, sitting as a Deputy Judge of the High Court) 13 November 2020**

*Administration- Directions- Contingent liabilities-Security- Facility agreements*

The administrators of Industrial North West LLP ('**INW**') applied for directions as to whether they should continue to treat a lender ('**Fairfield**') as a secured creditor of INW due to its potential costs liability pursuant to proceedings threatened by INW's owner ('**Mr Morley**'), notwithstanding that the relevant loan had been repaid in full.

Fairfield had advanced a loan of £61.25m to INW under the terms of a facility agreement (the '**Facility Agreement**') to finance the acquisition and development costs of a real estate development project for which INW had been established. That loan was secured under the terms of a security agreement (the '**Security Agreement**', together with the Facility Agreement, the '**Agreements**'). Amongst other things, the Facility Agreement provided that Fairfield could recover from INW its costs and expenses incurred in relation to any proceedings commenced by or against Fairfield relating to the enforcement of its security, which consisted of five plots of land. The Security Agreement provided that any contingent obligations owed by INW under, inter alia, the Facility Agreement, were secured thereunder. Following an event of default, Fairfield terminated the Facility Agreement and administrators were appointed in respect of INW. The administrators then sold three of the five plots of land which stood as security for Fairfield's loan, which was repaid in full.

Subsequently, Mr Morley alleged that Fairfield's enforcement of its security was invalid, and that INW had significant claims against Fairfield in relation to that enforcement, which he intended to pursue. Fairfield considered that Mr Morley was likely to do as he intended, and it was thus at risk of having to incur significant costs and expenses to defend those threatened proceedings. Fairfield nonetheless considered that it could recover these costs and expenses from INW under the Facility Agreement, and further these costs and expenses were a contingent liability of INW for the purposes of the Security Agreement and so secured thereunder. The question for the Court was therefore whether Fairfield remained a secured creditor of the INW in relation to these costs. Having reviewed the relevant authorities, the Court held that it so remained.

The Court found that there was both a real prospect that Fairfield would incur costs and expenses in defending any prospective litigation commenced by Mr Morley or INW, and that any such litigation would include an allegation that the Facility Agreement was unlawfully terminated. Accordingly, the Court considered that the costs of such litigation, if commenced, would be incurred in relation to a claim brought as a result of Fairfield's enforcement of its security, and therefore within the scope of its rights of recovery under the Facility Agreement. In this respect, it rejected the argument advanced on behalf of Mr Morley that only costs of proceedings already commenced fell within the relevant clause. The Court further found that Fairfield's potential liability for costs in respect of the threatened proceedings was a contingent liability and rejected that there was anything in the Agreements that was repugnant to INW's right of redemption. ■

**[Jeremy Goldring QC]**

# Bankruptcy

**Digested by Lottie Pyper**

## Protasov v Derev

**[2020] EWHC 2884 (Ch) (Mr Recorder Richard Smith, sitting as a Deputy Judge of the High Court) 19 August 2020**

*Bankruptcy – Foreign proceedings – Passports – Interim injunctions – Russia*

Mr Derev ('**D**') was a Russian citizen who was made bankrupt in Russia in 2019. At this hearing Mr Perev, his bankruptcy manager ('**P**'), sought to extend a passport order made as part of the interim relief sought pending determination of P's application for recognition of the Russian bankruptcy proceedings as foreign main proceedings under the Cross Border Insolvency Regulations 2006 ('**CBIR**'). The court had the power to make a passport order under paragraph 9(c) of Schedule 2 CBIR, which gives jurisdiction to *'make any other order which the court thinks appropriate'*. However, as D had provided substantial, albeit incomplete, disclosure about his assets and there was not sufficient evidence that he was about to quit the jurisdiction, the continuation of the passport order was neither reasonable, necessary or proportionate. ■

**[William Willson]**

## Gertner v CFL Finance Ltd

**[2020] BPIR 752 (Marcus Smith J) 22 May 2020**

*Bankruptcy petitions – Disputed debts – Individual voluntary arrangements*

This was the hearing of two appeals against a bankruptcy order made against Mr Moises Gertner ('**G**') on 15 July 2019 on the petition of CFL Finance Limited ('**CFL**') on 15 July 2019. G appealed the order together with his majority creditor, Laser Trust, ('**LT**'), who also opposed the petition and appealed the bankruptcy order. At the time when the bankruptcy order was made, LT held over 90% of the claims against G.

First, G contended that CFL's debt was disputed on substantial grounds, namely that it arose from a settlement agreement that contravened the Consumer Credit Act and/or the penalty rule. This ground failed, as the court held that the settlement agreement did not contravene either of those principles. Even if the settlement agreement had contravened the penalty rule, the offending clause could have been severed, leaving an outstanding debt that was well above the bankruptcy threshold.

Second, G and LT contended that the petition should have been stayed to enable an individual voluntary arrangement ('**IVA**') to be proposed. LT was G's majority creditor and would have a carrying vote on the IVA.

This ground of appeal was allowed. Where it was clear that the majority creditor would approve an IVA, the petition should be stayed to enable the IVA to be proposed, unless their vote ought to be discounted in light of the good faith rule. It was not for the court to second-guess the commercial decisions made by creditors, even if the dividend in the IVA was marginal and there were other factors that raised questions. In this case, LT's vote ought not to be discounted, and therefore the bankruptcy petition was stayed to enable G to propose the IVA. ■

**[Mark Phillips QC; Felicity Toube QC; Robert Amey]**

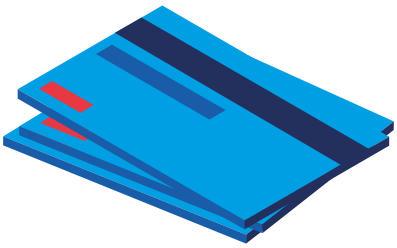
## Re Maud

**[2020] BPIR 903 (Snowden J) 8 June 2020**

*Bankruptcy petitions – Costs - Bankruptcy expenses*

Two creditors had presented bankruptcy petitions against Mr Glenn Maud ('**M**'), the Libyan Investment Authority ('**LIA**') and Edgeworth Capital (Luxembourg) SARL ('**Edgewort**h'). They had each incurred costs both in pursuing their own petitions and in supporting the other petition. M had been made bankrupt on the LIA's petition, which was presented first in time. In accordance with rule 10.149 of the Insolvency Rules 2016, the LIA's costs in pursuing its petition and Edgeworth's costs in supporting it both ranked as expenses of the bankruptcy. However, by analogy with the similar rules for winding-up petitions in rule 7.108, rule 10.149 had to be taken as an exhaustive list of expenses, and there was no room for the costs of a second petitioner, whose petition did not result in the bankruptcy order, or any supporting creditors' costs, to rank as an expense. Therefore, both Edgeworth's costs of pursuing its petition and LIA's costs of supporting it ranked as unsecured claims. ■

**[Stephen Robins]**



# Civil Procedure

**Digested by Roseanna Darcy**

## Slade v Abbhi

**[2020] EWHC 2181 (Comm) (Master Hill) 6 August 2020**

*Part 71 – Confidential Information – Article 8 of the ECHR*

The defendant ('**D**'), a judgment debtor, sought orders limiting the use that could be made of financial documentation provided by him during a CPR Part 71 examination process. The claimant ('**C**') obtained judgment against D in the sum of £430,000. The judgment debt went unpaid, and D was examined as to his means under CPR Pt 71. D disclosed over 1,000 pages of documents which included bank statements, documents concerning trusts relating to his wife and children, and material relating to unrelated commercial third parties. C refused to undertake not to use the documents other than for the purposes of the enforcement proceedings. D applied to prevent the information contained in the documents produced during the Pt 71 process becoming public. D argued that (1) the r.31.22(1)(a) exception was not engaged; (2) there should be an order to the effect that the examination was a private, rather than a public, hearing; (3) there should be an order under r.31.22(2) limiting C to using the documents only for the purpose of subsequent enforcement proceedings. Held, that for the purposes of the instant case, the r.31.22(1)(a) exception was engaged. Further, it was not possible to retrospectively classify the examination as a private hearing. However, the Court would make an order under r.31.22(2) limiting C's use of the documents. The principles of open justice meant that, in general, the court would exercise its discretion to make an order under 31.22(2) only cautiously, and derogations from open justice were wholly exceptional. However, it was necessary to balance the competing rights under ECHR Article 6, Article 8 and Article 10, and in this case the defendant's Article 8 rights weighed more heavily than did the Article 6 and Article 10 rights of the public and the press, *Re Coroin Limited* [2012] EWHC 5158 (Ch), per David Richards J, applied. The documents contained extensive personal and specific information about D's bank accounts, very detailed information about D's financial affairs and those of members of his family, and information about his dealings with unrelated commercial third parties. It was hard to see what proper interest members of the public or the press could have in the detail of that information. ■

**[William Willson]**

# Civil Procedure

## Organic Grape Spirit Ltd v Nueva IQT SL

**[2020] EWCA Civ 999 (David Richards, Newey, Arnold LJJ) 28 July 2020**

*Freezing Injunctions – Business Transactions – New businesses*

The question before the Court of Appeal was when, if ever, a company against which a freezing order is made should be permitted to pursue a fledgling business.

The interim order stated that the Appellant was not prohibited from dealing with or disposing of any of its assets in the *'ordinary and proper course of business'* and it was explained that the order was not intended to prevent expenditure on the business which was being developed. In giving judgment on the freezing order, Nugee J stated that he did not regard spending money on developing a start-up business as a dissipation, and that even if the business was imprudent and the business plan sketchy, trying to develop the business was not the same as avoiding a judgment.

The matter subsequently returned before Morgan J, who specifically barred the Appellant from pursuing the business plan and disposing of or diminishing the company's assets in developing the new business. His reasoning was based on the speculative nature of the new business and the risk that developing that business would run the substantial risk that the assets of the company would be significantly reduced.

On appeal, the Appellant challenged the prevention of pursuing the business plan, although accepted the freezing order itself. Upon reviewing the relevant authorities on freezing orders and business transactions, the Court of Appeal agreed with the Respondent that expenditure in pursuing the new business could not be considered expenditure in the *'ordinary course of business'*. However, the Court of Appeal did consider that the Morgan J should have exercised his discretion and sanctioned the dealings and disposals in pursuit of the new business in any event. There was no evidence to suggest that the Appellant was acting in bad faith or seeking to pursue its venture with the object of putting its assets beyond reach. Although the business had risk attached to it this was not an adequate reason for preventing trading especially as the Judge had not found that the business had no reasonable prospect of success. Accordingly, a business should not be prohibited merely because it carries even a substantial degree of risk. On that basis the appeal was allowed. ■

## The Financial Reporting Council Ltd v Frasers Group plc (formerly Sports Direct International plc)

**[2020] EWHC 2607 (Ch) (Nugee J) 5 October 2020**

*Litigation Privilege – Dominant Purpose Test*

The High Court was required to consider the question of whether three reports containing advice from accountants on a proposed new tax structure in the hands of the Respondent were subject to litigation privilege. An application for disclosure from the Respondent had previously been before Arnold J in the context of an investigation by the Financial Reporting Council ('**FRC**') into the conduct of Grant Thornton in relation to their audit of Sports Direct International ('**SDI**'). Arnold J ordered SDI to disclose the requested material with the exception of material over which SDI asserted privilege, giving a direction for any such claim to privilege to be determined at a further hearing. It is this privilege issue which came before Nugee J.

The FRC asserted that disclosure of the reports was necessary to assist with their investigation as it went to the question of whether the auditors had failed to disclose in SDI's financial statements the relationship between a subsidiary of SDI and another connected company. SDI argued that the reports were subject to litigation privilege because they concerned changes to the structure of the company for the exclusive purpose of responding to a real and present threat of litigation anticipated by French and other tax authorities.

The Court determined whether the three reports were produced for the sole or dominant purpose of litigation (*Three Rivers DC v Bank of England* (No 6) [2004] UKHL 48). Held that they were not. Even if SDI could establish that the reports were produced at a time when it was bone fide expected there would be litigation over SDI's distance selling arrangements, this did not in itself establish that the reports were written for use in that litigation. Even if it was contemplated that the company's structure would be attacked in future litigation, the advice on how to implement a new structure was not advice primarily aimed at the conduct of that future litigation, and was ultimately advice on how to pay less tax. As such none of the reports could be said to have been produced for the sole or dominant purpose of litigation and so litigation privilege did not apply. ■

## International Pipeline Products Limited v IK UK Limited and others

**[2020] EWHC 1602 (Ch) (David Stone, sitting as a Deputy High Court Judge) 24 June 2020**

*Security for costs – COVID 19*

This was an application for security for costs made in the context of wide-ranging claims. The application was dismissed.

The Court confirmed that the relevant test to apply by the court involved a two stage assessment: First the court had to be satisfied that there was a reason to believe the Claimant would be unable to pay the Defendant's costs, and second, the court must exercise its discretion and be satisfied that it is just to make an order for security to be given, applying the principles set out by Briggs J in *Chemistree Homecare Limited v Teva Pharmaceuticals Limited* [2011] EWHC 2979 (Ch).

On the question of whether there was reason to believe that the Claimant would be unable to pay the Defendant's costs, both parties had submitted evidence on the likely impact to the Claimant's business due to COVID-19. The court was therefore required to consider the relevance of this evidence as whilst it was accepted by the parties that the Claimant had sufficient net assets to satisfy any later costs order, the real question was whether things would deteriorate for the Claimant between the time of the application and the trial due to take place in late 2021.

The Judge was provided evidence from the Claimant that whilst the COVID-19 pandemic had led to a drop off in enquiries for new business, as the Claimant was in the oil and gas supply industry, there was no evidence to suggest that the Claimant would not continue to trade well and continue to make money. Despite this, the Defendant asked the Judge to consider the looming economic downtown, for which both parties had to accept, was an uncertainty. Nevertheless, despite this uncertainty, the Judge was satisfied that there was sufficient evidence on the Company's business prospects that suggested they would be able to meet any costs order made against them following the trial in late 2021. As the Defendant had therefore failed to reach the threshold question, the Judge was not required to consider whether it was just to make an order, although in any event, he concluded that it would not be just in all the circumstances to make an order for security for costs. ■

## Wolf Rock (Cornwall) Ltd v Langhelle

**[2020] EWHC 2500 (Ch) (His Honour Judge Paul Matthews) 23 September 2020**

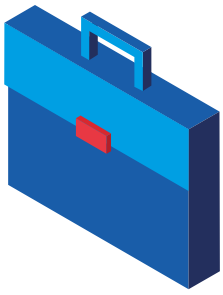
*Witness Statements – Relief from Sanctions – Winding-up Proceedings*

On an appeal against a winding-up order, the High Court confirmed that the test for granting permission to rely on evidence not filed and served in accordance with case management directions in winding-up proceedings was the same as that for relief from sanctions.

At the first hearing of the winding-up petition directions were given for the exchange of evidence. Subsequent directions were given extending time for service. Both parties complied with this order. However, two weeks before the adjourned hearing of the petition which was three months after the date for providing witness statements, the appellant company served further witness statements and sought permission to rely on them. The Judge considered that the position was similar to an application for relief from sanctions under CPR r.3.9 and made a winding up order.

The company subsequently appealed this decision, asserting that the Judge wrongly refused to admit the further witness evidence which had been served in accordance with r.7.16 of the Insolvency (England and Wales) Rules 2016. This provided that witness statements should be filed not later than five business days before a petition hearing.

The appeal was dismissed. The Judge considered that r.7.16 was only concerned with the preparation of the first hearing of the petition. Other subsequent witness statements were not governed by the rule which was particularly evident by the fact that Chapter 3 of Part 7 of the Insolvency Rules does not contain a code of procedure for the preparation and conduct of hearings of petitions. Instead, the relevant provision of the CPR apply except so far as inconsistent with the Insolvency Rules. Accordingly, when the Judge had given directions as to evidence, this was in accordance with CPR r.32.1 and in order for that evidence to be admissible it had to be filed and served in accordance with the prescribed timetable. As the appellant's further evidence did not comply with that timetable, they were in breach of the order. On that basis the Judge was not wrong in law to consider the question on permission to rely on that evidence from the perspective of relief from sanctions in accordance with the *Denton/Mitchell* principles. For policy reasons, the test for giving permission for evidence not filed and served in accordance with the court timetable had to be the same test for relief from sanctions under CPR r.3.9. ■



# Commercial Litigation

**Digested by Madeleine Jones**

## Enka Insaat Ve Sanayi AS v OOO Insurance Company Chubb

**[2020] UKSC 38 (Kerr, Sales, Hamblen, Leggatt, Burrows SCJJ) 9 October 2020**

*Arbitration – Choice of law*

In a landmark judgment likely to become a leading authority, the Supreme Court addressed the principles for ascertaining the proper law of an arbitration agreement and the role of the court of the seat of arbitration in granting anti-suit injunctions.

Enka, the claimant, agreed in 2012 to provide certain services in relation to the construction of the Berezovskaya power plant in Russia. There was a fire at the plant in February 2016. Chubb, the defendant insurer, claimed to have paid c. $400 million to the owner of the plant in respect of the damage caused by the fire. In September 2019, it commenced proceedings in the Moscow Arbitrazh Court against 11 parties, including Enka, alleging (as subrogee) that they were responsible for the fire. The Enka contract contained an arbitration agreement providing for ICC arbitration in London. Enka accordingly issued a claim in the Commercial Court for an anti-suit injunction restraining Chubb from pursuing the Russian proceedings. Chubb resisted the claim on the ground that the arbitration agreement was governed by Russian law and that the Russian proceedings did not fall within the scope of it, although it was common ground that they did if the proper law was English law.

At trial, Andrew Baker J dismissed the claim on the basis that the English court is not the *forum conveniens* to determine it. Following an expedited hearing in April 2020, the Court of Appeal allowed Enka's appeal, holding that *forum conveniens* considerations are irrelevant, that the arbitration agreement is governed by English law and that an anti-suit injunction should be granted to restrain Chubb from pursuing the Russian proceedings.

The Supreme Court dismissed Chubb's appeal. The majority judgment was given by Lord Hamblen and Lord Leggatt, with whom Lord Kerr agreed. They held, by contrast to the Court of Appeal's approach, that a choice of law for the main contract should generally be treated as a choice of law for the arbitration agreement, but that it is governed by the law of the seat as the default rule in the absence of a choice. The principles, including possible exceptions to the general rule, are considered at paras 53-146 and summarised at para 170. There are numerous points of interest in this discussion, but the following are perhaps of particular significance:

(1) the majority's construction of section 4(5) of the Arbitration Act 1996, overruling in this respect existing Court of Appeal authority: paras 73-94;

(2) the majority's endorsement of the so-called 'validation principle': paras 95-109;

(3) the majority's construction of article V(1)(a) of the New York Convention and section 103(2)(a) of the 1996 Act: paras 125-131; and

(4) the correct approach to the determination of the proper law of 'tiered' arbitration clauses, such as those providing for mediation as a first step: paras 164-169.

Applying those principles, the majority concluded that the arbitration agreement in the Enka contract was governed by English law, because the main contract, although governed by Russian law under article 4 of the Rome I Regulation, did not contain any choice of Russian law, express or implied. This meant that there was no choice of law for the arbitration agreement either, which was governed by the law of the seat as the default rule. As for *forum conveniens*, the Supreme Court(on this point unanimously) endorsed the Court of Appeal's conclusion that this is irrelevant to the exercise of the anti-suit jurisdiction, whatever the proper law of the arbitration agreement. Chubb's appeal was accordingly dismissed.

The expedition with which the trial, the appeal to the Court of Appeal and the appeal to the Supreme Court were heard (all in just over seven months) was described by the majority as *'a vivid demonstration of the speed with which the English courts can act when the urgency of a matter requires it'.* ■

**[Robin Dicker QC]**

## Banco San Juan Internacional Inc v Petróleos De Venezuela S.A.

**[2020] 2937 EWHC (Comm) (Mrs Justice Cockerill DBE)**
**4 November 2020**

*Loan agreements – Sanctions - Ralli Bros - Licences- Penalties*

Banco San Juan Internacional ('**BSJI**'), a Puerto Rican bank, applied for summary judgment in respect of its claims against Petróleos de Venezuela ('**PDVSA**'), the Venezuelan state-owned oil conglomerate, for overdue principal and interest under two loan agreements, governed by English law, and entered into by BSJI as lender and PDVSA as borrower.

PDVSA sought to defend the claims on the principal grounds that, by reason of certain United States ('**US**') sanctions targeting the Venezuelan government, including PDVSA, its payment obligations under the loan agreements were suspended on their own terms, while further payment into the contractually stipulated account, within the US, would be unlawful and therefore their obligation to pay was suspended applying the rule in *Ralli Bros v Compania Naviera Sota y Aznar* [1920] 2 KB 287. PDVSA argued in the further alternative that, to the extent the rule in *Ralli Bros* was not engaged, the relevant sanctions constituted overriding mandatory provisions of the law of the place of performance (the US) and that the Court should exercise its discretion so as to relieve it of its obligation to pay. It raised an additional argument in relation to BSJI's claim in respect of one agreement that the sum sought thereunder pursuant to a liquidated damages clause constituted an unenforceable penalty.

The Court rejected all these defences and granted BSJI summary judgment. As a matter of construction, PDVSA's payment obligations were not suspended as a result of the sanctions and PDVSA's payment obligations were also not suspended by the rule in *Ralli Bros*. PDVSA could lawfully make payment into the stipulated account by obtaining a licence from US federal authorities, which it was obliged to do, both under the general law and the loan agreements, in order to equip itself to perform. PDVSA had neither done so nor proved that any such licence would not have been granted if it had tried to obtain one. Accordingly, the Court held that irrespective of whether the sanctions prima facie rendered payment by PDVSA into the stipulated account unlawful, PDVSA could not rely on the rule in *Ralli Bros* to avoid payment. Equally, in these circumstances, PDVSA's argument that the US sanctions constituted overriding mandatory provisions in favour of which the Court ought to have exercised its discretion added nothing to the analysis and similarly failed. Finally, the Court found that the liquidated damages clause was not an unenforceable penalty, not least because it was common ground that liability thereunder did not arise upon breach. ■

**[Adam Al-Attar; Jamil Mustafa]**


## Attorney General of the Virgin Islands v Global Water Associates Ltd

**[2020] UKPC 18 (Lord Hodge, Lord Wilson, Lord Lloyd-Jones, Lady Arden, Lord Sales)**
**13 July 2020**

*Contract – Damages – Remoteness*

A (a water company) appealed against a decision that its claim for damages against R (the BVI Government) were too remote. A contracted with R to build a water treatment plant (under a design and build agreement, DBA) and separately to operate the plant for 12 years on its completion (under a management, operation and maintenance agreement, MOMA). R failed to provide a site for the plant. A terminated the DBA and claimed for damages for its breach, including damages for profits it would have received under the MOMA. Arbitrators had found that the damages were too remote because there were two contracts (although there was a 'vital interconnection' between them) and although there was a condition precedent in the MOMA that the DBA would be performed, there was no promise in the DBA that the condition precedent would be fulfilled; the Court of Appeal had held damages were too remote, because R could have found another contractor to operate the plant.

Held, allowing the appeal, that damages are not too remote when they are such as may fairly and reasonably be considered either to arise naturally, ie, according to the usual course of things, from the breach or to have been in the contemplation of both parties, at the time they made the contract, as the probable result of the breach (*Hadley v Baxendale* (1854) 9 Exch 341). The Board summarised the principles relating to remoteness of damages arising from the case law which elaborated on this principle.

Applying these principles in this case, the losses arising from an inability to earn profits under the MOMA were within the reasonable contemplation of the parties to the DBA when they made that contract. Losses under the MOMA were not too remote to claim under the DBA. ■

# Commercial Litigation

## Adare Finance DAC v Yellowstone Capital Management SA

**[2020] EWHC 2760 (Comm) (Mr Peter MacDonald Eggers QC, sitting as a Deputy Judge of the High Court), 19 October 2020**

*Summary judgment – Unconscionable bargains – Economic duress – Rule against penalties*

The claimant applied for summary judgment on a contractual debt claim against the borrower under a facility agreement and a guarantor (Mr Michel Ohayon, a wealthy property developer with business interests in Europe and Israel).

The defendants sought to resist summary judgment on four grounds, all of which were rejected by the Judge:

1. First, the defendants asserted that the relevant contract was an unconscionable bargain. The Judge noted that it is exceptionally difficult for a sophisticated businessman to rely on this defence, particularly where the defendants had independent legal representation. The Judge held that the facts pleaded by the defendants failed to establish an arguable basis for invoking the doctrine of unconscionable bargains.
2. Second, the defendants asserted that they were are the victims of economic duress. This was essentially because the claimant refused to extend the date for the completion of a refinancing transaction without being paid a fee to compensate for late payment. However, this contention was hopeless. The Judge held that, as a matter of law, the conduct of the claimant did not constitute economic duress. An allegation of economic duress requires conduct which is either unlawful or in bad faith. The defendants accepted that the claimant had acted lawfully, and had failed to advance any intelligible case of bad faith. In this regard, the Judge relied on the recent decision of the Court of Appeal in *Times Travel (UK) Ltd v Pakistan International Airlines Corp* [2020] Ch 98.
3. Third, the defendants asserted that an acceleration clause in the facility agreement was an unlawful penalty. The Judge held that this argument was contrary to the well-established rule that a provision for the acceleration of an existing loan upon the occurrence of an event of default is not a penalty.
4. Fourth, the defendants asserted that they had a discretion (not an obligation) to pay the amounts set out in the finance documents. The Judge held that this defence was unarguable and contradicted the clear and express language of the contractual documents.

In those circumstances, the Judge granted summary judgment on the claim. ■

**[David Allison QC; Ryan Perkins]**

## Primus International Holding Co v Triumph Controls - UK Ltd

**[2020] EWCA Civ 1228 (Henderson, Coulson, Carr LJJ) 22 September 2020**

*Contracts – Construction - Meaning of 'Goodwill'*

A sold two companies to R. R relied on financial forecasts provided by A which predicted that the companies though at the time loss-making would become profitable. After the sale, R discovered serious operational and business problems at the companies, that they failed to achieve their forecasted earnings and their performance was nothing like that predicted. R claimed for breach of a warranty that the forecast had been *'honestly and carefully prepared'*. A denied liability on the basis of an exclusion clause, which excluded liability *'to the extent that…the matter to which the claim relates… is in respect of lost goodwill'*.

At first instance the Judge concluded that A was in breach of warranty and was not assisted by the exclusion clause since the plain and natural ordinary meaning of goodwill in a commercial contract was business reputation. A appealed the construction of the exclusion clause. It argued the true construction of *'goodwill'* was *'a loss of share value, where that value represents the difference between the cost of acquisition and the fair value of its identifiable net assets and/or where that loss of share value is caused by the impairment of the value of non-identifiable assets.'* This was described as an *'accounting definition'*.

The Court of Appeal held that the Judge was correct that the ordinary legal meaning of goodwill is the good name and public reputation of the business concerned. It is to be distinguished from the *'technical'* accounting definition. If a contract contains a term to which the parties intend to give an unusual or technical or non-legal meaning, that must be spelt out. That the Judge's preferred definition of *'goodwill'* was the ordinary one was supported by the authorities. Other parts of the SPA also supported this reading. The Court also rejected the submission that since normal accounting methodology valued goodwill as the difference between the value of the assets, on the one hand, and the purchase price, on the other, *'goodwill'* (in the *'technical'* accounting sense) and 'value' were *'interchangeable'*. Merely because something – in this case *'goodwill'* – is of value and is capable of being valued, does not mean that it is the same thing as *'value'*. ■

## Delta Petroleum (Caribbean) Ltd v British Virgin Islands Electricity Corp

**[2020] UKPC 23 (Kerr, Briggs, Sales, Hamblen, Leggatt SCJJ) 12 October 2020**

*Contracts – Performance relief – Waiver by election*

R contracted to buy fuel from A for four years. The contract contained a clause entitling A to claim relief from its obligations if its supplier's refinery closed. The refinery gave notice of closure but A continued to honour its obligations by procuring fuel from an alternative supplier. A sought to negotiate a price increase to reflect the increased costs of supplying from the alternative supplier. When R refused, A sought to rely on the performance relief clause. R resisted, on the basis that A had exhausted its right to performance relief when it continued to perform under the contract when the refinery closed. The High Court held that A had waived its right to performance relief. The Court of Appeal upheld this finding.

Held that election by waiver is only capable of applying where a choice must be made between two alternative and inconsistent (in the sense of mutually exclusive) courses of action, such that adopting one of them necessarily entails forsaking the other. The relevant clause did not require A to make a binary, all-or-nothing choice either to terminate or continue the parties' obligations and it did not require performance relief to be claimed at any particular point in time. The right to claim performance relief continued as long as A's problems with procuring a supply did. Also, the contract required A to take all reasonable steps to minimise delay and damage. This virtually required it to investigate whether it could procure a supply from an alternative source without incurring financial loss. One way of achieving this was by discussing with the buyer whether it would agree a price increase.

Accordingly, A's actions in procuring an alternative supply and attempting to negotiate a price increase were not inconsistent and mutually incompatible with termination of the supply and claiming relief. The right to claim performance relief under the contract was not a right that in law required the making of an election. A did not make an election that caused the right to be lost. However, a failed in its counterclaim for loss suffered as a result of continuing to perform after its request for performance relief was rejected. This loss did not arise from any breach of a contractual obligation. ■

## AssetCo Plc v Grant Thornton UK LLP

**[2020] EWCA Civ 1151 (David Richards LJ, Phillips LJ, Sir Stephen Richards) 28 August 2020**

*Negligence – Causation of loss – Auditors*

A, an auditor, appealed an award of damages made in respect of its negligent audit of R, a company. A had reported that the holding company was profitable when in fact the group was insolvent due to management fraud. The true state of affairs became apparent two years later. A accepted it was in breach of duty, but challenged an award of damages on the basis that losses claimed were not within the scope of its duty of care.

Held, that there is a difference between a duty to provide information to enable someone to decide on a course of action and a duty to advise someone as to what course of action to take: *South Australia Asset Management Corp v York Montague Ltd* [1997] AC 191. Applying this principle, A's failure to detect the fraud had deprived R the opportunity to call the senior management to account and to ensure that errors in management are corrected. This was a principal purpose of the audit and the scope of an auditor's duty was determined by reference to the purposes of the statutory requirement for an audit. By failing to detect that the accounts were prepared, and deliberately prepared, by management on a wholly false basis, presenting an insolvent company and group as successful and profitable, A deprived R of the very information that would have caused it to cease its loss-making activities and to take the steps necessary to regain its solvency. It was therefore a substantial cause of the losses, including losses incurred by R in supporting its subsidiaries. ■

# Commercial Litigation

## CFH Clearing Ltd v Merrill Lynch International

**[2020] EWCA Civ 1064 (McCombe, Holroyde, Phillips LJJ)**
**14 August 2020**

*Construction – ISDA Master Agreements*

A foreign exchange liquidity provider ('**A**') appealed the summary dismissal of its claim against a bank ('**R**'). A provided R with FX liquidity pursuant, among other agreements, R's terms and conditions and a 2002 ISDA master agreement and a schedule incorporating the 1998 FX and Currency Option Definitions. R's terms provided that all transactions were 'subject to' applicable laws, rules, regulations and market practice.

During a period of volatility, A's automatic clearing system placed electronic market orders to trade euros for Swiss francs with R at the next available price. R fulfilled these at a price which turned out to be lower than the *'official low'* price declared on the main platform for euro/Swiss francs. A claimed that R's terms obliged R to comply with market practice and that this required it to re-price or cancel the transactions.

At first instance the Judge held that the words *'subject to'* did not incorporate market practice into the agreement. The Court of Appeal upheld this judgment.

The parties had been free to agree terms providing for market disruption. The electronic messages placing the trades constituted confirmations for the purposes of the ISDA master agreement, and pursuant to is terms formed part of that agreement. The ISDA master agreement prevailed over the bank's terms.

Whilst it was open for the parties to agree to vary, amend or supplement the ISDA Master Agreement, any alleged agreement to such effect must be considered in the context that the parties had adopted a detailed contractual regime, incorporating industry norms and practices and intended to be a single comprehensive contract for all subsequent transactions. The suggestion that the parties had agreed to incorporate *'market practice'* generally, even though not reflected in the ISDA Master Agreement and, indeed, overriding its provisions, must be treated with considerable caution.

Further, the words *'subject to'* do not necessarily result in incorporation. In this case the phrase referred to matters collectively defined as *'applicable rules'*, including market practice and the FSA Rules. As R's terms expressly provided the FSA Rules were not incorporated, here *'subject to'* could not result in incorporation. The alleged market practice was far too vague and uncertain to be incorporated as a contract term. ■

## Travelport Limited v WEX Inc

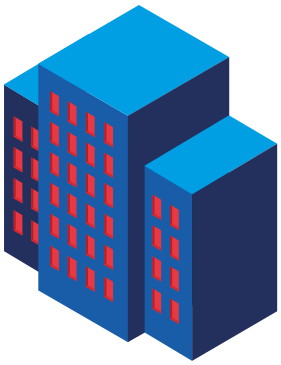
**[2020] EWHC 2670 (Comm)**
**(Mrs Justice Cockerill DBE)**
**12 October 2020**

*Contracts – Construction – Material adverse effect clauses*

The Court gave judgment on a number of preliminary issues in a case concerning whether the coronavirus pandemic engaged the material adverse effect ('**MAE**') provisions in an SPA which formed part of a US$1.7 billion transaction and so whether the purchaser is entitled to back out of the transaction. This judgment considered the basis against which two target companies' financial condition should be measured, in order to determine whether they had suffered a MAE. Travelport – the seller – said that the relevant industry for comparison is the *'travel payments industry'*, whereas WEX – the buyer – argued that there is no travel payments industry and that the appropriate comparator is the *'business to business payments industry'* or simply the *'payments industry'*.

Held that there was a dearth of relevant English authority on MAEs and noted that there was a better developed body of US case law, particularly from the Court of Delaware, and that the US is the leading forum for treatment these clauses. The Court reviewed this body of case law as well as US academic treatments of the subject.

On a construction of the relevant clauses in light of these authorities and the commercial purpose of the transaction – which was for WEX to buy a business which carried with it future value in other markets than the travel market – the Judge concluded that in determining whether WEX was entitled to rely on the MAE clause it was necessary to assess the position against the broader payments industry. ■



# Company Law

**Digested by Edoardo Lupi**

## Chu v Lau

**[2020] UKPC 24 (Lord Hodge, Lord Briggs, Lady Arden, Lord Leggatt, Lord Burrows) 12 October 2020**

*Just and equitable winding up – Deadlock – Alternative remedies*

The Privy Council confirmed the correct approach to determining applications for winding-up on the just and equitable ground of a company in functional deadlock.

The appellant originally made an application for the just and equitable winding up of a BVI company ('**OSL**'), in which he and the respondent were equal shareholders and sole directors, due to the breakdown of trust and confidence and functional deadlock in the management. OSL wholly owned a subsidiary company which in turn owned around half of a joint venture company. The winding-up was granted at first instance, but subsequently discharged by the Court of Appeal of the Eastern Caribbean Supreme Court.

The Privy Council overturned the Court of Appeal's decision in four respects.

Firstly, it confirmed that there is no rule that a just and equitable application for winding up had to be justified solely by reference to the position at the date of the filing of the application. The position should be considered at the time of the hearing and circumstances arising after the application can be taken into account.

Secondly, the affairs of the joint venture company were properly a matter for the management of the subsidiary, and accordingly the Judge was entitled to consider them in relation to the breakdown of trust and confidence.

Thirdly, the Court of Appeal had incorrectly concluded that the members' freedom to sell their shares was a means to avoid deadlock, as a third-party purchaser had strong disincentives to pay full value given the management difficulties and involuntary nature of the sale. This did not provide a basis for departing from the finding of functional deadlock. The lack of restrictions on the transfer of a member's shares also did not necessitate a finding that OSL was not a quasi-partnership.

Fourthly, the Court of Appeal had misdirected itself by taking the view that it was for the applicant to demonstrate there was no alternative remedy available to him. The onus lies with the respondent to invite the Judge to consider potential alternative remedies. This was a "paradigm case" of breakdown in trust and confidence in a quasi-partnership and functional deadlock, and winding-up was the appropriate remedy. ■

# Company Law

## Re Gulf Investment Corporation v The Port Fund L.P. and Port Link GP Ltd, FSD 235 of 2019; Kuwait Ports Authority v The Port Fund L.P. and Port Link GP Ltd, FSD 13 of 2020

**Grand Court of the Cayman Islands (Raj Parker J) 16 June 2020**

*Cayman Islands – Exempted Limited Partnership Law – True and full information*

These conjoined cases concerned the scope of and interaction between the Exempted Limited Partnership Law of the Cayman Islands (the '**ELP Law**') and the terms of an Exempted Limited Partnership Agreement ('**LPA**') in respect of The Port Fund L.P., an exempted limited partnership ('**Port Fund**'). The various plaintiffs were all limited partners of Port Fund (the '**LPs**'). The general partner responsible for managing the fund was Port Link GP Ltd ('**Port Link**'). The LPs had all made applications to the court pursuant to section 22 of the ELP Law, which entitles them to demand and receive '*true and full information concerning the state of the business and financial condition*' of the Port Fund, '*subject to any express or implied term of the partnership agreement.*' Port Link argued that, as the LPA entitled them to place '*reasonable conditions and restrictions*' on the LPs' ability to '*access*' the Port Fund's books and records, they had a discretion to redact documents and/or require that the LPs sign confidentiality agreements. The Judge disagreed. He held that section 22 of the LPA was freestanding and 'occupies the field', and that the motivation of the LPs in seeking certain documents was irrelevant to their statutory right under that provision. Section 22 was a '*very wide unqualified provision*' (at [86]) and Port Link was only entitled to place '*reasonable conditions and restrictions*' on the practicalities associated with providing the LPs with certain documents, which did not extend to redactions or any restrictions on use. This was particularly so as the LPA already had a separate confidentiality clause which the LPs were bound by. Indeed, there was nothing in section 22 of the ELP Law which suggested that there is any limitation to be put on what information might be required to be provided to satisfy the '*true and full*' requirement (at [104]). ■

**[Felicity Toube QC; David Allison QC; Tom Smith QC]**



## Re Trina Solar Limited

**Grand Court of the Cayman Islands (Segal J)**
**23 September 2020**

*Section 238 Cayman Companies Law – Valuation approach*

In determining the fair value of the Company's shares pursuant to s. 238 of the Companies Law, the Grand Court decided to give 30% weight to the Adjusted Market Price, 45% to the Merger Price, and 25% to a DCF analysis.

Much like the court's approach in *Re Nord Anglia Inc* (digested in a previous issue), the Grand Court saw no conceptual difficulty with blending the three methodologies. Segal J accepted that the Merger Price could be taken into account even where there were flaws in the deal process that had produced it. The Judge also held that there was sufficient evidence to demonstrate that the market for the company's shares was semi-strong efficient, despite the company's expert not carrying out an event study to test efficiency.

Applying the Privy Council's decision in *Re Shanda Games* for the first time since it was handed down, the Grand Court also proceeded to apply a minority discount of 2%, preferring the Dissenters' proposed discount to the Company expert's suggested 10% discount. ■

## Servilleja v Marex Financial Ltd

**[2020] UKSC 31 (Hale, Reed, Hodge, Black, Lloyd-Jones, Kitchin, Sales SCJJ) 15 July 2020**

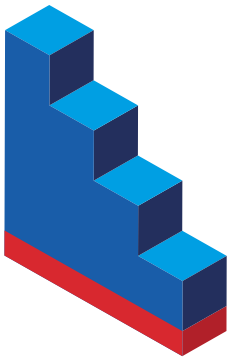
*Shareholders – Reflective Loss Rule*

The Supreme Court has restated the scope of the reflective loss rule following a hearing before a panel of seven justices and deliberations lasting some fourteen months. The judgment clarifies the narrow ambit of the rule as one of company law, applying specifically to companies and their shareholders. The Supreme Court unanimously held that the reflective loss rule does not apply to creditors.

The reflective loss principle was established in the case of P*rudential Assurance Co Ltd v Newman Industries Ltd* (No 2) [1982] Ch 204. That case decided that a diminution in the value of a shareholding which is merely the result of a loss suffered by the company in consequence of a wrong done to it by the defendant is not, in the eyes of the law, damage which is separate and distinct from the damage suffered by the company, and is therefore not recoverable. The principle was subsequently developed in *Johnson v Gore Wood & Co* [2002] 2 AC 1. By framing the principle as being based on the need to avoid double recovery, Lord Reed considered that Lord Millett's judgment in *Johnson* had paved the way to the over extension of the reflective loss principle in subsequent cases.

The key question for the Supreme Court was whether the rule applied to the creditors of a company. The Court of Appeal in *Marex* held that the principle applied to a claim brought by an ordinary creditor of a company, where the company had a concurrent claim. On the facts, it held that the reflective loss principle applied to about 90% of the Claimant's claim. The Supreme Court unanimously held that the rule does not apply to creditors. The relationship between a company and a creditor is not analogous to that of a company and its shareholder. The cases extending the ambit of the reflective loss rule – *Giles v Rhind*, *Perry v Day* and *Gardner v Parker* – had been wrongly decided.

The majority (Lord Reed, Lady Black, Lord Lloyd Jones and Lord Hodge, who delivered a separate judgment to the judgment of Lord Reed) held that the proper scope of the reflective loss rule was narrow, being limited to claims by shareholders in relation to whom, as a result of actionable loss suffered by their company, the value of their shares has been diminished. Lord Reed stated that *'[o]ther claims, whether by shareholders or anyone else, should be dealt with in the ordinary way.'* The minority comprising Lord Sales, Lady Hale and Lord Kitchin agreed with the majority on the result and the non-application of the rule to creditors. However, Lord Sales' dissenting judgment went further to consider the basis of the rule as set out in *Prudential and Johnson*. Describing the reflective loss principle as a flimsy foundation to build outwards into other areas of the law, Lord Sales' judgment considered that the bright line rule favoured by the majority may well favour simplicity but operates at the cost of working injustice on the shareholder who is deemed not to have suffered any loss or to have a cause of action. Accordingly, the minority considered that a shareholder should not be prevented by the rule from pursuing a valid personal cause of action, with the risk of double recovery instead addressed by case management or rights of subrogation. ■



# Corporate Insolvency

Digested by Ryan Perkins and Daniel Judd

## Re LB Holdings Intermediate 2 Limited (in administration) In Re Lehman Brothers Holdings plc (in administration)

**[2020] EWHC 1681 (Ch) (Marcus Smith J) 3 July 2020**

*Subordinated debt – Priorities – Release*

The Court considered the relative priority of over $10billion of subordinated liabilities in the administration of two Lehman Group entities, LB Holdings Intermediate 2 Limited ("**LBHI2**") and Lehman Brothers Holdings plc ("**PLC**").

LBHI2 issued regulatory subordinated debt under FSA standard form loan agreements (the "**LBHI2 Sub-Debt**") and floating rate subordinated notes pursuant to an offering circular (the "**LBHI2 Sub-Notes**") (which were subsequently amended on 3 September 2008). The LBHI2 Sub-Debt was held by PLC, and the LBHI2 Sub-Notes by Lehman Brothers Holdings Scottish LP 3 ("**SLP3**"). SLP3 argued the LBHI2 Sub-Notes and the LBHI2 Sub-Debt ranked *pari passu*; PLC argued that the LBHI2 Sub-Debt was senior. As a matter of construction, the Judge held that, pre-amendment, the LBHI2 Sub-Notes ranked senior to the LBHI2 Sub-Debt; but that, post-amendment, the position changed, such that the LBHI2 Sub-Debt debt ranked senior to the LBHI2 Sub-Notes. In the alternative, SLP3 had argued that, if, properly construed, their amendments made the LBHI2 Sub-Notes junior to the LBHI2 Sub-Debt, then they should be rectified for common mistake (as a consequence of which, they ranked *pari passu*). The Judge dismissed the rectification claim.

PLC issued regulatory subordinated debt under FSA standard form loan agreements (the "**PLC Sub-Debt**") and subordinated notes to certain limited partnerships (the "**PLC Sub-Notes**"), which in turn issued preferred securities known as *"ECAPS"*. The PLC Sub-Debt was held by a Lehman Group entity before it was assigned post-administration to Lehman Brothers Holdings Inc ("**LBHI**"), and the PLC Sub-Notes by the partnerships. LBHI argued that the PLC Sub-Debt and the PLC Sub-Notes ranked *pari passu*; the joint liquidators of LB GP No 1 (as general partner of the partnerships) and Deutsche Bank (as a holder of the ECAPS) argued that the PLC Sub-Notes were senior. As a matter of construction, the Judge held that the PLC Sub-Debt and the PLC Sub-Notes ranked *pari passu*.

The joint administrators of PLC also asked the Court to determine several further issues raised by Deutsche Bank: whether the PLC Sub-Debt had been released pursuant to a New York law settlement agreement dated 24 October 2011 (the "**Settlement Agreement**"); as well as how the PLC Sub-Notes should be valued for the purposes of distributions. The Court held, applying the principles of construction under New York law, that PLC Sub-Debt was not released pursuant to Section 8.02 of the Settlement Agreement. Further, it found that the PLC Sub-Debt had not been partially discharged by payments made to the original creditor by LBHI under a guarantee. Finally, the Judge concluded that the PLC Sub-Notes should be discounted for futurity under the Insolvency Rules 2016 to 27% of their face value. This was because subordinated debts were provable debts, the PLC Sub-Notes were future debts, and there was no basis on which the holder of the PLC Sub-Notes could prove for interest that accrues after the administration date. ■

**[Mark Phillips QC; Richard Fisher QC; William Willson; Edoardo Lupi]**

## Robertson v Wojakovski

**[2020] EWHC 2737 (Ch) (Zacaroli J)**
**14 October 2020**

*Bankruptcy petitions – Adjournments – Time to pay – Supporting creditors*

Zacaroli J delivered the first decision dealing with the relevance of supporting creditors debts to an adjournment application in a bankruptcy petition on the grounds of time to pay. The Petition was presented based on a statutory demand; the Petition Debt in the sum of £135,244.90 plus interest arose from a court order to make an interim payment on account of costs. There were a number of supporting creditors on the Petition whose debts originated from a derivative action by which a number of companies in the Tonstate Group sought the return of moneys wrongfully extracted from them by the Debtor. The supporting creditors' claims totalled approximately £16 million.

The Debtor accepted that there was no basis on which the Petition could be opposed but applied for an adjournment of the Petition to allow the Debtor time to pay. The Debtor contended there was a reasonable prospect of him being able to pay the Petition Debt within a reasonable time but accepted there was no reasonable prospect of paying the supporting creditors.

Zacaroli J held that as *"a matter of principle"* the Debtor *"would need to provide credible evidence of his ability to pay within a reasonable time both the petition debt and the debt due to the supporting creditors."* Bankruptcy was a class remedy – if the Debtor paid the Petitioner the inevitable result would be the substitution of one of the supporting creditors as Petitioner. Allowing an adjournment would *"conflict with the class nature of bankruptcy, as it would result in payment in full to one creditor in preference to the supporting (and any other) creditor"*. In any event, Zacaroli J held that the Petitioner had not shown a reasonable prospect of him being able to pay the Petition Debt within a reasonable time; let alone also being able to pay the debts of the supporting creditors. ■

## Re Ide (in Bankruptcy)

**[2020] EWCA Civ 1469 (Lewison, Arnold and Nugee LJJ)**
**9 November 2020**

*Insolvency proceedings – Transfer of proceedings – Deadline for service of application - Extensions of time outside the limitation period*

The Court of Appeal was called on to consider three points of importance in relation to the procedural aspects of insolvency applications.

Firstly, the Court of Appeal considered whether the County Court could transfer only a particular application in insolvency proceedings to the High Court under rule 12.30 (2) of the Insolvency Rules 2016 (the '**Rules**'). The Court of Appeal considered that the question was whether the term '*insolvency proceedings*' in rule 12.30 (2) should be given a narrow interpretation, under which it refers to the entirety of insolvency proceedings, or a wider interpretation, under which it is capable of applying to a particular application made in the bankruptcy. There was no available guidance on how to construe the phrase. In those circumstances, the Court of Appeal had to interpret it in a way that made practical sense, and this favoured the wider interpretation. This was supported by the Practice Direction on Insolvency Proceedings which clearly envisaged the transfer of a specific application.

Secondly, the Court of Appeal was required to construe rule 12.9 (3) of the Rules. This requires service of an application 14 days prior to the date fixed for its hearing. This could refer either:

a. to the date originally fixed for the hearing and endorsed on the application by the court, or,

b. the date ultimately fixed for the hearing.

The Court of Appeal held the first interpretation was the correct one. This followed from the structure of Part 12 of the Rules and the court should, if other things were equal, favour an interpretation that led to earlier service of applications rather than later.

Thirdly, the Court of Appeal had to consider whether the principles applicable to extensions of time to serve claim forms under the CPR apply also to extensions of time for service of insolvency applications. The Court of Appeal considered they did. Some insolvency applications were to recover sums of money and one would expect the same principles to apply. Moreover, the issues surrounding depriving the Defendant of a limitation defence applied to both insolvency proceedings and CPR proceedings. An applicant in insolvency proceedings needs to show exceptional circumstances for an extension of time to serve an application notice outside the limitation period. ■

# Corporate Insolvency

## Re Sunbird Business Services

**[2020] EWHC 2493 (Ch) (Snowden J)**
**18 September 2020**

v*Schemes of arrangement – Sanction Hearings - Adequacy of Information*

This is the a recent example of a court refusing to sanction a scheme of arrangement, despite it having been approved by the requisite majorities of scheme creditors.

The scheme was proposed by the UK holding company and financing vehicle ('**Sunbird**') for a number of operating subsidiaries providing serviced offices in Eastern and Southern Africa. The purpose of the scheme was to effect a debt to equity conversion of Sunbird's debt at a conversion price of US$0.33 per share. The debt for equity swap was part of a wider refinancing which involved a fully underwritten rights issue at a discounted issue price of US$0.22 per share.

Unusually, the convening hearing had been listed before an ICC Judge without notice to any of the company's creditors. The scheme was approved at the creditors meeting by creditors representing 80% in number and 87% in value of those voting on the proposal. Six scheme creditors representing 20% in number and 13% in value voted against the scheme (the '**Opposing Creditors**').

The Opposing Creditors opposed the sanctioning of the scheme on the basis that the information provided by the company in the explanatory statement and associated documentation was materially inadequate and misleading in a number of respects. The Court accepted the Opposing Creditors' arguments and held that the information provided to creditors was inaccurate, incomplete and, in certain respects, misleading. The Court declined to sanction the scheme.

Among other things, the court emphasised:

1. Creditors ordinarily ought to be provided with a detailed analysis which estimates the likely return for creditors under the scheme and in the alternative to the scheme. But that is the *"bare minimum"*. Creditors ought to be provided with the necessary information to understand how different groups of creditors and other stakeholders are being treated under the scheme so they can reach a view upon whether value is being appropriately allocated between stakeholder groups: [59]-[60].
2. In cases involving a debt-for-equity swap or a rights issue, the information provided to creditors must allow them to make an informed assessment of whether the debt to equity conversion rate / rights issue pricing is appropriate. This will involve disclosing details of the valuation methodology used and any assumptions which have been made: [85],[86],[90].
3. If a scheme is interdependent with a rights issue which is being offered at a discount, then the information provided to creditors ought to allow them to assess the appropriateness of that discount. A bland statement that the directors have exercised their *"commercial judgment"* is unlikely to be sufficient: [94]. It is also vital for scheme creditors to be very clearly informed of the adverse consequences for them and the corresponding benefits which would be obtained by others if they do not participate in the rights issue [97]-[101].
4. If directors wish to buttress the company's proposals and recommendations by reference to the views of an independent person (such as a professional adviser or expert), they need to be open and transparent about the identity of that person, the terms and basis on which they have given their advice or opinion and whether they are prepared to accept responsibility for it to scheme creditors: [64],[89].
5. Material deficiencies in the information provided in the formal scheme documents cannot ordinarily be remedied simply because the scheme company has provided better information outside the formal scheme process, especially if that information has only been given to some scheme creditors: [112], [116]. ■

**[Henry Phillips]**

## Re Sunbird Business Services 2

**[2020] 2860 (Ch) (Snowden J) 28 October 2020**

*Schemes of arrangement – Class composition*

Following the court's refusal to sanction its first scheme of arrangement (see the case digest above), Sunbird issued a new application seeking an order convening a single meeting of creditors for the purposes of considering and, if thought fit, approving a new scheme of arrangement (the '**New Scheme**').

The New Scheme was in substantially the same terms as the original scheme. It was accompanied by a draft explanatory statement which purported to rectify the defects identified by the court in the context of the original scheme.

The Opposing Creditors argued that scheme creditors ought to vote in two classes. Under the terms of the proposed scheme, all scheme creditors were entitled to have their debt claims against Sunbird converted into shares in Sunbird at a price of $0.33/share. However, pursuant to the broader restructuring, one scheme creditor ('**21st Century**') was also entitled to have a near-worthless claim against a subsidiary of Sunbird with a face value of US$750,000 converted into shares in Sunbird on the same terms. The Opposing Creditors argued that, as a consequence, the *"deal"* offered to 21st Century was a materially different *"deal"* to that offered to other scheme creditors. The Opposing Creditors submitted that the deal offered to 21st Century involved it receiving an extra tranche of shares in Sunbird in exchange for a worthless claim against a subsidiary, leading to a dilution in the post-scheme shareholdings of other scheme creditors

Snowden J observed that modern authorities have emphasized that in, assessing how creditor classes should be constituted for the purposes of a scheme, the scheme should not be looked at in isolation but should be viewed in the context of the restructuring as a whole, including any rights conferred in other agreements that are provided for under the terms of the scheme, or which are conditional upon it: [23]. Applying that approach, the Judge held that there was a material difference between the treatment of the rights of 21st Century and the treatment of the rights of other scheme creditors. In addition to the conversion of the debt which was owed by Sunbird into shares in Sunbird, 21st Century stood to receive an extra tranche of shares in Sunbird in exchange for its (different) rights against the subsidiary: [25].

However, Snowden J considered that the difference in rights was not such as to make it impossible for 21st Century to consult together with other scheme creditors on the merits of the proposal: [32]. In reaching that conclusion, the Judge held that the additional arrangement in respect of 21st Century did not amount to an additional benefit to 21st Century but instead involved it giving up valuable commercial leverage resulting from its right to seek full payment of its debt from the subsidiary once the scheme had become effective: [30]. ■

**[Henry Phillips]**

## Re Sky Solar Holdings Limited (FSD Cause No 190 of 2020)

**Grand Court of the Cayman Islands (Kawaley J) 14 October 2020**

*Winding up petitions – Abuse of process*

The Petitioner, a US hedge fund, petitioned for the winding up of the Company, a global operator of solar farms, on the basis of an unpaid petition debt of US$ 7.1m, part of a larger debt of US$ 93m. The Petitioner had also commenced proceedings before the New York Courts for summary judgment on the US$93m debt. The agreements giving rise to the indebtedness were subject to New York law and exclusive jurisdiction clauses.The Company applied to strike out the petition, alleging that the petition was an abuse of process because:

(i) the Petitioner had previously commenced the New York proceedings;

(ii) the Petitioner had alternative remedies available to it (i.e. the New York proceedings);

(iii) the Petition was presented for a collateral purpose, namely to stymy a proposed merger;

(iv) there were exclusive jurisdiction clauses;

(v) the Petition had been defectively served, five times;

(vi) the Petitioner had realised security prior to presentation of the petition, which overtopped the smaller, but not the larger, debt; and

(vii) both the smaller US$ 7.1m debt and the larger US$ 93 million debt were disputed.

The Judge addressed each of these points. He held that the issue of other proceedings was generally irrelevant. The existence of alternative remedies

# Corporate Insolvency

was irrelevant save where a party petitioned on the just and equitable ground. He added that collateral purpose, too, was irrelevant, save where it was the sole purpose of a petitioner, and a petitioner's purpose could typically not be determined in interlocutory proceedings. The exclusive jurisdiction clauses were irrelevant to the issue before the court, i.e. whether the debt was a bona fide and substantial dispute, and he noted that defective service of a petition was not an abuse of process. In this case, the smaller US$ 7.1m debt was subject to a counterclaim and disputed by reason of the realisation of the security. The Cayman Court might, in principle, take into account the global commercial relationship between the parties (including cross-claims, in accordance with *Montgomery v Wanda Homes Ltd* [2002] 1 BCLC 289). However, that principle might be applied differently in a Cayman Court where there was no balance sheet insolvency test. The petition might be amended, so that in principle the Petitioner might amend the petition so as to rely on the larger US$ 93m debt, but the US$93m debt was itself subject to a *bona fide* and substantial dispute. The petition was therefore struck out. ■

**[Barry Isaacs QC; Lloyd Tamlyn]**

## Walid Khalil Fakhry v Laurence Pagden, Simon James Underwood

**[2020] EWCA Civ 1207 (Floyd, David Richards, Newey LJJ)**
**15 September 2020**

*Members' voluntary liquidation – Company restoration – Appointment of new liquidators*

Three companies in the Core VCT group went into members' voluntary liquidation by large majorities and were dissolved. Minority shareholders then applied for the company to be restored to the register, on the basis that the affairs of the company (and its former liquidators) needed to be investigated. An order was made without notice to that effect and not served on the appellants. The former liquidators resisted the restoration application, seeking to set aside that order. Their attempt to do so was dismissed, and they appealed to the Court of Appeal.

A preliminary point concerned the standing of the former liquidators to challenge the order on the basis that the applicants were former members of the company. David Richards LJ rejected that submission: it was impossible to see why they should not have standing. The other objection was based on section 108 of the Insolvency Act 1986. It did not specify who may make an application, and so the court should decide whether the appellant had a sufficient interest. Members clearly did. It was argued that the appellants did not become liquidators again on restoration of the company to the register, and so were not *'former liquidators'*. David Richards LJ referred to the practice of joining former liquidators to restoration applications, which was inconsistent with that submission. The restoration application should therefore have been served on the former liquidators, to enable them to bring matters to the court's attention regarding the proposed restoration.

The court then turned to the broader grounds of appeal. The first was that decision-making in a solvent company is vested in its members, and that includes the decision whether to go into liquidation. The Judge noted that this did not itself preclude the appointment of liquidators by minority shareholders. Importantly, the minority shareholders had failed to pursue other remedies, such as derivative actions, or misfeasance proceedings. However, the appropriateness of these routes was a fact-sensitive issue not suitable for the appeal.

The second ground related to consideration of the views and wishes of the company's members. It was essential for the court to have considered whether (and if so how) the members should be consulted. This failure was a material consideration which should have been central to the court's decision. The application had been brought by a small minority of shareholders: it was manifest that members as a whole should have been consulted in a course of action, the appointment of proposed liquidators, apparently for their benefit. The Judge's order therefore could not stand.

The Judge considered what steps should follow. It was still not known whether the members wanted the new liquidators to continue their investigations. He would therefore not set aside the orders made below. Nor would he simply remove the present liquidators, as the company was in existence, and liquidators needed to be in place. The proper course was therefore to do what should have been done at the beginning, and convene meetings of the members of each company to resolve whether the company should remain restored. In the absence of exceptional circumstances, the court would give effect to the resolutions made at those meetings. ■

## Virgin Atlantic Airways Limited

**[2020] EWHC 2191 (Ch) and [2020] EWHC 2376 (Ch)(Mr Justice Trower (convening hearing) and Mr Justice Snowden (sanction hearing))**
**4 August 2020 and 4 September 2020**

*Part 26A of the Companies Act 2006 – notification - convening hearing - sanction hearing*

This was the first restructuring plan to be convening and sanctioned under Part 26A of the Companies Act 2006 ('**CA 2006**'). Virgin Atlantic Airways Limited ('**VAAL**') proposed the restructuring plan with four classes of its creditors as part of a wider restructuring with other stakeholders:

(1) secured creditors under a revolving credit facility;

(2) certain aircraft lessors;

(3) various connected parties; and,

(4) certain trade creditors (the '**Trade Plan Creditors**').

100% consent had been obtained from all of the classes save for Trade Plan Creditors before the convening hearing. Due to the plummet in demand for international travel caused by the ongoing COVID-19 pandemic, VAAL was likely to enter administration in mid-September if the restructuring plan was not sanctioned.

At the convening hearing Trower J held that, given VAAL's dire financial position, the threshold conditions in section 901A CA 2006 were plainly satisfied. Other than this, the case law applicable to Part 26 was broadly applicable to Part 26A, particularly in respect of notification and class composition. This was apparent from the wording of Part 26A itself, the accompanying Explanatory Notes and the recent Practice Statement published alongside the enactment of Part 26A. In terms of notification, the court had to be satisfied that the Trade Plan Creditors had been given adequate notice of the convening hearing, since they were the only class that had not been invited to sign support agreements in advance. There was no controversy over the four classes proposed, each of whom had different rights both absent and under the restructuring plan.

The class meetings took place by Zoom. The overwhelming majority of Trade Plan Creditors approved the restructuring plan, and each and every one of the creditors in the other classes voted in favour. Since over 75% by value of those present and voting in each class approved the restructuring plan, there was no need to apply for cross-class cram down under section 901G.

At the sanction hearing, Snowden J therefore followed the established approach for sanctioning traditional schemes of arrangement under Part 26, applying the familiar four-stage Buckley test. He noted that although the class of Trade Plan Creditors excluded certain categories of the company's trade creditors, this did not present any fairness issues because there were clear commercial justifications for those exclusions. ■

**[David Allison QC; Ryan Perkins; Lottie Pyper]**



## In the matter of Nuoxi Capital Limited

**BVI Commercial Court (Wallbank J) 20 October 2020**

*Provisional Liquidators – PRC Restructuring – Protection of Assets*

The bond trustee of a US$300,000,000 guaranteed bond programme ('**A**') issued by the respondent company ('**R**') applied to the BVI Commercial Court at short notice for the appointment of joint provisional liquidators. R had defaulted on the bonds, and in relation to two other substantial issuances, and was manifestly insolvent. R had claims of at least US$900,000,0000 pursuant to English law *'keepwell deeds'* against its ultimate parent, Peking University Founder Group Limited, which was in insolvency/restructuring proceedings in the People's Republic of China. A submitted that there was a real risk that, if the company did not assert this claim in the PRC restructuring, it might become excluded and/or procedurally barred from doing so (in circumstances were R's director had not yet pursued the claims in the PRC); such that the appointment of joint provisional liquidators was necessary to protect and preserve its sole (but very substantial) asset. Held that A had made out a *prima facie* case that the JPLs should be appointed to protect the sole asset of the R, and that it would be just/right to appoint the JPLs to pursue the company's claim in the PRC restructuring. ■

**[Mark Philips QC; William Willson]**


# Corporate Insolvency

## Re Fortuna Fix

**[2020] EWHC 2369 (Ch) (ICC Judge Jones) 3 September 2020**

*Purpose of administration – Administrators' proposals*

Administrators applied for approval of proposals for the achievement of the purpose of administration. The context involved an acrimonious dispute between the largest minority shareholder of the company and supporting creditor ('**Salamander**'), on the one hand, and companies connected with the majority shareholder, and the majority creditor ('**GTL**'), on the other. Salamander was concerned that the majority creditor rejected the administrators' proposals out of self-interest and for a collateral purpose, including to prevent the administrators from investigating the claim against GTL, among other claims. GTL, the opposing creditor, retorted that it rejected the proposals due to the lack of prospect of achieving the objective of administration. The administrators had rejected the proposals.

Two principal legal issues arose for consideration. The first was whether the court had jurisdiction to direct that the administrators shall not seek a decision from creditors under paragraph 56 of Schedule B1. ICC Jones held that the court did have this jurisdiction. This followed from the construction of the statute, which did not place any express fetters on the right to apply to court for directions. It did not constrain the court's overall role by statute, or its inherent jurisdiction, to control and direct insolvencies within the statutory scheme, which was well-established. The power to direct an administrator included the power to direct an administrator not to perform a duty.

The second issue related to the exercise of the court's discretion to direct a meeting, and the question whether or not an administration would achieve a better outcome for creditors than an immediate liquidation. The Judge noted that the court should have regard to all relevant circumstances, and that while the interests of the majority normally bear more weight, that was not necessarily so. The court could consider whether the reasons put forward were 'rational', such as whether those particular creditors were facing claims from the company in question.

In the above context, the administrators had issued two applications regarding the purpose of administration. One contained a proposal for achievement of the first purpose of administration. But there was no sufficient statement of how this might be achieved. Reference was made to *'consensual agreement'* with key stakeholders regarding, among other things, the ongoing litigation. This did not constitute a sufficient proposal, and nor did it have any prospect of success in view of the lack of evidence supporting it.

The second was whether the administration would result in a better outcome for creditors as a whole compared to an immediate liquidation. There was nothing to suggest that the result of the pending litigation would be any different in an administration, and again, no evidence was provided to support the conclusion that the claims would be funded in a liquidation but not in an administration. A *'licence agreement'* represented one of the potential assets of the company. However, there was no evidence to support a realistic prospect that it could be sold, or that there was a market for it. The evidence also failed to deal with whether the agreement was assignable.

The Judge therefore refused to authorise the administrators' proposals, and ordered an adjournment of 14 days, in which time creditors could consider their options, in advance of a decision whether to wind up the company compulsorily. ■

**[Jeremy Goldring QC; Marcus Haywood; Adam Al-Attar; Robert Amey]**




## Re Hat & Mitre Plc

**[2020] EWHC 2649 (Ch) (Trower J)**
**8 October 2020)**

*Validity of out of court appointment of administrators – Unfair harm*

The applicants were directors and, together, majority shareholders of Hat & Mitre Plc (the '**Company**'). The Company was placed into administration by its directors following a meeting at which the board was split, with the applicants voting against administration and the other two directors, who were minority shareholders, voting in favour. The appointment was approved by the chairman exercising his casting vote in its favour.

It was common ground that at all times the Company was balance sheet solvent. The applicants contended that the Company was also cash flow solvent and had been placed into administration for the improper purpose of furthering the interests of the minority shareholders at the expense of the interests of the majority. As a result, they argued that the directors who voted in favour of the appointment were acting in breach of duty and the appointment was void. The applicants also maintained that they had suffered unfair harm by reason of:

(i) being deprived of the ability to exercise their rights as majority shareholders;

(ii) the substantial costs of the administration; and

(iii) the sale of the Company's property, which would deprive the applicants of future revenue derived from letting the property; and that this harm would be remedied by the removal of the administrators.

The application was dismissed. The Judge found that the Company was cash flow insolvent at the time at which the administrators were appointed and that while part of the purpose of the directors voting in favour of the appointment was to prevent the majority exercising control, this was not improper as it was not part of their purpose to advance the interests of the minority shareholders at the expense of the majority. Further, even if an improper purpose had been shown, this would render the appointment voidable, not void. The proper mechanism to challenge the appointment of administrators on the grounds of improper purpose was paragraph 81 of Schedule B1 to the Insolvency Act 1986, which afforded the court a discretion and so avoided the real practical difficulties that would arise if an appointment were found to be a nullity on the basis of factors that were not discernible to the administrators. On the facts the administrators had not caused unfair harm to the applicants. ■

**[Andrew Shaw]**

## Re Codere Finance 2 (UK) Ltd

**[2020] EWHC 2441 (Ch); [2020] EWHC 2683 (Ch) (Falk J)**
**13 September 2020 and 6 October 2020**

*Schemes of arrangement – Class composition – Role of ad hoc groups*

This is a rare example of a fully contested scheme of arrangement, where the Court had the benefit of hearing adversarial argument on numerous issues of class composition.

The scheme was proposed by an entity within the Codere group of companies. (A different entity within the same group of companies had proposed a scheme in 2015, which was sanctioned by Newey J.) The purpose of the scheme was to extend the maturity of certain notes governed by New York law and to provide new money to the group. The company had acceded to the notes as a co-issuer for the specific purpose of proposing the scheme (adopting a technique first used in the original Codere scheme).

The terms of the scheme were negotiated between the company and an ad hoc committee of creditors (the '**AHC**'). At the convening hearing, a dissenting creditor (Kyma) argued that the members of the AHC vote in a separate class. The Court did not accept Kyma's arguments and held that a single class was appropriate.

The AHC was entitled to receive a number of fees under the scheme and the wider restructuring transaction. In relation to each fee, Falk J held that either

(i) the fee was not relevant to class composition; and/or,

(ii) the fee was not so material that it fractured the class.

Falk J also accepted the company's evidence on the comparator to the scheme.

The key points arising out of the convening judgment are as follows:

1. **Bridge financing.** It is common for a company to obtain bridge financing from a group of creditors prior to launching a scheme. In the present case, the company obtained bridge financing from certain members of the AHC (by issuing a series of *'Interim Notes'*), and the other creditors were not given an opportunity to participate in the Interim Notes.

# Corporate Insolvency

Falk J held that the Interim Notes did not fracture the class: see [46]-[63]. In reaching this conclusion, Falk J held that the relevant question was whether the Interim Notes should be regarded as a form of *'disguised consideration'* to the AHC for supporting the scheme (following the language used by Snowden J in *Re Noble*). Falk J held that the Interim Notes could not be characterised as a form of disguised consideration. In reaching this conclusion, Falk J placed particular reliance on the fact that the Interim Notes had been issued at a fair market price (following a market-testing process where the company sought to obtain a cheaper form of financing) for the purpose of preventing a liquidity crisis.

Falk J was initially troubled by the fact that the Interim Notes were issued pursuant to the lock-up agreement in respect of the scheme. However, this did not ultimately lead her to conclude that the Interim Notes were relevant to class composition.

2. **Backstop fees**. Falk J held that the payment of backstop fees to the AHC did not fracture the class: see [89]-[91]. This is the first case in which the Court has considered this issue with the benefit of adversarial argument, although backstop fees have been considered in a number of unopposed schemes in the past. The key points that emerge from the judgment are as follows:

   (i) Where backstop fees are payable, the company's evidence should carefully identify the justification for such fees and the reason why a backstop is required.

   (ii) The backstop fees payable to the AHC should be compared to the market rate for a comparable underwriting service provided by a third party.

   (iii) In principle, there is no reason why the backstop providers cannot receive a backstop fee in relation to their own share of the new money.

3. **Work fee.** Falk J noted that the *'work fee'* paid to the AHC could be regarded as a form of disguised consideration, and held that it was relevant (at least in principle) to the issue of class composition: see [64]-[67]. However, Falk J concluded that the work fee was not so material that it fractured the class. This was based on a comparison of the work fee to:

   (i) the total value of the scheme consideration and,

   (ii) the amounts that scheme creditors would receive in a liquidation (being the comparator to the scheme).

4. **Advisers' fees.** Falk J accepted that the payment of the professional fees charged by the AHC's legal and financial advisers did not fracture the class (although her reasoning is different than the reasoning of other judges in previous authorities): see [101]-[103]. Falk J placed particular reliance on the fact that the fees were payable pursuant to separate engagement letters and did not form part of the lock-up agreement. To the extent possible, this structure should be replicated in future cases.

Following the convening hearing, Kyma dropped its opposition to the scheme and voted in favour of the scheme at the creditors' meeting. The scheme was subsequently sanctioned by Falk J, who was satisfied that the treatment of the AHC was fair and appropriate. ■

**[Felicity Toube QC, David Allison QC, Tom Smith QC, Ryan Perkins]**




## Re ED&F Man Treasury Management plc

**[2020] EWHC 2290 (Ch); [2020] EWHC 2505 (Ch) (Zacaroli J and Meade J) 11 August 2020 and 9 September 2020**

*Schemes of arrangement – Class composition*

The company applied for an order convening two meetings of certain creditors for the purpose of voting on a scheme of arrangement under Part 26 of the Companies Act 2006. The purpose of the scheme was to compromise over US$1 billion of liabilities under a series of facility agreements, together with over US$150 million under a series of private placement notes. The comparator to the scheme was a formal insolvency proceeding.

At the convening hearing, Zacaroli J accepted the company's submission that the creditors should vote in two classes. Two classes were necessary because the creditors under one facility (called the 2020 facility) were given different treatment under the scheme. Zacaroli J held that the following factors did not fracture the proposed classes:

(i) the different interest rates and maturities of the debt;

(ii) the fact that the members of an ad hoc group of creditors were entitled to have their advisers' fees paid by the company;

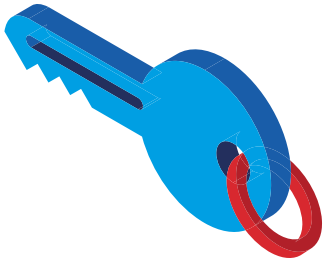
(iii) the *'elevation'* structure of the scheme (whereby creditors who agreed to lend new money were entitled to have part of their existing debt elevated in ranking); and,

(iv) the fact that the new debt instruments issued under the scheme did not have the same interest rates.

The third point is perhaps the most interesting. Under the terms of the scheme, an existing noteholder whose notes were converted into new notes would be entitled to receive the same interest rate on the new notes as it was already entitled to receive on its existing notes. This was despite the fact that the comparator was a formal insolvency (in which none of the creditors would receive any additional interest). Zacaroli J held that, whilst this aspect of the scheme created a difference in rights, the difference was not so material as to fracture the class.

The scheme was overwhelmingly approved at the creditors' meetings, and was subsequently sanctioned by Meade J. ■

**[David Allison QC; Ryan Perkins]**



# Property & Trusts

Digested by Riz Mokal

## Peninsula Securities Ltd v Dunnes Stores (Bangor) Ltd

**[2020] UKSC 36 (Wilson, Carnwath, Lloyd-Jones, Arden, Kitchin SCJJ)**
**19 August 2020**

*Restraint of trade — Covenant not to permit building of premises in competition with anchor tenant — Assignment of covenantor's interest in land — 'Pre-existing freedom' and 'trading society' tests — Practice Statement (Judicial Precedent)*

In 1980, the developer ('**Shortall**') of a shopping centre in Northern Ireland invited the defendant ('**Dunnes**'), a substantial and prestigious retail company, to serve as an *'anchor tenant'*, leasing a significant part of the centre with a view to inducing other retailers also to take out leases. Dunnes agreed subject to receiving the benefit of a restrictive covenant under which Shortall was precluded from permitting development of premises from which a business competing with Dunnes might be run. The shopping centre opened in 1982 and was a great success, but its fortunes declined over the years. The claimant ('**Peninsula**') — one of Shortall's companies, which in 1983 had taken assignment of his interest in the centre, and which at that point had given its own covenant to the same effect — blamed the covenant (by which it too was bound), and brought proceedings on the basis (among others) that the covenant was unenforceable at common law as being in unreasonable restraint of trade.

McBride J at first instance applied *'the pre-existing freedom test'* favoured by the majority of the House of Lords in *Esso Petroleum Co Ltd v Harper's Garage (Stourport) Ltd* [1968] AC 269 ('**Esso**'), by which a covenant restrictive of the use of land engages the common law rule only if the covenanter had a pre-existing freedom to use the land which they had given upon through the covenant. McBride J concluded that while Shortall had given pre-existing freedom upon giving the covenant, Peninsula had never had such freedom, with the result that the covenant it had given did not engage the common law rule. On appeal, the Court of Appeal allowed by appeal also in reliance on Esso, and remitted the case to the High Court to consider whether the covenant was reasonable. Dunnes appealed to the Supreme Court.

The Court of Appeal had focused on the question why Peninsula should not enjoy the common law rule's protection just because it surrendered no pre-existing freedom. In the Supreme Court, Lord Wilson (with whom the rest of the Justices agreed) began with the prior question why Shortall should have enjoyed the rule's protection just because he had surrendered pre-existing freedom. Following an extensive review of Commonwealth authority, Lord Wilson accepted longstanding academic criticism of the pre-existing freedom test to the effect that it leaves unexplained how the level of freedom initially available to the covenantor is pertinent to the public interest in restrictions on the use of land.

Instead, Lord Wilson turned to the broader, more flexible rule of reason (*'the trading society test'*) found in Lord Wilberforce's speech in Esso. Lord Wilberforce considered that provisions of contracts which had been moulded by negotiation, competition, and public opinion, and had come to reflect the accepted and normal currency of commercial relations, satisfied the test of public policy as understood at the time. Instead of being regarded as restrictive, such terms *'as accepted as part of the structure of a trading society'*. Adopting this test, Lord Wilson stated that it reflected the importance on the one hand of the freedom to trade, which generates the common law rule, and on the other the enforceability of contracts, which keeps that rule within bounds. Lord Wilson also highlighted the potential for change built into the trading society test to reflect changes in social circumstances and therefore in public policy.

On this basis, the Court invoked the *Practice Statement (Judicial Precedent)* [1966] 1 WLR 1234 to depart from the House of Lords' decision in Esso. ■

## Secretary of State for Business, Energy and Industrial Strategy v PAG Asset Preservation Ltd

**[2020] EWCA Civ 1017 (Floyd, Newey, and Asplin LJJ)**
**31 July 2020**

*Unoccupied commercial property - Scheme to avoid business rates — Whether misuse of insolvency legislation — Whether harm to public —Local Government Finance Act 1988, section 45(1) — Non-Domestic Rating (Unoccupied Property) (England) Regulations 2008, regulation 4(k)*

Two companies (the '**Companies**') had been incorporated as part of a scheme ('**Scheme 3**') to enable property owners to avoid liability for national non-domestic rates ('business rates') in respect of unoccupied commercial properties. The Companies' predecessor had been deployed in a previous version of the scheme ('**Scheme 2**') and had been wound up by Norris J in 2015 on public interest grounds on the basis that its business model demonstrated a lack of commercial probity as a result of a misuse of the insolvency legislation. Scheme 3 had been devised specifically to overcome the Court's objections to Scheme 2.

Under both versions of the Scheme, a landlord leased empty commercial property to a special purpose vehicle ('**SPV**') (owned, in case of Scheme 3, by the Companies), thereby making the SPV the owner of the hereditament for the purposes of section 45(1) of the *Local Government Finance Act* 1988 and liable for business rates in relation to it. The SPV was then placed in members' voluntary liquidation with the result that it was relieved of the liability to pay business rates as a result of regulation 4(k) of the *Non-Domestic Rating (Unoccupied Property) (England) Regulations* 2008. The SPV remained in liquidation until the expiry of the lease, by which time the landlord would likely have found another tenant.

Given these similarities between Schemes 2 and 3, the Secretary of State petitioned to wind up the Companies on public interest grounds. The Companies argued that Scheme 3 was materially different from Scheme 2 since it provided for the payment of a determination premium by the landlord to the SPV in the event that the landlord terminated the lease prior to the expiry of its term. This notwithstanding that the Companies accepted that the lease was highly artificial, that the determination premium was '*uncommercial*', and that it had been devised '*with a view to creating something of value to the SPV within the lease*' and with the intended consequence that the liquidator would be positively required to maintain the liquidation in being for the duration of the lease so as not to lose the opportunity of receiving the premium, were one to materialise. Further and in any case, it was understood that most of the premium would effectively be reimbursed to the landlord, were the latter to ask for such a reimbursement.

The Secretary of State for his part accepted that the leases were genuine (i.e. not sham) albeit artificial contracts with genuine albeit artificial terms as to the determination premium, and that the premiums were genuinely paid by the landlord if and when they became due even if the landlord was subsequently refunded almost all such payments.

Against this background, HHJ Stephen Davies rejected the petitions, and in the Court of Appeal, Asplin LJ (with whom the other Judges agreed), upheld his decision. Firstly, Asplin LJ approved Norris J's dictum that business rate avoidance schemes are not inherently contrary to public interest, and that this far-reaching economic and political question is one for Parliament. Second, she accepted the first instance Judge's conclusion that the determination premium created significant differences between Schemes 2 and 3: the premium was a genuine contingent asset in the liquidation and the liquidators were entitled if not required to continue the liquidation until all of the leases had determined. Thirdly, once it was accepted that the determination premium was genuine and not a sham, it could not then be impugned on the basis of the motive behind its creation. In the result, there was no misuse of the insolvency legislation. Fourthly and finally, the Court was required to identify for itself the aspects of the public interest which would be promoted by a winding-up order, and in this case, there was no evidence of harm to the public. ■

## In the matter of Supercapital Ltd

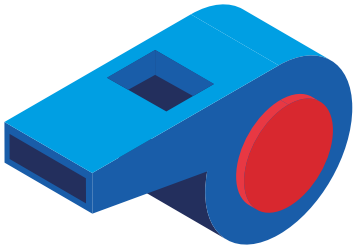
**[2020] EWHC 1685 (Ch) (Deputy ICC Judge Agnello QC) 29 June 2020**

*Authorised payments institution — Funds required to be segregated — Whether held on statutory trust — Payment Services Regulations 2017*

The Company was an authorised payments institution pursuant to the *Payment Services Regulations* 2017 ('PSRs'). As part of its business to effect international payment services, it received funds advanced by customers as well as proceeds of transactions executed on customers' behalf. The PSRs required segregation of such funds from the Company's general assets. Early in September 2019, the Financial Conduct Authority ('**FCA**'), the Company's regulator, requested and obtained an undertaking from the Company voluntarily to refrain from conducting business, and joint administrators ('the JAs') were appointed later that month.

The JAs' inquiries revealed that the funds segregated for customers fell considerably short of the sum that ought to have been segregated. They applied for directions and approval of a proposed distribution plan.

The Court held that funds required to be segregated pursuant to the PSRs were identifiable as a separate fund, were unavailable to the Company for its own use which precluded a debtor/creditor relationship notwithstanding an apparent reference to such customers as '*creditors*' in the PSRs, and customers' claims were to be paid in priority to creditors' in the Company's insolvency. Accordingly, the Company was required to hold such funds on a statutory trust, and the Court had jurisdiction, whether inherent or pursuant to paragraph 63 of Schedule B1 to the *Insolvency Act* 1986, to give directions for the funds' distribution. The Court approved the proposed distribution plan, under which all customers were to be treated *pari passu*. The issue of the JAs' remuneration was adjourned. ■



# Sport

**Digested by Andrew Shaw**

## Manchester City Football Club Limited v UEFA

*Football – Disciplinary proceedings – Financial fair play regulations*

Manchester City Football Club ('**MCFC**') appealed to the Court of Arbitration for Sport ('**CAS**') against a decision of the Adjudicatory Chamber of UEFA's Club Financial Control Body (the '**CFCB AC**') that MCFC had breached UEFA's financial fair play regulations by disguising equity funding as sponsorship income from Etihad and Etisalat and had failed to cooperated with UEFA's investigation. The CFCB imposed a two-season ban on MCFC from UEFA competitions and a fine of €30 million.

By a majority decision, CAS reversed the decision of the CFCB AC. CAS determined that there was insufficient evidence to support UEFA's allegations in relation to Etihad and that the allegations relating to Etisalat were time-barred. CAS upheld the finding that MCFC had failed to cooperate with UEFA's investigation, for which breach it imposed a fine of €10 million. ■

**[Mark Phillips QC; Andrew Shaw]**

## English Football League v Sheffield Wednesday Football Club

*Football – Disciplinary proceedings – Profit and sustainability rules*

The English Football League ('EFL') charged Sheffield Wednesday Football Club (the 'Club') with breaching its profit and sustainability rules (the 'P&S Rules') and with breaching its duty to act towards the EFL with the utmost good faith.

The Club had purported to comply with the P&S Rules for its accounting period ended 31 July 2018 but had only done so because it had included the proceeds of the sale of the stadium in its accounts for this period, despite the fact that heads of terms relating to the stadium sale had only been executed after this date. The Club maintained the heads of terms reflected a pre-existing oral agreement. The EFL also alleged that attempts had been made by officers of the Club to mislead it into believing the heads of terms had in fact been executed before 31 July 2018.

A disciplinary commission found that the stadium sale had occurred after 31 July 2018 and that, in consequence, the Club had breached the P&S Rules for the period ended 31 July 2018. However, it dismissed the allegations that the Club had failed to comply with its duty of utmost good faith, finding that there had been no deliberate attempt to by the Club to mislead the EFL. ■

**[Mark Phillips QC; Andrew Shaw]**

## English Football League v Derby County Football Club

*Football – Disciplinary proceedings – Profit and sustainability rules*

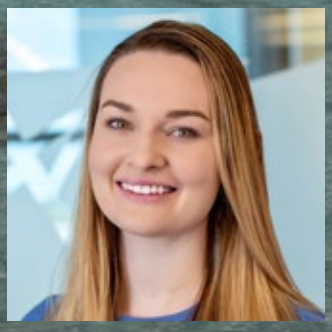
The English Football League ('**EFL**') charged Derby County Football Club (the '**Club**') with breaches of its profit and sustainability rules (the '**P&S Rules**'). The EFL alleged that the valuation applied by the Club to its stadium sale to a connected party was inflated and that the Club's approach to the amortization of player registrations did not meet the relevant accounting standards.

A disciplinary commission dismissed the charge relating to the stadium sale after hearing expert evidence. The disciplinary commission also found that the Club's amortization policy did comply with the relevant accounting standards but found that there had been a breach of those standards, and thus the P&S Rules as the Club had failed properly to disclose its change of policy in its accounts. ■

**[Mark Phillips QC; Andrew Shaw]**

# In Re LATAM Finance Limited: *is modified universalism alive and well in the Cayman Islands?*

**TOBY BROWN**



**ZOË NOLAN, ASSOCIATE**
WALKERS, GRAND CAYMAN

*Toby Brown, South Square and Zoë Nolan, Associate at Walkers and South Square / RISA Scholar (2019), consider the Grand Court's first judgment approving a direct cross-border court-to-court communications protocol in the context of Cayman Islands insolvency law.*

In contrast to the UK, cross-border insolvency law in the Cayman Islands remains to a significant extent based on common law principles rather than a comprehensive statutory regime. This was demonstrated by the Grand Court's recent decision in *In Re LATAM Finance Limited (and others)*[1], in which Neil Lupton, Marc Hecht and Zoë Nolan of Walkers represented the Joint Provisional Liquidators of three Cayman Islands domiciled companies in seeking approval of a direct cross-border court-to-court communications protocol between the courts of the Cayman Islands, New York, Chile and Colombia. Prior to the decision, the jurisdictional basis for the Cayman Court to grant such approval was unclear, as there appeared to be no unreported or reported judgment on point. In his judgment dated 24 August 2020, the Hon. Justice Kawaley therefore had to consider the source of the Court's jurisdiction at common law in respect of cross-border insolvency law. Before turning to the recent *LATAM decision*, this article will review Cayman Islands law in a cross-border insolvency context, whilst considering the extent to which "modified universalism" has been applied in the Cayman Islands.

The term "modified universalism" was described by Lord Hoffman to be "*the golden thread running through English cross-border insolvency law since the 18th century*"[2], although the precise scope of the principle at common law has been subject to judicial disagreement. In the context, "universalism" refers to the goal that there should be a single insolvency process for a debtor in which all worldwide creditors prove, administered globally by the principal liquidation proceedings[3]. The "modified" principle represents the reality that ancillary liquidation proceedings in other jurisdictions may be necessary, and the local court is under a common law duty to co-operate and assist the foreign liquidation, subject to local law and public policy. At its heart is the objective to ensure that the worldwide assets of a company or group of companies are fairly distributed amongst all creditors wherever located.

## Early common law assistance

When reflecting on Cayman Islands jurisprudence, it appears matters relating to foreign and cross-border insolvencies were not addressed in legislation until 2009. Notwithstanding this, the Grand Court has frequently recognised and provided assistance to foreign insolvencies and restructurings, and indeed sought assistance from foreign courts to assist proceedings in the Cayman Islands. This can be seen in the following three examples, though as Kawaley J recently noted in *LATAM*, the Court's long history of cooperation is not fully reflected in written judgments, given that the issues in question are usually uncontroversial.

Firstly, in *Kilderkin v Player*[4], a receiver appointed by the Supreme Court of Ontario to manage the affairs of a Canadian incorporated company, sought an order for recognition from the Cayman Court authorising it to recover the company's assets within the jurisdiction, namely monies traced to Cayman Islands bank accounts. The Court of Appeal held that (i) the Cayman Court may recognise foreign-court appointed receivers if there was a sufficient connection between the company and the jurisdiction appointing them to justify recognition of the foreign court's order; and (ii) the court's powers to refuse this recognition should only be exercised if there were strong and compelling reasons to do so. Accordingly, the Court of Appeal restored the Grand Court's order of recognition. The Honourable Chief Justice Anthony Smellie QC described *Kinderkin* as a seminal decision, commenting extra-judicially that *"the case is an expression of the Courts' understanding of the principles—later to be given the label of "universality"—with the particular emphasis upon ensuring the success of the "collective" approach to the administration of the debtor's estate"*[5].

The next decade saw the cross-border liquidation of the BCCI Group, where, as certain of the companies were registered in the Cayman Islands, the Cayman Court cooperated with parallel insolvency proceedings in England and Luxembourg. In *In Re BCCI (Overseas) Ltd*[6] the Grand Court authorised the liquidators of the primary BCCI overseas company to enter into an agreement to enable the assets of all the group companies to be pooled and distributed rateably amongst all creditors. The Court held that "*it was important and in the best interests of the creditors that the Cayman court should cooperate in enabling the assets of the group worldwide to be salvaged as far as possible and made available to the creditors*"[7]. Relevantly, a related decision in *BCCI* is also the first example of where the Grand Court issued a letter of request seeking assistance from the English High Court, pursuant to its inherent jurisdiction in the absence of a statutory provision[8].

Subsequently, in 2006 the common law world saw what was described as the "high water mark" for modified universalism in the Privy Council's well-known judgment in *Cambridge Gas Transp. Corp. v. Navigator Holdings plc*[9]. The key remaining proposition from Lord Hoffman's judgment is that modified universalism is a principle of the common law, namely that the Court possesses the power to assist a foreign insolvency process, so far as it properly can: "*recognition....carries with it the active assistance of the court*". Subsequently, as is equally well known, the decision was held to be wrongly decided on other points, first in *Rubin v Eurofinance SA*[10] and then in *Singularis Holdings Ltd v PricewaterhouseCoopers*[11]. In *Singularis*, the

1. Unreported, 24 August 2020, FSD 105, 106 and 154 of 2020.

2. *In re HIH Casualty and General Insurance Ltd* [2008] UKHL 21 at [30].

3. With full universalism only being attainable by international treaty. To be contrasted to "territorialism" which envisages that insolvency proceedings only have effect within each jurisdiction i.e. local assets for local creditors.

4. [1984-195 CILR 63].

5. *A Cayman Islands Perspective on Transborder Insolvencies and Bankruptcies: The Case for Judicial Co-Operation*, the Hon. Anthony Smellie QC, Beijing Law Review 02(04):145-154, January 2011.

6. [1992 CILR Note 7a].

7. For the parallel English decision approving the agreements, see *BCCI No 3* [1992] BCC 715.

8. *In Re BCCI (Overseas)*, Grand Court Cause 284 of 1991, December 7 2002, unreported, as cited in *In Re Basis Yield Alpha Fund (Master)* [2008 CILR 50].

9. [2007] 1 AC 508.

10. [2012] UKSC 46. The Supreme Court held that *Cambridge Gas* was wrong to hold that enforcement of insolvency judgments was governed by *sui generis* private international law rules.

11. [2014] UKPC 36.

Privy Council accepted that modified universalism is part of the common law, albeit in a more limited sense than was posed in *Cambridge Gas*, given that the court can only act subject to local law and public policy, and within the limits of its own powers. Accordingly, common law assistance could not extend to applying by analogy statutory provisions which would have been available in the case of a domestic liquidation. Although the Board held that the Bermudian court had the power at common law to assist a foreign liquidation by ordering production of information, the Court could not utilise the power as the Cayman liquidators could not obtain such relief under laws of their home jurisdiction, namely the ability to obtain working papers from auditors.

Turning back to Cayman authorities, *Cambridge Gas* was first cited in *In Re Lancelot Investors Fund Limited*[12] where shareholders petitioned for the winding-up of a Cayman incorporated company, notwithstanding that the company had already filed for Chapter 7 bankruptcy protection in the USA where a trustee had been appointed under the US Bankruptcy Code, who claimed to have exclusive jurisdiction over all the assets of the company. Against the arguments of the company and the trustee who sought to maintain the "universality" of the US bankruptcy proceedings, Quin J made a winding-up order and appointed a Cayman liquidator. However, as Quin J recorded, the Grand Court "*embraces the concept of co-operation and co-ordination as reflected by the principles of international judicial comity*". He accordingly stayed the winding-up order to allow the Cayman liquidator and Chapter 7 trustee to discuss their respective roles and try to agree a protocol between themselves for an efficient liquidation, and to apply for recognition in each other's jurisdictions. The case therefore exemplifies the "modified" nature of the principle as applied in the Cayman Islands.

## 2009 legislative changes

With that brief review of earlier Cayman authorities, we turn to changes made to put cross-border insolvency law onto a (partial) statutory footing, in circumstances where the Cayman Islands is not a signatory to the UNCITRAL

12. [2009 CILR 7].

Model Law on Cross-Border Insolvency. With effect from 1 March 2009, Part XVIII ("International Cooperation") of the Companies Law was enacted to codify the jurisdiction of the Grand Court to recognise and provide assistance to foreign representatives of overseas bankruptcy proceedings[13]. Additional provisions are contained in what is now the Foreign Bankruptcy Proceedings (International Cooperation) Rules, 2018.

Under section 241 of the Companies Law (2020 Revision), the Grand Court is able to make orders ancillary to a foreign bankruptcy proceeding, including staying legal proceedings against the debtor and requiring relevant persons to provide information or produce documents. The criteria contained in section 242 by which the Court is to exercise its discretion includes "*the just treatment of all holders of claims against or interests in a debtor's estate wherever they may be domiciled*"[14] and "*comity*"[15]. The criteria also reflects the "modified" nature of universalism, given that the Court is required to consider "*the protection of claim holders in the Islands against prejudice and inconvenience in the processing of claims in the foreign bankruptcy proceeding*"[16].

One of the leading cases on the new statutory powers is *Picard v Primeo Fund*[17] where the trustee in bankruptcy of BLMIS, as US entity, was recognised by the Cayman Court and sought assistance to bring clawback claims (including under US law) against Primeo, a Cayman company[18]. The Court of Appeal rejected the argument that modified universalism and comity required that section 241 of the Companies Law be interpreted as allowing transaction avoidance claims to be brought in Cayman under US law. However, the Court held such claims could be brought under that section by applying Cayman avoidance provisions in aid of the foreign insolvency proceedings.

It should be noted, however, that these statutory provisions are limited to situations where the debtor company is incorporated *outside* of the Cayman Islands, and has become subject to bankruptcy (including restructuring) proceedings. As a result, the common law remains applicable in other situations and in particular where the debtor is incorporated in the Cayman Islands (including, as we will see, in the case of *LATAM*).

## More recent cases

A number of cases over the last decade illustrate the continued relevance of the common law in cross-border insolvencies in the Cayman Islands.

For instance, in *In Re HSH Cayman I GP Limited*[19] the Court of Appeal considered whether winding-up petitions brought by creditors against four Cayman incorporated companies ought to have been stayed or adjourned on the basis, *inter alia*, that the companies had commenced proceedings under Chapter 11 of the US Bankruptcy Code in Delaware. Counsel for the companies claimed that the Cayman winding up orders had been made inconsistently with the common law principle of comity, and this raised issues which made the Delaware Court's task more difficult. The Court rejected the companies' argument and held that the orders would be affirmed, as they were in-keeping with the common law principles of comity and could not be said to make the Delaware Court's job more difficult than it would otherwise be. Accordingly, there was no basis on which winding-up orders could ultimately be refused.

Further, in *In Re China Agrotech Holdings Ltd*[20] liquidators appointed by the Hong Kong court over a Cayman incorporated company applied to the Hong Kong court for the sanction of a scheme of arrangement. In addition, the liquidators sought to implement a parallel scheme in the Cayman Islands, although they considered it undesirable to present petitions for winding up or for the appointment of provisional liquidators. Since this was not a foreign company, Part XVIII of the Companies Law was inapplicable, and therefore consideration had to be given as to the extent of the common law power which traditionally applied to recognition and assistance to foreign liquidators appointed in the place of incorporation. Notably, Segal J held that the power did extend to foreign liquidators even though appointed in a place which was not the country of incorporation. However, applying *Singularis*, Segal J refused to grant the precise relief sought since it would only have been available if Cayman provisional liquidators had been appointed. Nonetheless, the Judge, in demonstrating the Cayman Court's practical approach to issues of cross-border restructurings, held that the common law power did allow the Court to grant the liquidators the ability to promote a scheme of arrangement, and the Court assisted by authorising the liquidators to convene scheme meetings and consent to the scheme on behalf of the company. Further, Segal J innovatively directed that any proceedings issued against the company would be allocated to himself so he could consider whether to stay them.

Lastly, in the recent decision of *In Re Silk Road Funds Ltd*[21] the Grand Court was requested to recognise receivers appointed by the Bermudian Court over a segregated account (part of a Bermudian segregated accounts company), who sought assistance in the form of Norwich Pharmacal orders against liquidators of two Cayman companies. Smellie CJ agreed that Part XVII of the Companies Law was not applicable given that the segregated account did not fall within the definition of "debtor". He equally rejected the argument that modified universalism could apply where the company was not in

13. Smellie CJ writing extra-judicially (supra at FN 5) suggests that the legislation is aimed at codifying the common law and in further achieving the objectives of the UNCITRAL Model Law. In *Picard v Primeo Fund* [2013 (1) CILR 164] at [10], Jones J suggested that the draftsperson of the Cayman provisions appeared to have paid regard to the wording of s. 304 of (repealed) US Bankruptcy Code, and they were not intending to enact provisions based on the UNCITRAL Model Law.

14. Section 242(1) (a) of the Companies Law (2020 Revision).

15. Section 242(1) (g).

16. Section 242(1) (b).

17. [2014 (1) CILR 379].

18. In proceedings reported at [2010 (1) CILR 231].

19. [2010 (1) CILR 375].

20. [2017 (2) CILR 526].

21. Unreported, 8 February 2018, FSD Cause No 234 of 2017, ACSJ. Released from embargo on 30 May 2019.

liquidation. However, applying *Kilderkin* (above), the Judge granted the relief sought, and held that the Grand Court still had a power at common law to assist receivership proceedings taking place under the Bermudian Court's supervision, subject to the limits analogous to those set out in *Singularis*.

## LATAM: background

Against that backdrop we now address the *LATAM* decision, which concerned three Cayman domiciled companies (the '**Companies**') which form part of the LATAM Airlines group ('**LATAM**'), the most significant airline in Latin America. The impact of travel restrictions due to the COVID-19 pandemic severely impacted the airline industry and as a result, LATAM Airlines Group S.A. (the '**LATAM Parent**') and certain of its affiliated debtors and debtors-in-possession commenced voluntary reorganisation proceedings in the US Bankruptcy Court for the Southern District of New York, seeking relief under Chapter 11 of Title 11 of the US Bankruptcy Code.

As part of LATAM's restructuring strategy, the Companies made applications to the Grand Court pursuant to section 104(3) of the Companies Law, obtaining orders for the appointment of provisional liquidators (the '**JPLs**'). This is a commonly used procedure given that the Cayman Islands does not have an equivalent restructuring process to Chapter 11 in the US or to administration in the UK (although proposals are being considered to amend the Companies Law to permit the Court to appoint "restructuring officers").

The US Court issued an order authorising the LATAM Parent to act as the foreign representative in foreign proceedings and requested foreign recognition of the Chapter 11 proceedings. Following suggestions made by the Chilean Court, a motion was submitted to the US Court seeking approval of a protocol between the courts of New York, Chile, Columbia and the Cayman Islands (the '**Protocol**'). The Protocol was designed, amongst other things, to facilitate the efficient and effective administration of the proceedings and to implement a framework to address any cross-border issues that may arise from time to time in the proceedings and to promote international cooperation and respect for comity.

Accordingly, the JPLs made applications to the Grand Court seeking approval of the Protocol.

## LATAM: judgment

In his judgment delivered on 24 August 2020, Kawaley J noted that this appeared to be the first time that the Grand Court had approved a direct cross-border court-to-court communications protocol, stating that the jurisdictional basis for the decision was unclear. This was notwithstanding the importance of cross-border communications having been a key feature of international insolvency and restructuring for some time.

Since the Companies were incorporated in the Cayman Islands, the provisions of Part XVIII of the Companies Law concerning recognition of and assistance to foreign proceedings were not applicable[22]. Accordingly, as in the cases reviewed above, it was necessary for Kawaley J to consider the source of the Court's power at common law.

As those various cases demonstrate, the Judge commented that so far as cross-border insolvency law is concerned, the Cayman Islands remains to a significant extent a "traditional" common law jurisdiction, and the importance of international financial centres utilising common law powers in the absence of comprehensive statutory international cooperation codes has long been recognised.

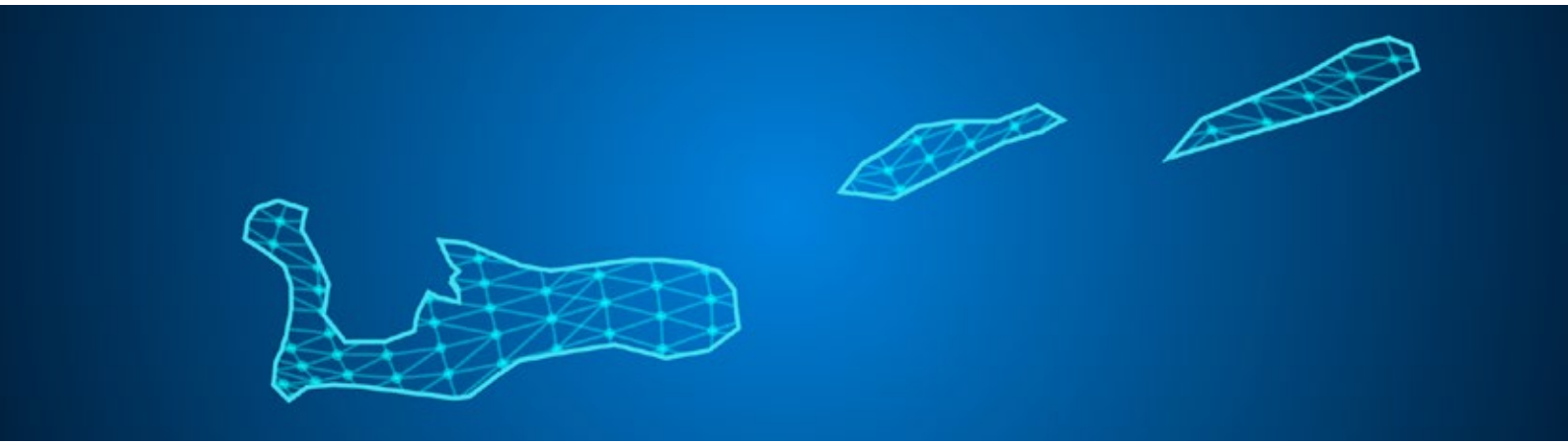
Citing *Cambridge Gas* and *Singularis* amongst other cases, Kawaley J remarked that the principal foundation of the Court's jurisdiction to approve the Protocol was the common law duty to assist foreign insolvency courts in service of the goal of universal application of the regime for dealing with creditors' claims being applied in the main insolvency proceedings (i.e. modified universalism). Kawaley J cited Smellie CJ's statement that the deeper underpinning of the common law power is the principle of comity: "*the over-arching principle is, of course, comity - that civilized notion that requires reciprocity of co-operation and assistance between the courts of different countries*".

On a review of a number of the Cayman decisions considered in this article, Kawaley J commented that "*the commercially-driven rationale of the doctrine of modified universalism underpins the instinctive assumption by this Court that it should manage insolvency cases with a crossborder element in way which fosters cooperation with overseas courts*". The Judge concluded that the cooperation seen in past cases had been grounded, even if only tactically, in the Grand Court's common law duty of assistance and "*to promote the most economically efficient administration of transnational insolvency estates*".

However, the Judge further acknowledged the relevance of other subsidiary sources of jurisdiction to approve the Protocol, namely the Court's inherent jurisdiction, fortified by the constitutional protections for judicial independence, being the source of its power to issue practice directions. Here, importantly, the Chief Justice had issued the Practice Direction No. 1 of 2018, which administratively approved two sets of guidelines for court-to-court communications (the '**Guidelines**'), published by the American Law Institute and the International Insolvency Institute ('**ALI/III**'), and the Judicial Insolvency Network ('**JIN**')[23].

22. Given the design of the Protocol, Order 21 of the Companies Winding Up Rules 2018 (which imposes a duty on official liquidators to consider entering into an international protocol with a foreign officeholder) was also not applicable.

23. In addition, Practice Direction No. 2 of 2019 adopted the JIN Modalities for Court-to-Court Communication, which govern the mechanics of communication between participating courts in parallel proceedings.



Kawaley J commented that the Practice Direction does not seek to promulgate new law, but seeks to encourage office-holders to consider incorporating some or all of the Guidelines into an international protocol for approval by the Court. The Guidelines include a series of practical operational principles, which are essentially different forms of communications, such as exchanging copies of court filings, communications between judges and joint hearings.

The Judge stated that the Practice Direction and associated Guidelines might be viewed as emerging sources of law which have been described as "soft law instruments", building on the more substantive common law principles mandating assisting foreign insolvency courts as far as possible and the inherent jurisdiction of the Grand Court to manage its own processes. Accordingly, the Judge held that the applicable governing principles for an application to approve a court-to-court communication could be summarised as follows:

a) *the Court is under a positive duty to assist the primary foreign main insolvency or restructuring proceeding, unless there are good reasons not to do so;*

b) *there is a starting assumption that a clear framework for communication between the Grand Court and any relevant foreign courts in cross-border insolvency cases will enhance the efficiency of the cross-border case; and*

c) *there is a starting assumption that the ALI/III Guidelines and/or the JIN Guidelines are suitable guides to adopt and apply in cross-border cases.*

In light of the clarity and depth of the common law principles commending judicial coordination and communication in cross-border insolvency cases, combined with the recent promulgation of the Practice Direction, Kawaley J held that it was obvious that the Protocol could only properly be approved. The approval sought also implicitly required the Court to recognise the Chapter 11 proceedings as the foreign main proceeding, which the Grand Court, with the courts of Chile and Colombia, was willing to assist. The Judge commented that the matter was entirely uncontroversial, given that the requisite recognition had already been effectively granted by the Court's initial appointment of the JPLs over the Companies for the purpose of pursuing a restructuring, which was contemplated to materialise primarily though the Chapter 11 proceedings in the US Bankruptcy Court.

## Conclusion: is modified universalism alive and well in the Cayman Islands?

The cases spanning decades reviewed in this article confirm that the Cayman Courts have applied the principle of modified universalismand accordingly provided recognition and assistance in aid of foreign insolvency and restructuring proceedings. No doubt there are other decisions of the Grand Court which do not result in reported judgments where the assistance was uncontroversial. Yet the decisions of the Grand Court and Court of Appeal above also show the limit on universalism, i.e. the *modified* nature of the principle, as well as the limits post *Singularis*.

Whilst there are arguments in favour of the Cayman Islands enacting a more complete statutory framework for cross-border insolvency, such as the UK's Cross-Border Insolvency Regulations 2006, the necessity can also be questioned by the demonstrated ability of the Cayman Court to provide assistance at common law. In this regard, Kawaley J concluded by citing what he described as the Chief Justice's propitious remarks 10 years ago[24], that the Grand Court's ability to co-operate could in large measure be attributed to "*the flexibility provided by the wide discretion vested in the Court*" and that the Cayman Islands' jurisprudence "*can be expected to develop well in pace with the development of the common law principles of comity, in keeping with the principles of the UNCITRAL Model Law and in keeping with the legitimate demands of the international financial markets within the wider global economy.*"

Those sentiments are undeniably reflected in the decision in *LATAM*, which in approving a direct court-to-court communications protocol for the first time, together with the Chief Justice's practice directions, exemplifies the willingness of the Grand Court to use the common law and its inherent jurisdiction to solve cross-border issues, absent a comprehensive statutory regime or international treaties. ■

24. *Supra* at FN 5.

# Euroland

PROFESSOR
CHRISTOPH G PAULUS

Even though the pandemic still dominates much of the economic and legal landscape of Euroland – everywhere a monster insolvency wave is predicted and expected, but nowhere is it currently much more than just little waves – I shall primarily review the CJEU's latest case law below.

### A. CJEU, decision from 16 June 2020 – C-253/19 (Novo Banco)

This is a decision which, as with *Eurofood, Interedil, Rastelli and Leonmobili*, deals with questions of Centre of Main Interests (COMI) as defined in art. 3 EIR. Irrespective of the attempted legislative specification of the definition through the Recast-Regulation 848/2015, the wealth of case variants is so enormous it appears that definition defies any precision – at least whilst the European Court puts so much emphasis on the specific particularities of each individual case.

In this case an employed couple with the names MH and NL functioned as plaintiffs; both are employed and have lived in Norfolk, England since 2016. One of the two defendants in this case was Novo Banco, a Portuguese bank, its involvement being the result of the plaintiffs having filed a petition to open an insolvency proceeding against themselves in Portugal. Despite the rule given in the 4th subpar. of art. 3 par.1 EIR which determines in the case of MH and NL that the court of their habitual residence, i.e. Norfolk, as the competent court, MH and NL relied on what Recital 30 offers as specification. With regard to an '*individual not exercising an independent business or professional activity*', it is stated that the presumption for the habitual residence should be rebuttable '*for example where the major part of the debtor's assets is located outside the Member State of the debtor's habitual residence...*' MH and NL had one immovable, real estate asset located in Portugal and they contended that their insolvency stemmed from transactions related to this real estate.

The court of first instance rejected the petition on the ground of lack of international jurisdiction. MH and NI lodged and appeal against that judgment, claiming that it was based on a misinterpretation of the rules laid down in Regulation 2015/848. In contrast, the Court of Appeal in Guimarães, Portugal, was uncertain because of Recital 30 and referred the case to the Court in Luxembourg. This is perfectly understandable given the CJEU's general preference to clarify issues primarily on the basis of the Recitals (and – until not too long ago – the Schmit/Virgós Report). This time, however, the CJEU deviated from this tradition and agreed with the Portuguese Insolvency Court.

It is at this point where the reader of the decision is eagerly expecting that hints will be given as to how to interpret the term '*habitual residence*'; after all, there is a high practical demand for this kind of information – and Attorney General Szpunar commendably tried to elaborate this question in his opinion. Not so, however, the Court – at least not in an overly helpful way. From par. 16 on it emphasizes the indispensable need for a uniform and autonomous interpretation of art. 3 EIR as well as the continuity in interpretation between the Original and the Recast Regulation, so that strong emphasis has to be given to the objective and subjective criteria that make the COMI ascertainable by third parties – all of which is not really more than repetition of what is well-known already. Without really drawing any conclusion from the foregoing, the Court summarizes: "*that the relevant criteria for determining the centre of the main interests of individuals not exercising an independent business or professional activity are those connected with their financial and economic situation which corresponds to the place where they conduct the administration of their economic interests or the majority of their revenue is earned and spent, or the place where the greater part of their assets is located.*"

This definition brings the reader more or less back to square one. The decisive argument for rejecting the Portuguese Court's jurisdiction has, thus, to be why the example given in Recital 30 is of no relevance in the present case. The Court refers to Szpunar's opinion and adds that the '*mere fact*' of the immovable asset's location being abroad '*is not sufficient on its own*' to rebut the presumption. And the submission that the debts primarily result from transactions around this immovable asset in Portugal is wiped aside as explaining the insolvency reason which is said to have nothing to do with the determination of the debtor's COMI. This is highly disputable as the creditors' ability to ascertain location is essential for the COMI concept – as the Court explained only a few lines before.

All this is slightly frustrating as there is little, if any, guidance given for future cases. In addition, what leaves a somewhat unpleasant aftertaste is that the decision confines its description of the factual circumstances to a bare minimum. One wonders where the plaintiffs had been before they moved to *England*? One is tempted to assume that they are possibly Portuguese nationals who had their real estate back home. But even if this were not the case it would have been a very valuable information for such future cases in which advice is to be given as to the employed debtor's COMI.

## B. Advocat General Bobek's opinion in the Matter J & S Service C-620/19

Among lawyers, there is a certain amount of joy over the CJEU's tendency to stretch its own competence quite far. Paradigmatic is the so-called "Dzodzi-doctrine" from the case with that name (C-297/88 and C-197/89) which has been upheld by the court despite harsh and constant criticism. The Dzodzi doctrine states that the Luxembourg court is competent to decide not only those cases where a rule within the European legislative act itself is in dispute, but also in those in which purely domestic rules are at stake which contain a reference to European law. The present case is, pursuant to Bobek, testing the utmost borderline of such indirectness – and indeed the Advocat General recommends the CJEU rejects the case on the ground of lacking competence.

The facts of the case are rather simple. An insolvency administrator in Germany, acting for the estate of a company, requested files regarding the debtor company from the tax authorities in order to prepare potential claw-back claims against them. Irrespective of the general free information act in that particular "Land" (Nordrhein-Westfalen) the authorities rejected the request by referring to sec. 32c par.1 no.2 of the General Tax Code ("Abgabenordnung"). This states that a person concerned may not request access to its person-related data when there is the possibility it may impair the authorities' defense in a private law action; a reference is given in the legislative text to art. 23 of the European General Data Protection Regulation EU 2016/679. German claw-back actions from insolvency administrators are a private law matter. The German legislator has included this exception in sec. 32c General Tax Code because, without it, the tax authorities would be in a worse position than all other potential defendants in claw-back cases; none of them has a corresponding duty to bring forward the evidence which can be used against them (*nemo tenetur edere contra se ipsum*).

The court of first and second instance, nevertheless decided in favour of the suing insolvency administrator. Only the Supreme Court in Administrative law (*Bunderverwaltungsgericht*) referred several questions to the court in Luxembourg, based on the Dzodzi-doctrine.

I shall not present these questions in this edition of the South Square Digest, though this may change at a later date when, and if, the CJEU rejects Advocat General Bobek's plea not to accept the case on lack of competence. For the moment it is of primary interest to read his arguments. In the first place – but mentioned only in footnote 4 – he pleas for a complete abandoning of the Dzodzi-doctrine. However, realistic enough to

1. CJEU, dec. from 18 September 2019 – C-47/18; cf. Euroland, in South Square Digest, November 2019, p. 36.

know the quite unshakeable path-dependency of the court, Bobek concentrates on arguing why he thinks that in this particular case the court should reject acceptance of the case. For this purpose he submits a fine-tuning of the doctrine: In his opinion it should be applicable only when

(1) *the respective national law refers directly, unconditionally, and in a general manner to the rule of European law the interpretation of which is the subject of the referred question;*

(2) *the context of the national rule and of the European law rule has to be functionally and legally comparable and similar since only then there is a need for a uniform interpretation at all; and*

(3) *the referring national court has to precisely line out that and in how far the previous two requirements are met.*

What is new in this check-list is step no. 2. And it is exactly here where Bobek cannot see a need for a uniform interpretation. Whereas the Regulation rule is determining the limits of the protection of the individual's data, the General Tax Code aims to guide the tax law application in Germany. And whereas the Regulation deals with the relationship between individual and the responsible person, in the German rule the insolvency administrator is treated as a third party (i.e. he is not replacing the debtor). And finally, whereas the Regulation protects only the rights of individuals, the German rule applies in the context both of natural and legal persons. Under these circumstances, the German rule is so intrinsically embedded in a specific German legal context that there is no urgency to provide for a uniform understanding of the data protection rule. One is eager to see how the Court will react to this proposal – if it reacts at all.

## C. In the Matter Riel, Reference for a preliminary ruling, reference number C-25/20

Mr. Riel is the insolvency administrator in one of the biggest Austrian cases ever, Alpine Bau GmbH. In this position he has already made it once to the CJEU in a Poland-related case and the decision is known under his name[1]. Now he approaches the Court again – this time related to the Slovenian extension of Alpine. A final decision is certainly not to be expected before the end of next year – or, more likely, the first half of the year thereafter.

The Austrian proceeding commenced in June 2013 and was declared by the Vienna court as being the main proceeding pursuant to art. 3 EIR (EC 1346/2000). One month later or so, Mr. Riel requested the opening of a secondary proceeding in Slovenia; the court in Celje complied and had the secondary proceeding opened a few days later. Slovenian insolvency law (as does, for example, Hungarian insolvency law) includes the feature that claims are to be lodged within three months and failure to do so means loss of the claim.

Art. 32 par. 1 EIR (EC 1346/2000) allows all creditors to lodge their claims in any of the proceedings, main or secondary. Complementing this attempt to have all creditors participating in the various insolvency proceedings of their common debtor, par. 2 of that norm obliges ('*shall*') all administrators to lodge the claims of their proceeding in the other ones when and if this serves the interests of their creditors. In many – if not most – cases creditors will not know about the commencement of a parallel proceeding abroad so that usually the administrator is called upon to act as art. 32 par.2 EIR (EC 1346/2000) prescribes.

This is what Mr. Riel wanted to do. However, the sheer size of the proceedings caused the determination of the claims admitted in the Austrian proceeding to take literally years. In order to fulfill his obligation, Mr. Riel lodged those claims in the Slovenian proceeding in early 2018. The court in Celje declared this as belated which, in turn, meant that the respective claims are to be treated under Slovenian law as being extinguished. Mr. Riel opposes this ruling and requests the CJEU to decide on the question whether the administrator of a main proceeding must be given the possibility to lodge "his" claims in any secondary proceeding.

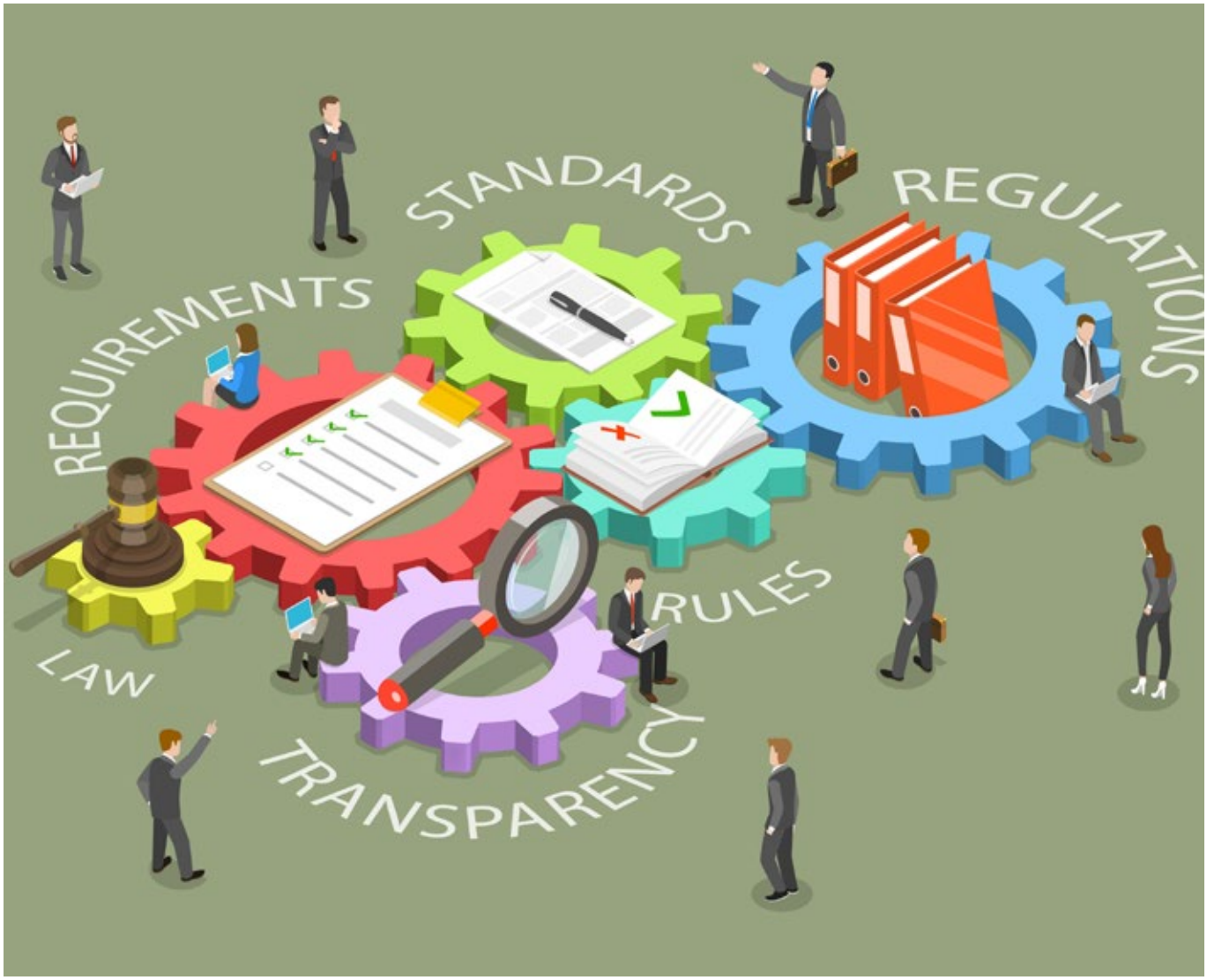
It is impossible to predict what the outcome will be. Option one is the emphasis on the independence of a secondary proceeding that is explicitly, art. 28 (EC 1346/2000), subjected to the domestic insolvency law. When, thus, Slovenian insolvency law has such an extinction rule then it has to applied and to be obeyed. After all, all creditors of the Austrian proceeding had the right and chance to lodge their claims on their own at the Celje court. Mr. Riel could have instructed and recommended them to do so.

On the other hand, the complex task of examining and verifying the claims which took the Austrian administrator of the main proceeding some five years would have been an almost unsurmountable task when and if it had to be done by the Slovenian administrator of the secondary proceeding. Most of the relevant files are presumably at the debtor's centre of main interests, i.e. in Austria. Therefore, for primarily practical reasons, the better result would be when the CJEU confirms Mr. Riel's request and opens the possibility for him to lodge those claims. The dogmatic argument could be the one that this very court had already used in its *Handlowy* (C-116/11): there, a court of the secondary proceeding was ordered to have regard to the principle of sincere cooperation as laid down in art. 4 par. 3 EU in order to adjust the Polish proceeding to the needs and peculiarities of the French main proceeding. But – again: it is usually very hard to anticipate the CJEU's result.

## D. Preventive restructuring framework in Germany

Having mentioned the Dutch proceeding that transposed the Directive EU 2019/1023 on preventive restructuring frameworks, we briefly describe the German version. The first draft was published in mid-September by the respective Ministry and it is supposed to enter into force by 1 January 2021. The reason for this almost breath-taking speed is COVID-19 and the anticipated and still expected insolvency wave which it is hoped will be softened by such insolvency avoidance procedure.

Whereas the Dutch legislation is marketed and designed as the successor-in-waiting of the English scheme of arrangement after Brexit, the German draft is surprisingly silent in that regard. All that is mentioned is that the proceeding shall be



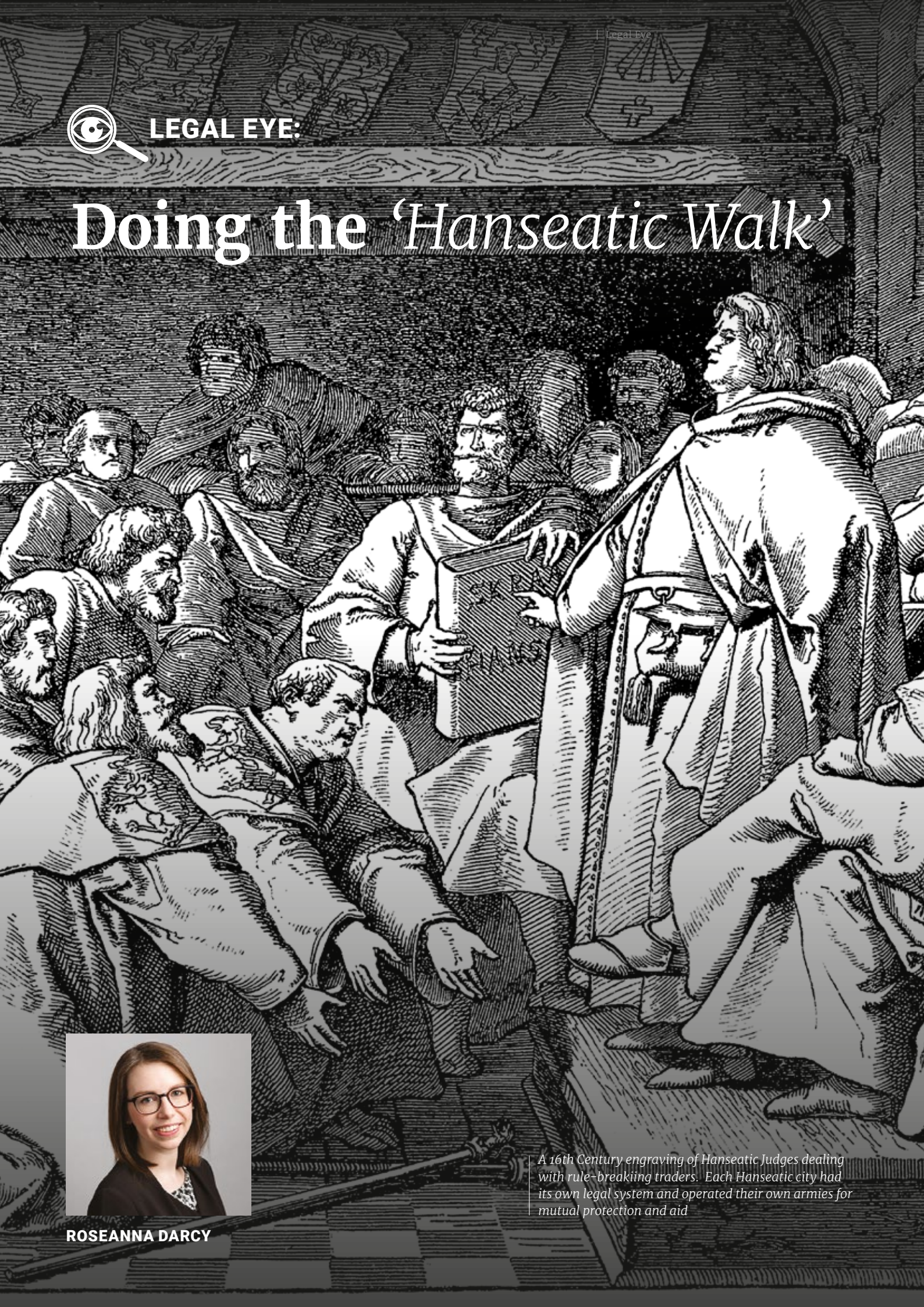

included in Annex A of the EIR when and if the debtor requests the court to register it for public notification. This is important for automatic recognition in the EU member states but presupposes that the debtor's COMI is in Germany.

The draft statute provides not so much a coherent proceeding but offers, more or less, a tool-box from which the debtor can draw whatever might be suitable for rescue. The tools range from mediation-like support for negotiations with the creditors over a pre-check of the envisaged plan by the court, a plan proceeding (in many aspects strongly resembling the plan proceeding in the insolvency code), to a moratorium of 3 months (prolonged under rare circumstances for up to 8 months) to terminating executory contracts. The appointment of a restructuring representative ('*Restrukturierungsbeauftragter*') is mandatory, i.e. in cases in which the envisaged restructuring supposedly affects rights of consumers or micro-small or medium enterprises. In the light of such a rule it is to be assumed that there will rarely, if ever, be a case without a mandatory restructuring representative. However, as in an insolvency proceeding in which the debtor is not replaced by an administrator ('*Eigenverwaltung*'), the debtor has a right to propose a particular person with experience in such affairs, to act independently from the debtor and creditors and to be suited for the case at hand.

The advantage of such a tool-box approach is its flexibility and adaptability to the individual case. Particularly to the English readership of this Digest it might be recorded that the plan proceeding shares with its English counterpart in sec. 901A et seq. Companies Act 2006 not only the name (*Restrukturierungsplan*) but has also many commonalities – such as being permitted only when insolvency is threatening, the selection of particular creditors to be included in the proceeding, cross-class cram-down, etc. However, much of the flexibility is buried under a detail-obsessed legislation. The draft has 108 sections many of which are themselves quite wordy; this is an unfortunate feature of most German legislation. ■

LEGAL EYE:

# Doing the *'Hanseatic Walk'*



ROSEANNA DARCY

*A 16th Century engraving of Hanseatic Judges dealing with rule-breakiing traders. Each Hanseatic city had its own legal system and operated their own armies for mutual protection and aid*

It is hoped readers will read the title of this latest edition of the Legal Eye in the tune of "Doing the Lambeth Walk", for it was this Noel Gay jingle which sprang to mind when I first discovered Hanseatic Walk, a small back street in the City of London behind Canon Street station, on the banks of the River Thames and surrounded by a multitude of law offices. Indeed, it was this location which attracted my "legal eye".

In fact, as it turns out, the location and name of Hanseatic Walk reveals a whole hidden history of London and other cities across Europe which, in the context of our ongoing trade talks with the EU (which by any luck will have resulted in some form of agreement by the time this article reaches publication), is both topical and may even provide a glimpse into a possible new trading future.

Hanseatic Walk may now just be a pleasant path to walk along by the river. However, between the 13th and 17th centuries it was the site of an important trading post for the Hanseatic League – a trading union of towns, cities and merchant guilds across northern Europe. At its height in the 13th and 14th century, the Hanseatic League was made up of around 200 towns stretching from Novgorod in Russia to King's Lynn in Norfolk.

London itself was never formally a Hanseatic city. However an area known as "Steelyard", on the site where Canon Street station now stands, became one of the most important trading hubs of the League. Populated principally by Germanic merchants in the cloth and fur trade, the site became a well-recognised and trusted part of the English economy. Some estimates suggest that the trade from this site represented some 15% of the national import and export market. Its status was bolstered when in 1232, Henry III granted a charter to "*the merchants having a house in the City of London*" specifying that they "*should be maintained and upholden through the whole realm by all such freedoms and free usages, or liberties as by the king and his noble progenitors' time they had, and enjoyed*".

Hanseatic Walk is not the only reminder of the Hanseatic League's presence in England. The only remaining Hanseatic building in England is the timber framed Hanse House in King's Lynn, a warehouse used to store, weigh and assess goods. Back in the City, you will find Steelyard Passage, Skinner's Hall where the fur trade was based, and the Pelt Trader pub. There is even a theory that the name or our currency "*sterling*" is a corruption of "*Easterling*", the name given to the residing merchants who minted coins in their own name. Further afield, reminders such as the German "*Lufthansa*" airline, and football team "*Hansa Rostock*" evidence the enduring roots of the League.

One of the reasons for the success of the Hanseatic League was its uniformity across the region in which it operated. Close relations were developed between individual guilds or "*Hansas*", innovative payment mechanisms were offered allowing borrowers lines of credit, standardised weights and measures were used along with a form of trademark to stamp on cloth to prevent imitation, regular meetings were held to regulate affairs, and from 1373 a court of appeal operated in the German port town of Lübeck to settle disputes. In fact one such dispute in 1473 (which was settled prior to escalation to this court of appeal) took place in Bruges (one of the Hanse towns) and was attended by representatives of Lübeck and other Hanse towns, the Society of the Merchants' Hanse in London, as well as three commissioners from King Edward IV. It seems that hostilities had broken out between the English crown and the Hanse merchants. In a settlement treaty reached between the parties, it was agreed that all aggressions between the parties would cease, with compensation due from King Edward to the Hanse merchants in the sum of £15,000 reduced to £10,000 in consideration of protection against further suits for past-grievances. It was also agreed that King Edward would prevent vexatious delays at London's Customs House and confirmed that the London based Hanse merchants would continue to enjoy their privileges first bestowed to them by Henry III's charter.

However, the League's downfall was ultimately at the hand of the rise of the nation state. Whilst in the earlier periods, the League was able to quell the interference from weaker medieval governments, by the 16th century this was beginning to change. In 1597, Queen Elizabeth I evicted the Hansa from Steelyard stemming from fears the Hanseatic's maritime dominance threatened that of England. Although the merchants were subsequently allowed to return, the site never regained the same significance before it was finally destroyed in the Great

The Steelyard – The Hanseatic League's London Base

Fire of London. Similarly in Lübeck, a war with the Swedish monarchy in the 1530s resulted in the end of the trading monopoly across the Baltic Sea. The final nail in the coffin came in the form of the Thirty Years' War in the 17th century where the newly emerged nation states no longer accepted the presence of the League, with the final gathering of the Hanseatic League taking place in 1669.

There are those who suggest the Hanseatic League was some form of prototype for the European Union. Indeed Angela Merkel described the League as a role model for the EU during the opening ceremony for the Hansemuseum in Lübeck in 2015. One can see why, although the League certainly never had the kind of political or economic integration associated with the EU. Nevertheless, the League allowed individual cities to flourish and prosper outside of any national discourse. Operating separately from the nations which housed it, the League was able to survive and transcend clashes between governments and monarchs and it is its economic achievements which are remembered today.

This has led some to query whether there is any prospect of some form of revived Hanseatic League in the post-Brexit era where the linking between particular businesses, industries and urban centres could help to transcend international politics. Whilst the collaboration between eight northern EU members led by the Netherlands has been dubbed "Hanseatic League 2.0" in its efforts to promote free markets and more liberal economics, another "New Hanseatic League" has also formed, simply known as Hanse. This organisation is made up of 194 Hanseatic cities across 16 countries, with King's Lynn once again flying the flag so to speak on behalf of English towns. It is joined by Boston, Great Yarmouth and Hull, along with Aberdeen and Edinburgh in Scotland. As it states on its website, Hanse *"has set itself the task of reviving the ideas and spirit of the European city/municipality on the basis of the cross-border concept of the historic Hanseatic League."* With an active network, it not only promotes the exchange of ideas, culture and tourism, but also supports an international network of businesses, with members regarding themselves as *"respectable merchants of modern times".* Whilst disputes between members and individual traders may today have to be pursued through the ordinary courts, as with the original Hanseatic League, Hanse does have its own Assembly in which member cities send their delegates to be represented at Hanse-wide meetings.

And so, whilst nations move to become more independent, this has not prevented cities from retaining a sense of shared community with enduring international links. As one commentator expressed; *"Nations come and go. Cities endure".* Regardless therefore of Britain's future trading links with fellow countries, the collaboration between towns and cities will continue. It only remains to be seen who else will end up Doing the Hanseatic Walk. Oi! ■

# Behind closed doors: *the Government's Pre-Pack Review*

JAMIL MUSTAFA

## Introduction

On 8 October 2020, the Government published its review into the effectiveness of certain voluntary measures in improving the transparency of sales in pre-packaged administrations or 'pre-packs (the '**Pre-Pack Review**'), which were introduced following the Graham Review into pre-pack administrations (the '**Graham Review**').[1] The Government concluded that legislative intervention was necessary to address continuing concerns in relation to pre-packs, in particular their perceived lack of transparency and prejudice to unsecured creditors where they involve the sale to a company, new or otherwise, connected to the insolvent company (a 'connected person').[2] However, a question mark lingers over both the likely efficacy and prudence of the Government's proposed legislative reforms.

## Pre-packs

As explained by HHJ David Cooke (sitting as a High Court Judge) in *Re Kayley Vending Ltd* [2009] EWHC 904 (Ch) (at [2]):

*"Pre-packs are increasingly common, and highly controversial. The term refers to a sale of all or part of the business and assets of a company negotiated 'in principle' while it is not subject to any form of insolvency procedure, but on the footing that the sale will be concluded immediately after the company has entered into such a procedure, and on the authority of the insolvency practitioner appointed. That procedure is now most commonly used in administration, but not necessarily so."*

Accordingly, pre-packs allow directors of insolvent companies, prospective administrators and purchasers to agree a sale of the business and assets of an insolvent company before placing any proposals before its creditors and without the approval of the court.[3] *Ex hypothesi*, secrecy is inherent in the pre-pack process. This secrecy has significant advantages. It enables the business and assets of an insolvent company to be sold swiftly, and without the adverse publicity of insolvency proceedings, thereby preserving their value and securing a better price for them. As a result, and significantly, pre-packs often preserve the jobs of the insolvent company's employees. At the same time however, the secrecy of pre-packs has caused concern, largely on the interrelated grounds that they lack transparency and prejudice the unsecured creditors of the company, who are unable to participate in the decision for a pre-pack sale, which is made unbeknownst to them by the directors of the company, the prospective administrator(s) and purchaser. When later made aware of the sale, the general body of the company's creditors are presented with a *fait accompli*, which they lack the information to properly interrogate, and if necessary, challenge.[4]

These concerns are most acute where a pre-pack involves a sale to a connected person, for example a new company controlled by the existing management of the insolvent company and/or their associates. They further precipitated the promulgation of a statement of insolvency practice devoted to pre-packs, SIP 16, requiring an administrator to disclose material details of a pre-pack sale to the company's creditors, to ensure that they have sufficient information to understand the decision for a pre-pack sale, and enable them to question and/or even challenge the decision, albeit after the event.[5]

## The Graham Review

The same concerns also later prompted the Graham Review. The Graham Review was an independent review commissioned by the then Secretary of State for Business, Innovation and Skills, the Rt Hon Vince Cable MP, to investigate the use and wider economic impact of pre-packs, which reported in June 2014.[6] The Graham Review did not recommend the prohibition of pre-packs, recognising that they "*have a place in the insolvency arena*".[7] In particular, it found that in many cases a pre-pack was the best *"or perhaps more fairly the least worst outcome for all stakeholders in a business-including all classes of creditor."*

Nevertheless, the Graham Review concluded that reforms were necessary. Notably, it found that pre-pack sales to connected parties accounted for nearly 65% of pre-packs within its 2010 dataset, and that such sales were less likely to deliver a return to creditors than unconnected pre-packs.[9] Furthermore, it discovered that the (new) purchasing company was more likely to fail within its first three years in connected sales than in unconnected sales.[10]

By way of reform, the Graham Review recommended six voluntary, industry-led measures, largely directed at alleviating concerns relating to connected sales. These measures significantly included:

- The establishment of a group of experienced businesspeople, the so-called 'Pre-Pack Pool' which could be approached, on a voluntary basis, for an opinion in respect of a proposed pre-pack sale to a connected person. A negative opinion from the Pre-Pack Pool would not prevent a pre-pack sale from going ahead, albeit the administrator(s) would have to refer to that opinion in their SIP 16 report.
- The requirement for a connected party purchaser to prepare a 'viability statement'

1. The Pre-Pack Review can be found at https://www.gov.uk/government/publications/pre-pack-sales-in-administration.

2. A connected person or party is a term of art within the insolvency legislation, and although defined in slightly different ways (see sections 249 and 435 of the Insolvency Act 1986 and paragraph 60A of Schedule B1 to the Insolvency Act 1986), the essence of the definition is broadly the same. In this respect, where used interchangeably herein, the terms connected person/party and connected sale refers to the situation where, in relation to a pre-pack sale, the owners of the (usually new) purchasing company are the same as, or associated with, the owners and/or controllers of the insolvent company.

3. *Re Kayley Vending* at [2] and [16]-[17] per HHJ David Cooke; see also *Re Hellas Telecommunications (Luxembourg) II SCA* [2009] EWHC 3199 (Ch) at [8] per Lewison J.

4. *Re Kayley Vending* at [11] per HHJ David Cooke.

5. Re Kayley Vending at [4] and [12] per HHJ David Cooke; see also Re Hellas Telecommunications at [7] per Lewison J.

6. A copy of the Graham Review can be found at https://www.gov.uk/government/publications/graham-review-into-pre-pack-administration.

7. Para 8.2 of the Graham Review.

8. Para 8.13 of the Graham Review.

9. Para 7.50 of the Graham Review.

10. Para 9.3 of the Graham Review.

in respect of the new company, explaining how it will survive for at least the next twelve months following the sale.[11]

- Changes to SIP 16 incorporating the other measures proposed by the Graham Review.
- Marketing for pre-pack sales to be undertaken in accordance with a set of six principles of good marketing, any deviation from which to be fully explained in the SIP 16 report.
- Valuations to be carried out by independent valuers with professional indemnity insurance ('PII'). If a valuer lacks such cover, the administrator must explain their choice of valuer.

The then-Government accepted all of the recommendations of the Graham Review, which were then adopted by the insolvency industry in late 2015. The Graham Review further suggested that the Government consider introducing a reserve legislative power to regulate pre-pack sales to connected persons in case the above measures failed to have the desired effect.[12] The Coalition Government also accepted this further recommendation. Section 129 of the Small Business, Enterprise and Employment Act 2015 (the '**SBEEA 2015**') inserted paragraph 60A into Schedule B1 to the Insolvency Act 1986 (**'IA 1986**'), which granted the Secretary of State a power, in a sunset clause, to prohibit or restrict pre-pack sales to connected persons. That power expired in May 2020 but was revived until the end of June 2021 by the Corporate Insolvency and Governance Act 2020 ('**CIGA 2020**').

## The Pre-Pack Review

Against this background, the central purpose of the Pre-Pack Review was to determine whether that revived power should be exercised considering the impact and effectiveness of the reforms introduced following the Graham Review. Accordingly, the Pre-Pack Review focused on connected sales.

The Pre-Pack Review found that compliance with the measures recommended by the Graham Review varied considerably. Despite the number of pre-pack sales to connected persons increasing since 2016, it found the number of referrals to the Pre-Pack Pool was consistently very low. Similarly, a very low proportion of connected sales included a viability statement in their SIP 16 statements (just 28%). Conversely, the Government found that marketing activity had increased for connected sales. Equally, the Pre-Pack Review found substantial compliance with the requirement for an independent valuation by a valuer with PII, and further that a majority of connected sales were made at or above any such valuation. That being said, the Pre-Pack Review also found that compliance with the six principles of good marketing varied greatly from case to case, and that a significant number of connected sales (over a third) were at less than the relevant market valuation.

Overall, the Pre-Pack Review concluded that the reforms introduced by the Graham Review had failed to live up to expectations, and concerns remained in relation to the transparency of pre-pack sales to connected parties and potential prejudice to unsecured creditors. Nevertheless, the Government affirmed the value of pre-packs as a useful tool in insolvency and concurred with the Graham Review that they should not be banned. It did however conclude that further regulation was necessary, and the power in paragraph 60A of Schedule B1 to the IA 1986 ought to be exercised.

## The Draft Regulations

The Pre-Pack Review recommends that the power be exercised along the lines of draft regulations, entitled the 'Administration (Restrictions on Disposals etc. to Connected Persons) Regulations 2020', published alongside the Pre-Pack Review (the '**Draft Regulations**'). The Draft Regulations apply where an administrator intends to make a "*substantial disposal*", defined as a disposal, hiring out, or sale of all or a substantial part of a company's business and assets to one or more connected persons[13] within eight weeks of the company's entry into administration. [14]

The Draft Regulations prevent an administrator from making any such substantial disposal without either the approval of the company's creditors or a report from a qualified person.[15] The person providing any such report, the "*evaluator*", must be independent of the company in administration, the connected party purchaser and the administrator, and the administrator must have no reason to doubt their independence. However, the obligation rests on the connected person, rather than the administrator, to obtain the report.[17]

Where a report is provided, the administrator is obliged to consider it.[18] The report must either state that "*the case is made*" for the proposed disposal, meaning the evaluator is satisfied that the consideration provided and the grounds for the substantial disposal are reasonable in the circumstances, or "*the case is not made*" if the evaluator is not satisfied of these matters.[19] A report stating that the case is not made does not stop an administrator from proceeding with the disposal, albeit they must provide a statement

11. Para 9.10 of the Graham Review.

12. Paras 9.37-39 of the Graham Review.

13. As defined in paragraph 60A(3) of Schedule B1 IA 1986.

14. Regulation 4 of the Draft Regulations.

15. Regulations 5, 8(1), 9 and 10 of the Draft Regulations.

16. Regulations 7(b) and (f), 8(1)(b) and 10 of the Draft Regulations.

17. Regulations 7(a) and (c) and 10 of the Draft Regulations.

18. Regulation 7(e) of the Draft Regulations.

19. Regulation 8(3)(f) of the Draft Regulations.


setting out their reasons for doing so.[20] Further, the administrator must provide copies of any such report to the company's creditors (redacted if and where appropriate) and to Companies House.[21]

## Comment

The Pre-Pack Review confirms that pre-packs remain susceptible to criticisms of opacity and prejudice to unsecured creditors in relation to connected sales. It further confirms that the approach of voluntary, industry-led reform, recommended in the Graham Review, has not succeeded in allaying concerns in this respect. Consequently, the Government has chosen to take more concrete legislative measures, which it intends to bring forward as soon as possible before June 2021. However, its Draft Regulations are far from a panacea.

The Draft Regulations do not require creditor approval of a connected sale. A connected party purchaser may simply obtain a report from an evaluator, on the basis of which an administrator can approve the pre-pack sale without consultation with the company's creditors. The likelihood of administrators adopting this approach is amplified by the fact that they are typically involved in the negotiations for a pre-pack sale prior to their appointment. Moreover, the Draft Regulations impose the obligation to obtain that report on the connected party purchaser who can therefore choose the evaluator, albeit subject to the requirements of the Draft Regulations. While those requirements stipulate that the evaluator must be independent of the connected party purchaser, administrator and the company, there is nothing preventing a connected party purchaser from seeking reports from multiple potential evaluators and selecting the report most supportive of the proposed sale.

In any event, an administrator may proceed with a connected sale even if an evaluator provides a case not made opinion so long as they justify their decision to do so. While, in principle, there is no objection to this, insofar as the pre-pack sale furthers the purpose(s) of the administration, it begs the question of what purpose is served by the proposed legislative reforms if decision-making power remains with the directors, the administrator(s) and the connected party purchaser, who will continue to make the material decisions behind closed doors.

As explained above, the secrecy of the pre-pack process is simultaneously the source of its significant benefits and drawbacks. The Draft Regulations internalise, albeit they do not resolve, this tension. Perhaps the better conclusion to the Pre-Pack Review would have been to accept the rough with the smooth and abstain from further regulation. Such acceptance would not have left pre-packs unsupervised. Administrators are officers of the court, even when appointed out-of-court, and are subject to its control, albeit they are accorded great latitude in relation to pre-pack sales. The trouble with further legislative restrictions is that they risk doing too much, eviscerating the benefits of pre-packs, or too little. ■

20. Regulation 12(1)(b) of the Draft Regulations.

21. Regulation 12(1)(a) and (2) of the Draft Regulations.

22. See *Re Kayley Vending* at [24] per HHJ David Cooke; and *Re Hellas Telecommunications* at [8] per Lewison J; see also *Re Moss Groundworks* Ltd [2019] EWHC 2825 (Ch).

# Legislative Developments: *Extension of Temporary Provisions and Return of Crown Preference*

PAUL FRADLEY

The Government has recently extended a number of the temporary provisions to protect companies from the economic effects of the COVID-19 pandemic which were introduced in the Corporate Insolvency and Governance Act 2020 ('**CIGA**'). These temporary provisions, along with the other provisions of CIGA, were discussed earlier this year by Mark Phillips QC, William Willson and Clara Johnson in July's "Special Edition" of the Digest. The temporary provisions in CIGA were due to come to an end on 30 September 2020, however, the continuing effect of the pandemic has led to the extension of many of them. The Corporate Insolvency and Governance Act 2020 (Coronavirus) (Extension of the Relevant Period) Regulations 2020 (the '**Extension Regulations**') were made contemporaneously with the Chancellor's announcement of a renewed package of support for the economy and came into force on 29 September 2020. They were followed on 1 October 2020 by the Corporate Insolvency and Governance Act 2020 (Coronavirus) (Early Termination of Certain Temporary Provisions) Regulations 2020 (the '**Early Termination Regulations**') which curtail the effect of some of the extensions made by the Extension Regulations. These extensions provide welcome additional breathing space for companies struggling with the economic effects of the pandemic.

The extensions fall into four categories with different new expiry dates. Firstly, restrictions on the use of statutory demands and the presentation of winding-up petitions have been extended to 31 December 2020.[1] A winding-up petition cannot, therefore, be presented on the basis of a statutory demand served from 1 March 2020 to 31 December 2020. This was further extended to 31 March 2021 by the Corporate Insolvency and Governance Act 2020 (Coronavirus) (Extension of Relevant Period) (No. 2) Regulations 2020. While the other grounds for winding-up a company remain open, until 31 March 2021, a petitioner cannot present a petition unless they have reasonable grounds to believe that the pandemic has not had a financial impact on the Company, or that the relevant grounds would have applied even if the pandemic had not had an effect on the Company (the '**Coronavirus Test**'). Additionally, a court may not make a winding-up order unless it satisfied that the Coronavirus Test has been met. The Government's reason for the extension is to "*continue to provide breathing space to companies whilst coronavirus related restrictions remain in place (including social distancing and regional lockdowns).*"[2] However, the Explanatory Memorandum also recognises that this "*is a significant intervention into the normal working of insolvency law, in particular the rights of creditors and consequently any single extension of this measure should be of a shorter duration.*"[3]

Secondly, some of the temporary provisions in the new Rescue Moratorium procedure[4] have been extended. The default position is that these temporary provisions have been extended to 30 March 2021 by the Extension Regulations. However, this must be read in conjunction with the Early Termination Regulations, by which certain provisions of Schedule 4 of CIGA cease to have effect. The temporary provisions which continue until 30 March 2021 include: (a) the ability of a company subject to an outstanding winding up petition to obtain a moratorium by filing or lodging documents at court, (b) the rule that only an overseas company may obtain a moratorium by making a court application under section A4 of the Insolvency Act 1986, and (c) the ability of a company to obtain a moratorium even if the company has been subject to a different moratorium, CVA or administration in the last 12 months. However, the Early Termination Regulations terminate, from 1 October 2020, provisions including: (a) allowing a Monitor to disregard aspects of the Company's financial position that relate to the pandemic when considering whether the Company is rescuable for the purposes of having a moratorium, and (b) relaxing the conditions for extending, monitoring and terminating the moratorium on the grounds that any worsening of the Company's financial position, because of the pandemic, should be disregarded.

The effect of the changes is that from 1 October 2020 the lower threshold for entering into a Rescue Moratorium will no longer apply and the Monitor will not be able to disregard the economic impact of the pandemic when considering whether the Company is rescuable. The Government explained that "[t]*he temporary moratorium measures will make the procedure more accessible to companies during this difficult period, which therefore provides breathing space for companies to consider rescue and restructuring options, which ultimately could lead to the rescue of more companies impacted by coronavirus*".[5] When explaining the Early Termination Regulations, the Government highlighted the original legislative intention of the Rescue Moratorium to minimise "*the risk of increasing the number of so-called zombie companies*" and justified the curtailing of the extensions on the ground that "[a]*llowing the rescue criteria to take into account any worsening of the financial position caused by coronavirus could impede restructuring in the wider economy, leading to further damage to creditors or suppliers.*"[6]

1. See CIGA, Sch. 10.

2. The Explanatory Memorandum to the Extension Regulations, para. 7.2.

3. The Explanatory Memorandum to the Extension Regulations, para. 7.3.

4. See Part A1 of the Insolvency Act 1986.

5. The Explanatory Memorandum to the Extension Regulations, para. 12.1.

6. The Explanatory Memorandum to the Early Termination Regulations, para. 7.4.

Thirdly, the temporary exception for 'small entities' from the new ban on the termination of contracts for the supply of goods and services on the basis on insolvency[7] (or 'ipso facto' clauses) has been extended to 30 March 2021. The Government considered that "[e]*xtending this measure provides certainty to small suppliers that whilst they attempt to recover from any financial impact coronavirus has had on their business they can continue to rely on contractual termination clauses where their customer has entered a formal insolvency procedure*".[8] Fourthly, companies and other qualifying bodies will continue to be able to hold their Annual General Meetings ('**AGMs**') virtually until 30 March 2021,[9] but the provisions allowing the delaying of AGMs have not been extended.[10] According to the Government the original extension to 30 December 2020 followed substantial representations from the business community seeking such an extension.[11] The further extension to 30 March 2021 was required because public health measures are *"highly likely"* to be required into the New Year.[12] It should be noted that the extension applies only to some, but not all, qualifying bodies under the original provisions in CIGA.[13]

The notable absence from the Extension Regulations is any mention of the *'temporary suspension'* of wrongful trading liability ('the **Temporary Suspension**'). Section 12 of CIGA provides that in a wrongful trading claim the court will assume that a director is not responsible for any worsening of the company's, or its creditor's, financial position between 1 March 2020 and 30 September 2020. This was not extended and came to an end on 30 September 2020. No particular reason was given in the Explanatory Memorandum as to why the Temporary Suspension was not extended.[14]

However, on 26 November 2020 the Government published new regulations which apply the Temporary Suspension between 26 November 2020 and 30 April 2020.[15] It is notable though that the new extension does not have retrospective effect – there is, therefore, a gap between 1 October 2020 and 25 November 2020 when the Temporary Suspension did not apply. The Government justified the move on the grounds that the level of economic uncertainty caused by the second national lockdown is in various respects comparable to that in the first national lockdown.[16]

## New Temporary Insolvency Practice Direction

A new Temporary Insolvency Practice Direction (the '**TIPD**') took effect on 1 October 2020, following the approval of the Lord Chancellor, and will continue until 31 March 2021.[17] The TIPD replaces the previous Temporary Insolvency Practice Direction which came into force on 6 April 2020 but ceased to have effect on 1 October 2020. The TIPD covers: (a) notices of intention to appoint, and notices appointing, an administrator, (b) winding-up and bankruptcy petitions, (c) other insolvency hearings, and (d) statutory declarations. Winding-up and bankruptcy petitions will continue to be heard remotely,[18] however, for other insolvency hearings the parties will be required to liaise in order to agree the format of the hearing, being either in-person, remote or hybrid.[19] If the parties are unable to agree on the format, they must provide their proposals to the Court, which will determine the format for the hearing.[20] The position as regards notices of intention to appoint, and notices appointing, an administrator and statutory declarations remains substantively the same as in the earlier (6 April 2020) practice direction.[21]

## Return of Crown Preference

In a non-COVID related legislative development, the Finance Act 2020 received Royal Assent on 22 July 2020. Practitioners will no doubt recall that tax debts were once given preferential status in the statutory Waterfall that applies when distributing the assets of a debtor (commonly known as '**Crown Preference**'). The preferential status of assessed taxes (such as corporation tax) was removed in 1986[22] and for the remaining collected taxes (such as VAT or PAYE) it was removed in 2002.[23] The total abolition of Crown Preference was accompanied by the introduction of the Prescribed Part,[24] by which (up to a cap) certain funds which would have been distributed to the floating charge holder are instead earmarked for distribution to unsecured creditors.

Under the Finance Act 2020 and the accompanying regulations,[25] a limited form of Crown Preference is back. For insolvency proceedings commencing after 1 December 2020, HMRC will be a secondary preferential creditor in respect of taxes including VAT, PAYE income tax, employee national insurance contributions, student loan repayments and construction industry scheme deductions (the '**Relevant Taxes**'). The effect of this is that HMRC's claims for the Relevant Taxes will rank behind employee preferential debts but ahead of floating charge holders and unsecured creditors. This preferential status applies regardless of when a floating charge was created.[26] The Government justified this reform by highlighting the £3.5 billion HMRC writes off each year due to insolvency and the "*limited scope* [HMRC has] *to recover outstanding tax debt once a business becomes insolvent because of its status as a non-preferential*

7. Insolvency Act 1986, s. 233B.

8. The Explanatory Memorandum to the Extension Regulations, para. 7.5.

9. Originally 30 December 2020 but extended by The Corporate Insolvency and Governance Act 2020 (Coronavirus) (Suspension of Liability for Wrongful Trading and Extension of the Relevant Period) Regulations 2020 (the '**Suspension and Further Extension Regulations**'), reg. 3.

10. CIGA, Sch. 14.

11. The Explanatory Memorandum to the Extension Regulations, paras. 7.8 –7.9.

12. The Explanatory Memorandum to the Extension Regulations, para. 7.11.

13. See the Extension Regulations, reg. 2 (5).

14. The Explanatory Memorandum to the Extension Regulations, para. 6.4.

15. The Suspension and Further Extension Regulation, reg. 2.

16. Explanatory Memorandum to the Suspension and Further Extension Regulations, paras 7.5-7.9.

17. Temporary Insolvency Practice Direction, para. 2.

18. Temporary Insolvency Practice Direction, para. 2.

19. Temporary Insolvency Practice Direction, paras. 5.1-5.2.

20. Temporary Insolvency Practice Direction, paras. 5.3-5.4.

21. Temporary Insolvency Practice Direction, paras. 3 and 6.

22. By Schedule 6 of the Insolvency Act 1986.

23. By the Enterprise Act 2002, s. 251.

24. Insolvency Act 1986, s. 176A.

25. The Insolvency Act 1986 (HMRC Debts: Priority on Insolvency) Regulations 2020.

26. Unlike the Prescribed Part which applies only to floating charges created on or after 15 September 2003.


*unsecured creditor*".[27] The focus of the various explanatory documents was entirely on the financial benefit to HMRC from the changes.[28]

However, the return of Crown Preference will inevitably reduce returns to floating charge holders and unsecured creditors in a liquidation or a distributing administration, thus increasing risks for lenders and those doing business with struggling companies. The position of other creditors is, in fact, worse than it was prior to the Enterprise Act 2002 in two respects. Firstly, the balance struck in the 2002 Act of giving to the floating charge holder with one hand (by abolishing Crown Preference) and taking with the other (through the Prescribed Part) has been undermined. The floating charge holder faces the double-whammy of returned Crown Preference and the continued Prescribed Part, both reducing recoveries. Moreover, the Government recently increased the maximum size of the prescribed part from £600,000 to £800,000 for floating charges created on or after 6 April 2020.[29]

Secondly, both floating charge holders and unsecured creditors will be impacted by the lack of a restriction in the new law on the amount or age of collected tax debts which have preferential status. This is unlike the pre-2002 Act law where collected tax debts only had preferential status if they were referable to periods of 12 or 6 months (depending on the type of tax) before the commencement of the insolvency process.[30]

The impact of this difference on the floating charge holder and unsecured creditors could be magnified by the Government's programme allowing companies to defer various tax liabilities, including VAT. As restrictions on creditor action against companies end at the start of 2021, companies entering into insolvency processes could owe significant deferred tax liabilities to HMRC, which now have preferential status in their entirety.

In addition, the return of Crown Preference will have an impact on efforts to restructure struggling companies. Because of HMRC's status as a preferential creditor, a CVA or IVA must allow for those debts to be paid in preference to unsecured creditors unless HMRC's consent.[31] The status of some HMRC debt as preferential could also create class difficulties in any scheme of arrangement under Parts 26 or 26A of the Companies Act 2006. HMRC will, therefore, have a great deal of power in restructurings, in circumstances where their interests may not be in line with those of the unsecured creditors. It was concerns over the impact of the return of Crown Preference on finance for companies, especially SMEs, and the rescue culture which underlined opposition to the changes by professional bodies, including R3.[32] The changes brought by the Finance Act 2020 are oddly incongruent with CIGA and efforts to support and rescue business through the pandemic. ■

27. The Explanatory Memorandum to the Insolvency Act 1986 (HMRC Debts: Priority on Insolvency) Regulations 2020, paras. 7.1 -7.2.

28. See also the Explanatory Notes to the Finance Act 2020, pp 177-179.

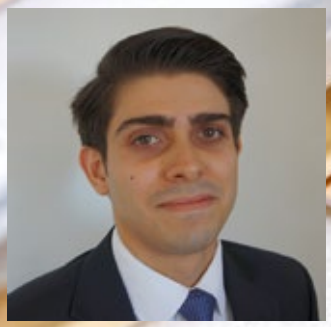
29. The Insolvency Act 1986 (Prescribed Part) (Amendment) Order 2020.

30. Insolvency Act 1986, Sch. 6.

31. Insolvency Act 1986, s. 4 (4) and 258 (5).

32. See R3's response to the Government's 2019 consultation exercise at: https://www.r3.org.uk/stream.asp?stream=true&eid=22210&node=206&checksum=3980287DCCB674126785FA13F6.

# Update:
## *the Disclosure Pilot Scheme*



JAMIL MUSTAFA

On 22 September 2020, the Rt Hon Lord Justice Flaux, Chair of the Disclosure Working Group ('**DWG**'), published an update on the operation of the Disclosure Pilot Scheme (the '**DPS**') in Practice Direction 51U ('**PD 51U**').[1] Published alongside the update was the Third Interim Report into the DPS, dated 25 February 2020, prepared by Professor Rachael Mulheron, which collated and analysed responses from legal practitioners to a questionnaire circulated in October 2019 seeking their views on the operation of the DPS to date.[2]

In particular, the questionnaire sought practitioners' views on: (i) specific aspects of PD 51U, including Initial Disclosure and the Disclosure Review Document ('**DRD**'), which is a central pillar of the DPS; and (ii) the overall effect of the DPS to date, which was "*intended to effect a culture change*" in the disclosure process, encouraging co-operation between the parties and their legal representatives in the disclosure process, and ensuring that disclosure is no wider than is reasonable and proportionate to the resolution of the issues in the proceedings.[3]

With respect to the second of these matters, and significantly, practitioners were overwhelmingly critical and disparaging of the DPS. The DPS was introduced to simplify the disclosure process and reduce costs by targeting disclosure to the specific issues arising in the proceedings. Conversely, the Third Interim Report found that an overwhelming majority of practitioners were of the view that the DPS has increased costs. Equally, a large majority of practitioners stated that the DPS had increased, rather than reduced, the burden on the courts with respect to disclosure. Further, and importantly, a similarly large majority of practitioners said that the DPS had failed to achieve the culture change that it was hoped it would bring.

Accordingly, in the DWG's update, Flaux LJ outlined a number of proposed amendments to PD 51U for consideration by the Civil Procedure Rules Committee ('**CPRC**'). Broadly, the proposed amendments have one of three (intended) effects:

- **They clarify certain matters in relation to the DPS which were hitherto unclear.** In this respect, and amongst other things, the Third Interim Report found that many practitioners were uncertain as to whether parties' obligations to disclose 'known adverse documents' arose when a party gave Initial Disclosure or later. One proposed amendment confirms that any such obligation does not take effect unless and until Extended Disclosure is ordered. Likewise, another confirms that parties' legal representatives may confirm, on their behalf, that they have complied with their duties of document preservation.
- **They reduce the obligations of parties and/or their legal representatives under the DPS.** Perhaps most significantly, the proposed amendments to PD 51U include limiting the obligation to complete the DRD to those cases where the parties agree that search-based Extended Disclosure Models are required, namely any one of Models C-E. The DRD was heavily criticised by practitioners in their responses to the questionnaire, who reported finding the DRD to be a time-consuming, costly, and difficult document to prepare. The DWG no doubt hopes to respond to these criticisms by restricting the requirement to complete the DRD to where the parties opt for a search-based disclosure model. Similarly, elsewhere, a proposed amendment relieves parties of the obligation to prepare a List of Issues for Disclosure where they agree to restrict Extended Disclosure to Models A and/or B.
- **They make it easier for parties to seek the assistance of the court in relation to navigating the DPS.** Notably, the DWG proposes an amendment to PD 51U to the effect that parties may seek guidance in relation to any point concerning the operation of the DPS, subject to the maximum hearing length and pre-reading time. Presently, the availability of such hearings is limited to queries relating to the operation or implementation of Extended Disclosure (in advance of or after a case management conference). To a similar end, another proposed amendment is the insertion of a new paragraph into PD 51U providing that a party may apply to the court for directions in relation to any aspect of search-based disclosure under Models C-E.

Whether these proposed amendments will adequately address practitioners' concerns with respect to the cost, complexity and laboriousness of the DPS, only time will tell. For this reason, amongst others, no doubt, the proposed amendments also extend the DPS for a further year, until the end of 2021. ■

1. https://www.judiciary.uk/announcements/update-on-the-operation-of-the-disclosure-pilot-scheme-disclosure-pilot/.

2. https://www.qmul.ac.uk/law/media/law/docs/research/Third-Interim-Report-(RM,-25-Feb-2020).pdf.

3. *UTB LLC v Sheffield United Ltd* [2019] EWHC 914 (Ch) at [75] per Vos C; see also *McParland & Partners Ltd v Whitehead* [2020] EWHC 298 (Ch) at [4], [53] and [58] per Vos C; and paras 2.4, 6.4 and 7.3 PD 51U.

4. Para 2.4 PD 51U; see also *Maher v Maher* [2019] EWHC 3613 (Ch) at [7]-[8] per HHJ Hodge QC (sitting as a Judge of the High Court).

# News in brief

## Dumbledore Sued by London Lawyer

Toby Clouston, legal counsel at a London-based aviation firm, is suing Sir Michael Gambon for £55,000 after his foot was run over by the actor's car in April 2017.

Clouston alleges that Sir Michael, best known for portraying Hogwarts headmaster Albus Dumbledore in the Harry Potter film franchise, did not initially notice when the Land Rover he was driving hit Clouston, who at the time was seated on a bicycle outside his home in Shepherds Bush, West London. The incident left Clouston with *'a broken ankle, ligament damage and permanent mental anxiety'* and he claims he now has difficulties standing and exercising, suffers from *'travel anxieties'* and worries about cars while cycling. Clouston believes his condition is likely to be permanent.

The Sun newspaper reports that there has been an admission of liability on behalf of the veteran actor by his insurers, but that they do not accept Clouston's account and may call in their own medical experts to verify his claims. The case continues.

### New Route to the Legal Profession – cutting costs or dumbing down?

Under the biggest reform to legal education for a generation, from 2021 aspiring solicitors will no longer require a university degree. Instead, school leavers can join law firms as paid apprentices for on-the-job experience, followed by a new two-part Solicitors Qualifying Exam.

Naturally, the move has caused controversy since it was mooted some 5 years ago. The Legal Services Board argues that this route will help *'create a profession that better reflects society'*, enabling people from non-traditional backgrounds and those who cannot afford a university education followed by legal qualification (at a current total cost of some £60,000) access to the profession. On the other hand, many firms and legal academics accuse the new regime of a *'dumbing down'* of entry requirements for the profession will diminish public confidence.

The new process will take five to six years of on-the-job training with the advantage that those qualifying through that route would be able to earn at the same time. The Solicitors Qualifying Exam fee is £3980 and it is expected that students taking this new route would sign up for *'crammer'* courses to prepare them, for a fee of around £6000 – shaving around £50,000 off the cost of the traditional route.

### Arcadia in Administration

British fashion group Arcadia, controlled by News-In-Brief regular Philip Green, denied claims made in the Sunday Times newspaper in mid-November that it was about to go into a *"trading administration"*, saying instead it was taking *'appropriate steps'* to protect the business from the impact of the latest coronavirus lockdown. Arcadia runs brands including Topshop, Topman, Dorothy Perkins and Burton, and currently employs about 15,000. At the time of going to press Arcadia had just fallen into administration, with Deloitte appointed as joint administrators.

### Dead-end for Debenhams

British department store group Debenhams is set to close all its UK shops after 242 years in business, putting 12,000 jobs at risk in the country's second major corporate failure in as many days. The decision to liquidate the Group followed hours after Arcadia collapsed into administration. Arcadia is the biggest concession operator in Debenhams, accounting for about 5% of Debenhams' sales, and its collapse looks to have been the final straw, ending buyout talks with JD Sport. FRP Advisory, appointed as administrators, have confirmed that all 124 UK stores will begin to wind down operations.

# Bitter Blow for Boris

The woes of former tennis champion Boris Becker never seem to end. In September of this year he appeared at London's Westminster Magistrates Court accused of failing to comply with obligations to disclose information during his 2017 bankruptcy proceedings. The Insolvency Service is now prosecuting criminal charges of failing to disclose money and property during those proceedings.

Becker has pleaded not guilty to all 28 charges against him, which include:

- Seven alleging he concealed property (including his 1985 and 1989 All England Club trophies, and those from the Australian Open from 1991 and 1996) from his receiver or trustee, and a further charge that he concealed a debt.
- An allegation he hid his stake of shares in artificial intelligence (AI) firm Breaking Data Corp and did not mention bank accounts in Belgium and Guernsey.
- Two counts of removing property which was required to be delivered to the receiver.
- A charge that he failed to disclose the disposal of property and four charges alleging he did not disclose the details of his estate.
- A further charge that he failed to disclose ownership of a flat in Coleherne Court, Chelsea, along with two further German properties.

At a preliminary hearing in late October, Mr. Becker was released on bail ahead of his trial, scheduled for September 2021.

Becker was a teenage tennis phenomenon when he became the youngest Wimbledon men's singles champion in 1985, at the age of 17 years and seven months. He is now available for virtual tennis lessons at £39.99 a go!

## Pre-packed Côte Brasserie

Côte Restaurants has become a further casual dining chain to undergo a restructuring after being acquired by new investors via a pre-pack administration.

Côte, which was founded in 2007, said that it had been trading well before lockdown, with record sales and strong growth in underlying earnings in its last financial year. In response to the crisis it had achieved a successful launch of Côte at Home, an online shop delivering pre-packed (!) menus, fresh meat and wines.

The group of almost 98 French brasseries will suffer the closure of three outlets operating under its other brands — Limeyard and Jackson & Rye — with the loss of 56 jobs, but the Côte brand remains intact. The sale of the Côte Restaurants business to Partners Group, a private markets investment manager, secures the future of 94 restaurants and 3,148 jobs.


## Less Dough for Pizza Hut Landlords

In late September Pizza Hut's landlords agreed to reduce rents on its restaurants after voting through a Company Voluntary Arrangement (CVA).

Pizza Hut is one of the latest restaurant chains to attempt to push through site closures, with Pizza Express, Wahaca, Wasabi, Byron and Yo! Sushi all using the CVA process. Recent months have also seen a number of retail CVAs, including New Look, which have led to rental agreements being compromised on the basis of store turnover, rather than by a fixed amount. Creditors have continued to vote favourably on CVAs during challenging times for high streets, preferring to secure agreements based on lower rents rather than risk pushing retailers or restaurant chains towards more severe insolvency processes by rejecting proposals.

The deal means 29 Pizza Hut restaurants will shut, with 450 jobs at risk, while a further 215 will keep trading, saving 5,000 jobs. Takeaways are not affected!

# News in brief

## UK Automotive launches Safe Habour Scheme

Carmakers including Jaguar Land Rover and Nissan have joined forces with lenders to create a network to protect the industry's supply chain from the dual threat of COVID-19 and a possible no-deal Brexit.

The impact of the pandemic and subsequent challenging market conditions has had a devastating effect on the UK automotive sector. Output of private vehicles fell by -40.2% in the first eight months of 2020, representing a year-on-year loss of 348,821 cars worth some £9.5 billion to the sector. Commercial vehicle production also fell-20.0% in the year to date equivalent to more than 9,000 units worth almost £730 million. This has led to a loss of at least 9,000 jobs across the sector as a whole with an additional 5,000 in the UK supply chain.

The Safe Harbour Scheme and framework has been developed by the Society of Motor Manufacturers and Traders (SMMT) with support from major manufacturers, the Automotive Council and Department for Business, Energy and Industrial Strategy (BEIS), alongside independent third-party partners Deloitte, Grant Thornton, KPMG and RSM. The scheme operates within competition compliance requirements set out in UK and EU regulations and is available to any company operating in the UK automotive sector.

The Safe Harbour process begins with a confidential conversation between a company experiencing difficulties and SMMT to determine if they want to proceed, and there is no obligation to do so. For businesses deciding to enter Safe Harbour, SMMT facilitates engagement with all relevant stakeholders and an independent third-party to identify and implement measures to ensure business continuity.


(Image courtesy of SMMT)

## Deputy Master of the High Court at 32

Jason Raeburn, a senior associate/ solicitor-advocate at Baker McKenzie, London, is believed to be the youngest person on record to be promoted to the position of Deputy Master in the Chancery Division of the High Court in England and Wales. Government figures show that 76% of all court judges, as opposed to those sitting in tribunals, are over 50 years of age. Mr Raeburn's appointment is also unusual because the majority of judges start their careers as barristers.

In the part-time role, Mr Raeburn will deal with all aspects of legal actions from issue to trial, referring cases to a senior High Court judge where necessary.

## Supreme Spending Spree

According to its annual report, published in September, operating costs at the country's highest court increased by around 18 % last year, rising to £6.13 million. A spokeswoman for the Court confirmed to *The Times* newspaper that the increase was mainly down to a rise in salary and pension costs.

# The FINcen Files

Ever since James Norton held viewers transfixed in the BBC hit McMafia in 2018, ordinary investors have been far more attuned to the prevalence of money laundering. However, new rumours are afoot that the City of London remains affected by money laundering following the leak of over 2,500 documents. Over 3,000 UK companies are named in the FinCEN files – more than any other country.

Suspicious activity reports, or 'SARs', are some of the international banking system's most closely guarded secrets. Whilst banks use them to report suspicious behaviour, they are not proof of wrongdoing or crime. The FINcen documents, leaked to Buzzfeed News, were originally sent to the US Financial Crimes Enforcement Network ('FINcen'): concerns about transactions made in US dollars need to be sent to FinCEN, even if they took place outside the US.

The documents in the FinCEN files cover about $2tn of transactions and they are only a tiny proportion of the SARs submitted over the period.

The FINcen leaks differ from previous financial revelations such as the Panama Papers, Paradise Papers, Swiss Leaks and LuxLeaks as they come from a wide range of banking sources, not just one or two companies.

Amongst the revelations are allegations that:

- JP Morgan allowed a company to move more than $1bn through a London account without knowing who owned it. The bank later discovered the company might be owned by a mobster on the FBI's 10 Most Wanted list.
- One of Russian President Vladimir Putin's closest associates used Barclays bank in London to avoid sanctions which were meant to stop him using financial services in the West. Some of the cash was used to buy works of art.
- Chelsea owner Roman Abramovich once held secret investments in footballers not owned by his club through an offshore company.

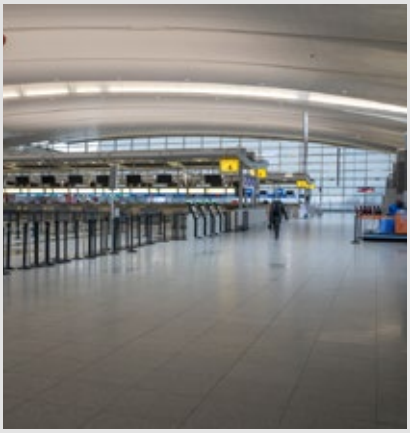
FinCEN said the leak could impact on US national security, compromise investigations, and threaten the safety of institutions and individuals who file the reports and has announced proposals to overhaul its anti-money laundering programmes. The UK has also unveiled plans to reform its register of company information to clamp down on fraud and money laundering.

Regardless of who is to blame, litigation is likely.

# News in brief

## Almost 200 airports face insolvency

A recent report by ACI Europe, the body representing over 500 of Europe's 740 airports estimates that 193 European airports are now considered at risk of insolvency in the coming months due to the slump in passenger numbers caused by COVID-19. Those at risk are mainly smaller, regional airports with fewer than 5 million travellers each year. Larger European airports are also burning through cash at an unsustainable rate, with the top 20 European airports having added 16 billion euros of debt to the balance sheet, a sum equivalent to nearly 60% of their revenues in a normal year.



## Marcus Haywood appointed to Attorney General's Panel

Marcus Haywood has been appointed to the Attorney General's Panel of Junior Counsel to the Crown (B Panel), joining South Square's Hannah Thornley (also on B Panel) and Charlotte Cooke (C Panel).

The Attorney General's panels of counsel consists of just over 400 junior counsel who undertake civil and EU work for all government departments. B Panel deals with substantial cases and members of panel will generally be instructed where knowledge and experience of a particular field is required.

## A robot is 'not a person'

In late September the High Court declared that a robot cannot (currently) be recognised as an inventor purely because it is not a natural person.

One Dr Stephen Thaler, the owner of AI DABUS (Device for the Autonomous Bootstrapping of Unified Sentience for those who have not been following proceedings closely), has been testing the concept that the robot, which he has listed as the inventor in patent applications of both a food container and an emergency warning light, can be considered 'an inventor' under current patent laws in force around the world.

The question before the Court was whether a machine can be 'an inventor'. The answer from London is "no", just has it has been elsewhere. Thaler argued that the Patents Act 1977 was drafted prior to several changes in technology and is simply not equipped to handle an AI inventor. Mr Justice Marcus Smith concluded in his judgment at [46] that:

*"I should stress that nothing in this analysis should be taken to suggest that DABUS is not itself capable of an inventive concept. As I have noted, I am proceeding on the basis that DABUS has "invented" the inventions the subject of the Applications. Nevertheless, I conclude that DABUS is not, and cannot be, an inventor within the meaning of the 1977 Act, simply because DABUS is not a person."*

## Pro Bono: through the pandemic and beyond

South Square is proud to support Advocate and the Pro Bono Week which, in this its 19th year, took place from 2 – 6 November. Events and campaigns in Pro Bono Week offer an opportunity to celebrate and recognise the voluntary contributions made by lawyers across the four nations of the UK in giving free legal help to those in need.

In this year of unprecedented challenges, for both the voluntary and legal sectors, the role of pro bono legal assistance has never been more important. The overarching theme of Pro Bono Week 2020 was "Pro bono: Through the pandemic and beyond".

Several Members of Chambers volunteer through Advocate as well as volunteering for CLIPS, the Chancery Bar Litigant in Person Support Scheme.

## Cayman Islands and Oman Removed from EU Blacklist of Tax Havens

In early October, Finance Ministers at the European Union removed Oman and the Cayman Islands from its EU blacklist of tax havens - officially the EU list of non-cooperative tax jurisdictions. The list, created in 2017, is managed by the Code of Conduct Group for Business Taxation and monitored by the European Commission. Anguilla and Barbados were, however, added to the list which now includes 12 jurisdictions: American Samoa, Anguilla, Barbados, Fiji, Guam, Palau, Panama, Samoa, Seychelles, Trinidad and Tobago, the U.S. Virgin Islands, and Vanuatu.

# Redtape reduced for SMEs seeking CVA protection

## Redtape reduced for SMEs seeking CVA protection

With an awareness that the COVID-19 pandemic is pushing a growing number of small and medium businesses (SMEs) into serious financial difficulty, R3 (the Association of Business Recovery Professionals) and law firm Fieldfisher have developed a new COVID-19 Company Voluntary Arrangement (CVA) Standard Form for smaller businesses.Based to a large extent upon R3's Standard Conditions for Individual Voluntary Arrangements with amendments mutatis mutandis appropriate for companies, the forms are available free of charge from the R3 website.

Whilst not replacing professional advice, the provision of a Standard Form is intended to save time and costs and thus make it easier for small businesses to be entered into CVA deals that help their directors reorganise and restructure their operations in ways that represent a more sustainable financial footing.

Outlined within the contents of the 'R3 COVID-19 Standard Form' documents are statements regarding breathing space periods that would give struggling businesses the opportunity to restructure and reorientate without the fear of having to fend off creditor actions. Whilst the length of the 'breathing space' is not specified, the forms do outline a framework for plans designed to ensure companies pay off their debts over time in line with the terms of a given CVA agreement.

Additional aspects of the forms include details that relate directly to the pandemic and reference situations in which businesses have needed to close because of local lockdowns or because they haven't yet been able to restart their operations following the initial COVID-19 lockdown that began in late March in the UK.

## Professor Sarah Worthington QC (Hon), DBE

All at South Square are absolutely delighted that Academic Member of Chambers Professor Sarah Worthington QC (Hon) was made Dame Commander of the Order of the British Empire (DBE) in the 2020 Queen's Birthday honours for her services to English private law. DBE is one of the higher awards bestowed to recognise outstanding achievements of people across the United Kingdom.

A Deputy High Court Judge, Downing Professor of the Laws of England and Vice-Chancellor at the University of Cambridge, Sarah is also Director of the Cambridge Private Law Centre (which she helped to found in 2012) which promotes informed debate across all branches of private law including property and family.

A much-respected academic author, Sarah's main interests lie in the areas of company and commercial law and equity, in particular the need for a coherent and substantive integration of common law and equity.

Sarah's honour is much deserved.

# SOUTH SQUARE CHALLENGE

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The global pandemic has brought personal tragedy and financial hardship to millions and has also caused a number of new words and phrases to enter our lexicon, or given them new resonance.

Without trivialising the difficulties so many are facing, the challenge for this issue is to find as many of these words and/or phrases as you can in the word search opposite, including the 2020 Oxford Children's Word of the Year and the Collins Dictionary Word of the Year. The winner will the entrant with the greatest number of these words, and will be drawn from the wig tin as is traditional in the event of a draw.

As is also traditional, the prize is a magnum of champagne and a coveted South Square umbrella. **Good luck!**

Entries, please to Kirsten (kirstendent@southsquare.com) by 15 January 2021.

The winner of the June 2020 Challenge, drawn from the wig tin, is Edward Couzens of Slaughter & May who correctly identified the following sporting individuals, all of whom have surnames connected with the judicial system:

Dwain Chambers

Margaret Court

Denis Law

Jo Durie

Ashley Chambers

Jose Luis Clerc

Josh Law

Johnny Bench

Samantha Judge

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SOUTH SQUARE

*South Square "Dominates in the insolvency and restructuring market."* **LEGAL 500**

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Christopher Brougham QC
Richard Hacker QC
Mark Phillips QC
Robin Dicker QC
Martin Pascoe QC
Fidelis Oditah QC
David Alexander QC
Glen Davis QC
Barry Isaacs QC
Felicity Toube QC
Mark Arnold QC
Jeremy Goldring QC
David Allison QC
Tom Smith QC

Daniel Bayfield QC
Richard Fisher QC
John Briggs
Adam Goodison
Hilary Stonefrost
Lloyd Tamlyn
Stephen Robins
Marcus Haywood
Hannah Thornley
Clara Johnson
William Willson
Georgina Peters
Adam Al-Attar
Henry Phillips
Charlotte Cooke

Alexander Riddiford
Matthew Abraham
Toby Brown
Robert Amey
Andrew Shaw
Ryan Perkins
Riz Mokal
Madeleine Jones
Edoardo Lupi
Roseanna Darcy
Stefanie Wilkins
Lottie Pyper
Daniel Judd
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