


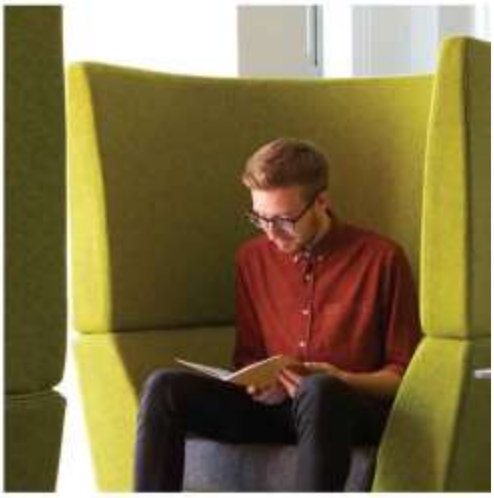





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Welcome to the Summer 2018 edition of the Bulletin which, I am delighted to say, has once again been written by students on our LLM courses.

The first two cross-border cases concern restructuring techniques familiar to English insolvency lawyers: schemes of arrangement and pre-packs. Although the First Pacific case is a decision of the Australian Court of Appeal, it has been included for its consideration of the issue of class composition in schemes. The decision of the CJEU in the Smallsteps case is important for the consideration it has given to the question of whether a Dutch pre-pack arrangement constituted “bankruptcy proceedings or analogous insolvency proceedings” for the purposes of employee protection.

The Court of Appeal decision in the BW Estates case clarifies the law on the Duomatic principle, overturning the first instance decision and making it clear that the principle cannot be used to cure fundamental invalidity. Similarly, the Court of Appeal decision in Wilson provides a useful discussion of the law around the crystallisation of floating charges and the order of priorities.

I would like to thank all the students who have participated in the Summer edition for all their work and to congratulate them on their contributions. You can read their profiles at the back of the Bulletin.

It only remains for me to wish you all the very best for a lovely summer holiday when it finally arrives.

Paula

Paula Moffatt

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CROSS-BORDER

First Pacific Advisors LLC v Boart Longyear Ltd [2017] NSWCA 116

Executive summary

This Australian Court of Appeal case concerned class composition in schemes of arrangement and specifically whether creditors whose rights would be affected differently by the schemes could still be in the same class. It was held that they could.

Facts

Boart Longyear Ltd (BLY) provided drilling services for the global mining industry. The company was headquartered in the USA but incorporated in Australia. BLY had had serious financial troubles for a number of years. BLY's debts consisted of senior secured notes (SSNs), a secured term loan A (TLA), secured term loan B (TLB) and senior unsecured notes (SUNs). Due to its financial difficulties, the company was on the brink of insolvency. Without a rescue plan, BLY was likely to end up in liquidation. Therefore, two creditors' schemes of arrangement (the "Schemes") were proposed under s 411 of the Australian Corporations Act 2001, one for the secured creditors (the "Secured Scheme") and one for the unsecured creditors (the "Unsecured Scheme"). These two groups of creditors were essentially made up of BLY's largest creditors: Ares Management LP (Ares), Centerbridge Partners LP (Centerbridge) and Ascribe II Investments LLC (Ascribe). Together they held 50.8% of the SSNs, with the applicant in this case, First Pacific Advisors LLC (First Pacific), holding 29.07%. Furthermore, companies associated with Centerbridge were the sole holders of TLA and TLB.

The Schemes were complex, but in essence their effects were the following. Under the Unsecured Scheme, a large part of SUNs were to be converted to 42% of post-restructuring equity. The remaining SUNs would be reinstated with a lower interest. Under the Secured Scheme, the holders of the SSNs and the term loan holders would vote as one class. Under the Secured Scheme, the due dates of TLA, TLB and the SSNs were all extended to 31 December 2022, while the existing due date of the SSNs was 1 October 2018 and that of the term loans 3 January 2021. Also, the payment of interest would be converted to payable in kind until December 2018, while the interest of the term loans was already payable in kind, so this would not change. Lastly, under the Secured Scheme the SSN and term loan holders would waive their rights in any change of control event occuring due to the restructuring. Both Schemes were dependent upon the execution of the so called Recapitalization Transactions. The effect of these transactions was that the interest payable on the term loans would be reduced from 12% to 10%. In exchange for this reduction, Centerbridge would receive 52.4% of the ordinary shares post restructuring. The result of this was that Centerbridge would hold 56% of the ordinary shares in BLY after restructuring. The transactions also allowed Centerbridge to appoint an extra director, allowing it to appoint five directors instead of four.

It is important to note that for the Schemes to be approved, according to s 411(a)(i) of the Corporations Act, at least 75% in value of each class of creditors needed to vote in favour of each Scheme. Centerbridge, Ares and Ascribe had bound themselves by agreement to vote in favour of the Schemes. As Centerbridge was the holder of the term loans and was in the same class as the SSNs under the Secured Scheme, Centerbridge plus the above mentioned parties, held 77.9% of the value of the debt in that class. If the term loans had been in a separate class, this would have resulted in First Pacific effectively having a veto, as they held 29.07% of the value of the SSNs. This is why First Pacific, being against the Schemes, appealed against the decision in the primary judgment that the term loan holders and the holders of the SSNs should vote as a single class.

Decision

The leading judgment came from Bathurst CJ. He held that the relevant test to determine whether creditors should be in a single class consists of three questions. The first question involves the rights existing creditors have against the company and to what extent they differ from one another. The second question is whether the scheme affects these rights differently and if so, to what extent. The third question is whether these differences in treatment of rights make it impossible for these creditors to consider the scheme in one class. Bathurst CJ deemed his approach consistent with authority, citing the cases *Re Hills Motorway Ltd* (2002) 43 ACSR 101; [2002] NSWSC 897 and *Re HIH Casualty and General Insurance Ltd* (2006) 200 FLR 243; [2006] NSWSC 485.

Furthermore, Bathurst CJ elaborated on when it is impossible for creditors to consider the scheme in the same class. He held that when comparing the creditors' rights, one should take the context of the scheme into account. In the present case, the only alternative for the schemes was insolvency and probably liquidation. Therefore, the relevant comparator to the rights of creditors under the scheme was the rights of creditors in liquidation. Bathurst CJ supported his argument by referring to inter alia Richards J's comments in *Re Telewest Communications PLC* [2004] BCC 342; [2004] EWHC 924 (Ch).

Bathurst CJ then went on to consider two issues. The first was the grant of equity to Centerbridge and the waiver of rights concerning any change of control event. The second was the issue regarding interest payments. In relation to the first issue it was held that although both the term loan holder and the holders of the SSNs would lose the right to call up loans, this would affect Centerbridge differently, because the amount of shares it would receive under the Recapitalization Transactions would make it possible for Centerbridge to gain legal control of the company. However, it was held that this difference did not make it impossible for the term loan holder and the holders of the SSNs to be in the same class, because the right to call up loans would be of little benefit in the likely alternative to the Schemes, namely, liquidation. As both groups of creditors would face significant loss in the absence of the Schemes, the difference was not enough to make it impossible for the creditors to consult one another with a view to their common interest.

The fact that Centerbridge would receive additional equity post-restructuring did not change this. The following reasons were given: the holders of the SSNs did not hold any equity in BLY, Centerbridge already had de facto control of the general meeting prior to the restructuring due to its holding of 48.9% of the shares and the equity would not cause a significant financial advantage for Centerbridge, as the shares would likely be of little value post restructuring. As the additional equity did not pose a problem, the right to appoint an extra director also could not pose any problems, as once Centerbridge had gained legal control, it could use its rights to appoint directors as it pleased.

The interest issue was dealt with very quickly. Bathurst CJ stated that in the context of imminent liquidation the differences in treatment of payment of interest under the Schemes were not such to prevent the creditors from consulting in the same class. Also, any benefits conferred upon Centerbridge under the Schemes were not to the detriment of the SSN holders.

Lastly, Bathurst CJ found that the combined effect of the above mentioned issues did not prevent the creditors from consulting in the same class. The appeal was thus dismissed. Judges Beazley and Leeming agreed with this judgment.

Comment

Although this is an Australian case, it sets an important precedent as to what extent creditors' rights under a scheme can be affected differently, while the creditors still remain in the same class. It is not unusual for there to be differences in the treatment of different groups of creditors within a class. However, the difference in treatment of the term loan creditors and the SSN holders in the Boart Longyear case is the most extensive to date in any reported English or Australian case. For example, it is the first case in which has been decided that creditors receiving equity benefits post-restructuring can be in the same class as creditors who do not receive such benefits. It can therefore be stated that the case has pushed the boundaries of class composition, allowing for the composition of broader classes in the future. However, the case also brings uncertainty, as it does not clearly state what the new boundaries of class composition are.

This case could also be seen as an example of the courts' reluctance to let schemes fail on technical grounds. A different decision in the BLY case would after all have meant that First Pacific would have had sufficient power to block the scheme. Broader class composition can thus prove useful as a cramdown mechanism for refusing creditors. Although it may seem that this can provide unfair results for these creditors, there are sufficient safeguards to prevent this from happening by way of a final court hearing. In Australia schemes are approved in a final court hearing where the court has a broad discretion, taking into account all facts and evidence, to set the schemes aside based on fairness grounds. This way, creditors are protected from broad class composition leading to unfair results.

In conclusion, it remains to be seen whether this will be the start of a trend that sees creditors with differential rights being contained in the same class. It also remains to be seen whether this will indeed result in a more prominent role for the court's fairness discretion in the final hearing. Lastly, it will be interesting to see whether the English courts will follow this approach, as they are the main authority on issues relating to schemes of arrangement.

Dámaris Engelschman

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Federatie Nederlandse Vakvereniging & ors v Smallsteps BV [2017] I.C.R. 1316 Case 126/16 CJEU, 22 June 2017

Executive summary

A pre-pack arrangement did not fall within the concept of "bankruptcy proceedings or analogous insolvency proceedings" under article 5(1) of Council Directive 2001/23/EC[1] therefore the insolvency exception to the general rule protecting workers where there was a transfer of an undertaking under articles 3 and 4 of the Directive did not apply.

Facts

The case revolved around the restart (restructuring) of a Dutch childcare company Estro Groep by means of a pre-pack. When using a pre-pack, a prospective insolvency practitioner is appointed. The prospective insolvency practitioner in this case was appointed on 20 June 2014. Thereupon, a transfer of a large part of the childcare centres of Estro Groep to Smallsteps was prepared which would take effect after Estro Groep was declared

[1] Council Directive 2001/23/EC of 12 March 2001 on the approximation of the laws of the Member States relating to the safeguarding of employees' rights in the event of transfers of undertakings, businesses or parts of undertakings or businesses

insolvent. On 5 July 2014, the application for a suspension of payments was amended to an application for a declaration of insolvency, which was granted that same day. Also on 5 July 2014, a 'pre-pack' was signed between the insolvency practitioner and Smallsteps, by which Smallsteps purchased approximately 250 of the childcare centres and undertook to offer employment to almost 2 600 Estro Groep employees on the day the company was declared insolvent.

On 7 July 2014 the insolvency practitioner dismissed all the Estro Groep employees. Smallsteps offered a new contract of employment to almost 2,600 staff formerly employed by Estro Groep, but in the end over a thousand were dismissed.

The Dutch trade union Federatie Nederlandse Vakvereniging (FNV) and the four joint applicants (who worked in childcare centres taken over by Smallsteps but were not offered new contracts of employment after the insolvency of Estro Groep), brought an action before the referring court which focused primarily on the pre-pack. FNV believed that the pre-pack concluded between Estro Groep and Smallsteps was subject to the normal rules of a take-over, because the transfer was used for a reorganisation instead of liquidation. Therefore, the exception of Article 5 of Directive 2001/23 – on which Article 7:666 Dutch Civil Code is based – does not apply. This means that those four joint applicants had to be regarded as henceforth working for Smallsteps, as of right, while also retaining their conditions of employment.

Ruling

The Court of Justice stated that Article 5(1) of Directive 2001/23 entails three cumulative conditions: (1) the transferor needs to be the subject of bankruptcy proceedings or any analogous insolvency proceedings; (2) those proceedings must have been instituted with a view to the liquidation of the assets of the transferor; and (3) those proceedings also needed to be under the supervision of a competent public authority (paragraph 44).

Condition 1

The first condition was the easiest to satisfy, as the Court decided that the pre-pack was prepared before the declaration of insolvency, even though it was in fact put into effect after that declaration. Therefore, such a procedure could be covered by the concept of 'bankruptcy proceedings or any analogous insolvency proceedings', within the meaning of Article 5(1) of Directive 2001/23 (paragraph 45-46).

Condition 2

In reviewing the second condition, the Court experienced difficulty in effectively applying the exception of Article 5(1) of Directive 2001/23. In paragraph 47 the Court decided: 'Article 5(1) of Directive 2001/23 requires the bankruptcy proceedings or any analogous insolvency proceedings to be instituted with a view to liquidation of the assets of the transferor. In that regard it is clear, as follows from the case-law of the Court, that a procedure aimed at ensuring the continuation of the undertaking in question does not satisfy that requirement'. In other words: it is not enough that the insolvency procedure is aiming at liquidation, the procedure has to be initiated for the purpose of liquidation.

According to the Court, a pre-pack is aimed at preparing the transfer of the undertaking down to every last detail in order to enable a swift relaunch of the undertaking's viable units once the insolvency has been declared and to safeguard the value of the undertaking and the employment posts (paragraph 49). Therefore, a pre-pack does not meet the second requirement laid down in Article 5(1) of Directive 2001/23 that those proceedings must have been instituted "with a view to the liquidation of the assets of the transferor".

Condition 3

The third condition, that the procedure referred to in Article 5(1) of Directive 2001/23 must be under the supervision of a public authority, is not met by the pre-pack procedure. Although a prospective insolvency practitioner and a prospective supervisory judge are appointed, the Court considered that they have no formal powers. Accordingly, they are not supervised by a public authority.

In addition, the Court believed there is also a lack of supervision in a pre-pack after the declaration of insolvency. The insolvency practitioner asks for authorisation from the supervisory judge for the transfer of the company and receives the authorisation. Therefore, the judge must have been informed of the transaction and essentially raised no objection to it before the declaration of insolvency (paragraph 56). It was the view of the Court that this erodes the level of supervision that takes place during bankruptcy because "such an approach may defeat almost entirely the purpose of the supervision of the insolvency procedure by a competent public authority"(paragraph 57).

In paragraph 58 the Court concludes that the pre-pack procedure in this case does not satisfy all the conditions laid down in Article 5(1) of Directive 2001/23. Therefore, there can be no derogation from the protection scheme laid down in Articles 3 and 4 of that directive.

Comments

This case has had a big impact on the Dutch legal practice. The pre-pack is relatively new and still non-statutory in the Netherlands, but the Dutch pre-pack took a big hit due to the ruling of the CJEU. The advantage of transferring a business outside insolvency is that employee rights are protected; the corollary is that certain employee protections are disapplied on insolvency. Specifically, the 'normal' employment protection rules under

Article 40 of the Dutch Bankruptcy Act do not apply on insolvency; and, similarly, the transfer of the undertaking does not result in the automatic transfer to the transferee of the employer's rights and obligations arising from a contract of employment (Article 7:666 Dutch Civil Code).

The outcome of this case has some undesirable consequences for the restart of undertakings. If all the employees, including their entitlements, are passed on to the restarter (transferee), it is likely that the purchase price will be brought down. This may cause the insolvency practitioner to liquidate the company and sell the assets separately, because the insolvency practitioner needs to keep the interest of the joint creditors in mind. The biggest downside of this is that the insolvency practitioner may be able to preserve far more jobs if the exception to the Directive applies.

On the other hand, it is also undesirable to leave the legislation regarding transfer of undertakings fully unapplied. The consequence of this is that employees are subjected to the arbitrariness of the restarter. The restarter is allowed to decide freely whether to keep the employees and on which terms and conditions. Vulnerable workers such as older and weaker employees can be adversely affected by this approach.

Verstijlen[2] has criticised the decision of the Court of Justice on two grounds. First, in relation to condition two, where the Court spoke of the liquidation of an *undertaking*, while the Directive refers to liquidation of *assets*. On this subject, Verstijlen believes that the assets of the debtor are liquidated when the undertaking is transferred as a whole, because the undertaking is being preserved.[3] Although the Court speaks of 'liquidation of an undertaking' in paragraph 51, it seems clear that the Court is aiming at liquidation of assets: 'the mere fact that the 'pre-pack' procedure may also be aimed at maximising satisfaction of creditors' collective claims does not make this a procedure instituted with a view to the liquidation of the assets of the transferor within the meaning of Article 5(1) of Directive 2001/23'.

Verstijlen has also criticised the approach of the Court in relation to condition 3. He believes that just because a functionary has no powers, this does not imply that the functionary is not under the supervision of a public authority. Moreover, Article 5 of Directive 2001/23 states it is decisive if the 'procedure' is under supervision of a public authority.[4]

He also considers that this response under-estimates the professionalism of the supervisory judge during a pre-pack. The advantage of the pre-pack is that the supervisory

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[2] F.M.J. Verstijlen, annotation by HvJ EU 22-06-2017, ECLI:EU:C:2017:489 (*Federatie Nederlandse Vakvereniging e.a./Smallsteps*).
[3] Annotation: F.M.J. Verstijlen, paragraph 6.
[4] Annotation, F.M.J. Verstijlen, paragraph 8.

judge before the declaration of insolvency got familiar with the undertaking and the prospective transfer. The supervisory judge is then able to calmly form a decision based on comprehensive information, which makes the supervision more effective rather than insufficient.

In conclusion, it is hard to recognise the Dutch pre-pack procedure in the description given by the Court. A pre-pack is not necessarily aiming for a restart, it is also possible that a pre-pack aims for a clean liquidation. For example, a hospital benefits from an insolvency practitioner who is prepared and capable to make decisions on the spot, because the public interest is at stake. In cases involving a restart, the judge will explicitly note that realising the highest possible proceeds should be paramount. Verstijlen points out that in the Estro case the prospective insolvency practitioner was urged not to take a stand on the matter of a potential restart.[5]

How far the effects of the Estro case will reach is yet to be revealed. The main focus is going to be the legislative proposal which should give a legal base to the pre-pack. After the ruling of the Court the legislative proposal has been put on hold. For now, it is up to the legislator to decide where to go from here.

Nikki Charlotte Bosboom

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Screw Conveyor Limited, Outer House, Court of Session [2017] CSOH 129, 19 October 2017

Executive summary

The Scottish court did not have jurisdiction to put a company incorporated in England and Wales into administration based solely on the company's centre of main interest ("COMI") being situated in Scotland.

Facts

On 25 September 2017, a petition was lodged for an administration order of Screw Conveyor Limited (the "Company") before the Court of Session in Scotland (the "Scottish Court"). The petitioner was Bank Leumi PLC, a secured creditor of the Company. The Company was a company incorporated in England and Wales having its registered office in Birmingham. At the hearing for the administration order, the Scottish Court first considered the question of its jurisdiction.

Counsel for the petitioner argued that the Scottish Court had jurisdiction to make an administration order in respect of the Company under Article 3(1) of the EU Regulation

[5] Annotation, F.M.J. Verstijlen, paragraph 7.

2015/848 (the “EU Regulation”), on the grounds that the Company’s COMI was in Scotland, even though it was registered in England and Wales. This submission was based on the argument that section 120(6) of the Insolvency Act 1986 – regarding Scotland - and section 117(7) – regarding England and Wales - incorporated Article 3 of the EU Regulation into domestic law. On this basis, it was contended that the concept of COMI would not only apply in international conflicts between different Member States of the EU, but also internally between the individual parts of the United Kingdom.

Decision

Based on an ordinary reading of the mentioned legislation, the judge rejected the petitioner’s interpretation of section 120(6) and 117(7) as ‘untenable’.

It was held that it is still a matter of domestic law to determine which courts have jurisdiction to open insolvency proceedings within the different parts of the United Kingdom. The EU Regulation only applies to international conflicts between more than one Member State of the EU. For the purpose of the EU Regulation, the United Kingdom and its different jurisdictions i.e. Scotland, Northern Ireland and England and Wales are regarded as one Member State.

Section 120(1) of the Insolvency Act 1986 provides that the Scottish courts have jurisdiction to make an order for administration regarding any company registered in Scotland and section 120(6) states that section 120 is subject to Article 3 of the EU Regulation. Section 120(6) has to be interpreted as meaning that when a company’s COMI is not in the United Kingdom but in another Member State, the courts of that other Member State have jurisdiction. However, there is no reason to believe that Article 3 of the EU Regulation also applies to determining the territorial jurisdiction within the United Kingdom. There is no sign in the legislative history of the legislature’s intention to expand the concept of the COMI to the United Kingdom. The same interpretation applies *mutatis mutandis* to section 117(7). Therefore, the petitioner’s position that section 120(6) and section 117(7) had incorporated Article 3 of the EU Regulation was rejected.

Furthermore, the Member States were not entitled to an alteration of their domestic law on territorial jurisdiction by section 2(2) of the European Communities Act 1972. Nor was the legislature authorised to do so by the Insolvency Act Amendment No 2 Regulations 2002, Regs 6 and 7.

Comment

Taking into account the wide variety of academic writers Lord Doherty referred to for supporting his view (which included D*icey, Morris and Collins on the Conflict of Laws* (15th ed); *Sheldon, Cross-Border Insolvency* (4th ed); and *Maher and Rodger, Civil Jurisdiction* *in the Scottish Courts*), the outcome of this case is not very surprising. What this decision however does, is give clarity. Even if a company carries out its main activities in Scotland, the Scottish courts do not have jurisdiction to grant a winding up order or an order for administration when the company is registered in England and Wales. The internal domestic rules on territorial jurisdiction apply to this matter and it is up to the United Kingdom's own sovereignty to decide whether to apply the concept of the COMI also internally. It has to be assumed that the concept applied in this case also applies to determining the differing material insolvency rules within the United Kingdom.

Unfortunately, neither the petitioner, nor Lord Doherty elaborate further upon the petitioners reference to the cases *In re BRAC Rent-A-Car International Inc*[6] and *In re Salvage Association*[7]. One issue that this case does throw up is whether the decision in *In re 3T Telecom*[8] can still be upheld after the court's decision in *Bank Leumi*. Gillian Carty expresses doubt about this.[9] In *In re 3T Telecom* the English court gave an administration order in relation to a company registered in Northern Ireland because the court was convinced that the company's COMI was situated in England. The author does not agree with Carty's approach since this case concerned section 441 (2) of the Insolvency Act 1986 which excludes the application of the Insolvency Act 1986 to the jurisdiction of Northern Ireland except for provisions expressly relating to companies incorporated elsewhere than in Great Britain. The main question in this case was whether there was a provision expressly relating to companies incorporated elsewhere than in Great Britain on the basis of which the court could exercise jurisdiction. Such a provision was found since the domestic law itself states that those provisions apply to companies incorporated in Northern Ireland. Companies incorporated in Northern Ireland are subject to special provisions and exceptions. Therefore, the concept of the COMI was applicable in that case.

Lisa Münchow

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[6] *In re BRAC Rent-A-Car International Inc [2003] 1 WLR 1421*
[7] *In re Salvage Association* [2004] 1 WLR 174.
[8] In re 3T Telecom [2005] EWHC 275.
[9] Gillian Carty, *When Is COMI Not Enough?* (2018) 15 International Corporate Rescue 1, 8-9.

ADMINISTRATION

SAW (SW) 2010 Ltd v Wilson [2017] EWCA Civ 1001

Executive Summary

A debenture granted by a company over assets subject to a prior charge in breach of the negative pledge contained in the earlier charge did create an enforceable qualifying floating charge over the company's assets under which administrators could be appointed.

Facts

In 2007 the company ("PELL") granted to a mortgage lender ("CHL") both fixed and floating charges over its property in return for a loan. The company covenanted not to create any further security to the property without the lender's prior written consent. In the case of such an event, the floating charge would automatically crystallise.

In 2008, Derbyshire Building Society (hereafter "Nationwide" as its successor in title) granted a loan subject to a first ranking debenture over its property by means of a floating charge. The transaction proceeded without CHL's prior written consent but the company warranted that it had good and marketable title over the charged property.

When the company was in great financial distress, Nationwide attempted to realise its security and with the consent of CHL, appointed joint administrators pursuant to the power granted by the debenture.

A shareholder and a creditor of PELL sought to challenge the validity of the appointment of the adminstrators on the basis that the debenture was granted without the prior written consent of CHL, causing the automatic crystallisation of the first floating charge over all of the company's assets. Furthermore, they argued that the debenture could not constitute a floating charge under the meaning of Sch. B1 para. 14 of the Insolvency Act 1986, because there was not, at the time of its grant any property to which it could attach nor any power to acquire new property to which the debenture could attach in the future.

Decision

It was held that the debenture was indeed a qualifying floating charge. The consent of the first chargeholder had been obtained as was required under Sch. B1 thus Nationwide's appointment of joint administrators was valid.

Briggs LJ rejected the appellants' main argument that the validity of the debenture as a floating charge depended on whether any uncharged property existed at the time of its creation. A company might wish to grant further floating charges over a specific asset on the basis that the prior charges will be redeemed by repayment of the previous charges.

Despite the automatic crystallisation of the first floating charge over the company's assets, the debenture was held to be an enforceable floating charge at the time of its *creation* being the time at which the assessment is made for the purposes of section 251 Insolvency Act 1986. The argument is that the effect of an automatic crystallisation of an earlier charge on a later charge only affects the priority and not the validity of the second charge.

Arden LJ also suggested that the crystallisation of the first charge occurred after the creation of the second floating charge and not at the same time. Therefore the crystallisation did not invalidate the appointment of the administrator.

Comment

The decision was entirely sensible. At the time the company granted the debenture, they warranted that they had good and marketable title to the assets, thus it would be unfair to invalidate the second floating charge on the basis that there was not any uncharged property at the time of its creation. Furthermore, Arden LJ's argument that crystallisation only affects the priority rather than the validity had been a great point to the judgment.

Gavriella Mylona

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Re BW Estates Limited [2017] EWCA Civ 1201

Executive Summary

The Court of Appeal unanimously held that the appointment of joint administrators by one of two shareholders in circumstances where the second shareholder was a dissolved company could not be validated by the Duomatic principle.

Facts

The appellants, the "Randhawas" were creditors of BW Estates Ltd (the "Company") which was incorporated in 1986. On incorporation, 75% of the Company's shares were held by Mr Robert Williams and his wife held the remaining 25%. The wife's shares were transferred to an Isle of Man company, Belvadere, which was later dissolved and its assets were passed to the Crown as bona vacantia. Mr Robert Williams' son, David, was appointed as director of the Company on the 12th of August 2009 and the following day, Robert resigned as the director, leaving David as the sole director.

On the 8th of November 2012, the Randhawas obtained a judgment against Robert Williams for damages in excess of £2 million. On the 28th of August 2013, a directors' meeting of the Company was convened and David, being the sole director, attended the meeting along with a solicitor and insolvency practitioners. The outcome of that meeting was that it was in the Company's best interests to appoint administrators. In September 2013, David, being the sole director, appointed joint administrators of the Company under para 22(2) of Schedule B1 of the Insolvency Act 1986. The Randhawas contended that a valid appointment of administrators could not be made without a valid quorum of two directors as per the Company's articles of association (the "articles") and that the Duomatic principle could not be extended.

The Randhawas were unsuccessful at first instance and appealed to the Court of Appeal on the grounds that the judge was wrong in not declaring that the joint administrators' appointment was ineffective. The issues raised on appeal were:

Issue 1: Was the Company properly to be regarded at the relevant time as a single member company so as to allow David to make up a valid quorum of one for members' meetings?

Issue 2: Should the judge have held that the sole director of the Company had the right to appoint the joint administrators under para 22(2) of SchB1 notwithstanding the quorum provisions as to directors' meetings contained in the articles?

Issue 3: Was the judge right to hold that the articles had been informally varied by a consistent course of conduct by Robert and David?

Issue 4: Was the judge right to conclude that the consent of either David or Robert and David was sufficient in the circumstances of this case to engage the Duomatic principle?

Issue 5: If not, were the Randhawas estopped from contending that the joint administrators had not been validly appointed either (a) by acquiescence, or (b) because it was an abuse of process to raise the matter only in this application?

Decision

The Court of Appeal unanimously allowed the appeal. Referring to the first issue, it was held that the world "member" in relation to a company means any member in the company's register of members according to the Companies (Table A to F) Regulations 1985 Sch.1, para.40 and in the Companies Act 2006, s112, s114, s123, s127 and s318. It was held that the Company had never been a single member company, since 25% of the shares of Belvadere remained on the Company's register despite the dissolution of Belvadere. This fact alone, did not make the Company a single member company.

Concerning issue 2, the court concluded that the judge at first instance had wrongly decided that the sole director had the right to appoint the joint administrators under para. 22(2) of Sch. B1 when a quorum of two directors at board meeting was required under the articles; this is because an appointor can only act in accordance with the company's articles.

It was difficult to see how the Duomatic principle, could have applied as the principle required the consent of all members of the Company who had the right to attend and vote at a general meeting to agree. In this case, Belvadere, the other registered shareholder of the Company, was never notified of the proposal. The principle could not be applied simply because Belvadere had been dissolved and so was incapable of consenting. Nor could Belvadere's consent be inferred by looking to what the other shareholder thought; similarly, Belvadere could not have consented to informal changes to the articles made by David or Robert.

It was held that the judge at first instance was wrong in thinking that the Randhawas were not allowed to contend that the joint administrators had not been validly appointed either (a) by acquiescence, or (b) because it was an abuse of process to raise the matter only in this application.

Comment

The points that the Chancellor, Sir Geoffrey Vos, came forward with brought much clarity to the Duomatic principle:

> "In my judgment, however, regard must be had to the *Duomatic* principle itself. As Buckley J framed it at page 373 in *Duomatic* itself: "I proceed upon the basis that where it can be shown that all shareholders who have a right to attend and vote at a general meeting of the company assent to some matter which a general meeting of the company could carry into effect, that assent is as binding as a resolution in general meeting would be". Without labouring the point, those who must assent are "all shareholders who have a right to attend and vote at a general meeting of the company", not those of the shareholders that may be available at the time." [para 81]

Essentially, the Duomatic principle allows an action to be binding if all shareholders entitled to attend and vote at a registered meeting agree to that action. In this case, Belvadere had been dissolved but was still on the Companies Register and so had to be considered as a shareholder, despite its dissolution. The fact that it was dissolved was insufficient for the Duomatic principle to apply even though it was difficult to see how Belvadere could have been notified and given its consent. Thus, as it seemed to the Chancellor, "David's resolution was incurably invalid." [para 85]

Gireeja Bhoobun & Paula Moffatt

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LIQUIDATION

Officeserve Technologies Ltd (in compulsory liquidation) v AM [2017] EWHC 1920 (Ch)

Executive Summary

The release of contractual rights such as a debt by a creditor company in favour of a debtor constitutes a 'disposition' of property of the company within the meaning of s 127 of the Insolvency Act 1986.

Facts

Officeserve Technologies Ltd ("the company") was a company operating in the "lunch at work" market. Under its director and majority shareholder (the "respondent") it acquired two businesses in the first half of 2016 as it rapidly grew. However the company failed to pay the agreed instalments for one of the businesses and was presented with a winding up petition in October 2016.

Following a meeting of the directors of the company in December 2016 at which, *inter alia*, it was established that he had misapplied monies belonging to the company the respondent was forced to resign on terms set out in a "Settlement Agreement" signed on 23 December 2016 one of which stipulated that he would surrender a significant number of his shares in the company. It was hoped that the respondent's shares would be used, partly, to finance settlement of the winding-up petitioner's claims. The Settlement Agreement also contained terms purporting to release the parties from each other's present and future claims. The negotiations with the petitioner failed and the company was wound up in February 2017.

Notwithstanding the aforementioned agreement, the company's liquidators applied to court for various declarations that the respondent had misapplied company monies, and that certain payments to him were void under s 127 of the Insolvency Act 1986 and that he should repay £535,477.31. By consent the court resolved that certain preliminary issues had to be determined before the application itself. Those preliminary issues can be summed up as follows:

1. Whether the terms of the Settlement Agreement barred the company from any claims against the respondent; or
2. Whether the release of contractual rights in the Settlement Agreement constituted a disposition of property within the meaning of section 127 of the Insolvency Act 1986.

The respondent's case was that on its true construction the Settlement Agreement barred all claims while the applicants argued that it did not and that in any event s 127 of the Insolvency Act 1986 rendered the agreement void.

Decision

The court found in favour of the applicants, ruling that on its true construction the Settlement Agreement had not released the respondent from his obligations and that s 127 of the Insolvency Act 1986 would in any event avoid any such release.

HHJ Matthews (sitting as a Judge of the High Court) was satisfied that having looked at the factual background the ordinary and natural meaning of the words used in the Settlement Agreement revealed that the respondent was only to be released from claims connected with or arising from his employment and not those connected with or arising from his directorship. Accordingly the agreement did not bar the liquidators from bringing any claims against him in his capacity as a director.

In any event the court held that the Settlement Agreement could still be avoided under s 127. The court rejected as being too restrictive the meaning of 'disposition' in *Re Mal Bower's Macquarie Electrical Centre Pty Ltd* [1974] 1 NSWLR 254 and in *Coutts & Co v Stock* [2000] 1 WLR 906 preferring the wider meaning of 'disposition' in s 127 given in *Akers v Samba Financial Group* [2017] AC 424. HHJ Matthews approvingly noted Lord Neuberger's words in *Akers v Samba Financial Group* supra, "… the surrender of a lease or giving up of contractual rights by a company would be a 'disposition' within section 127, as would a surrender of a life interest…"(para 97).

Accordingly, the judge held that the release of the respondent's contractual obligations such as debts in the "settlement agreement" constituted a 'disposition' of property of the company within the meaning of s 127.

Furthermore, although the settlement did not involve the transfer of property, it was still within the mischief against which s 127 is directed in that it destroyed or at least reduced the value of the company property to the extent of any claims it had against respondent. It was therefore "sufficient that identifiable property by some act having legal consequences (so excluding mere effluxion of time) ceases to be in the ownership of the company, so that it is no longer available to the liquidator of the company for the statutory purposes, and the value accrues to some other person (so excluding consumption or waste), even though that other person cannot necessarily be said to become the owner of the same property" (para 99).

The court also rejected the request by the respondent to use its discretion to validate the "settlement agreement" under s 127 because it ruled that it was entitled to consider the matter with the benefit of hindsight. The settlement had to be set aside because it was a bad bargain on the creditors as a whole. Accordingly the liquidators were free to pursue any claims against the respondent.

Comment

The judgment confirms the breadth of the meaning of 'disposition' within s 127 of the Insolvency Act 1986.

Courts will not hesitate to strike down any post winding-up petition arrangements, especially those involving directors, which have the effect of destroying or reducing the value of company property available to liquidators for the general benefit of the creditors and they will use the benefit of hindsight to assess whether the 'disposition' was for the benefit of the creditors as a whole.

Stephen Nyasha Gwaza

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Willmont & ors v Shlosberg [2017] EWHC 2446 (Ch)

Executive summary

The High Court has provided clarification for insolvency practitioners regarding how they can appropriately use documents and information obtained under compulsion and, in particular, the circumstances in which such documents can be shared with related insolvent estates.

Facts

The Liquidators of Webinvest Limited (Mr Shlosberg's former business, hereafter "Webinvest") and Mr Shlosberg's trustees in bankruptcy (the "Trustees") sought directions from the court as to how they could use particular documents and/or information they had obtained in the course of their investigations. Mr Willmont acted as both the joint-liquidator of the Company and as Mr Shlosberg's joint-trustee in bankruptcy.

There were various claims arising from the two insolvencies:

1. Avonwick Limited (Webinvest's principal creditor), Webinvest and the Liquidators had brought a claim against Mr Shlosberg and other third parties that they had conspired to deprive Webinvest of its only major asset (a debt due to it under a

loan agreement). Proceedings were brought under sections 423 (transactions defrauding creditors), 238 (transactions at an undervalue) and 239 (preferences) Insolvency Act 1986;

2. Possession proceedings were brought by the Trustees that Mr Shlosberg was the beneficial owner of two London properties; and

3. Proceedings were brought against the directors of Webinvest and others for breach of fiduciary duty.

In pursuit of such claims, the Liquidators as well as the Trustees requested directions from the court over whether information obtained by the Trustees under compulsion - i.e. using their powers under s366 Insolvency Act 1986 - could be shared with the Liquidators.

The Liquidators and Trustees also sought an order that documents disclosed to Avonwick by Mr Shlosberg in the conspiracy claim could be disclosed to the liquidators, as well as permission to approve a Privileged Material Segregation Protocol (the “Protocol”) which would deal with the privileged material that had been the subject of earlier litigation.

Decision

The judge agreed with the argument of the applicants that there were two justifications for disclosure and gave judgment accordingly. The first and main purpose of obtaining information by compulsion is to aid office holders in carrying out their functions and responsibilities. The applicants argued that sharing the information met this purpose because the claim may have led to a surplus in the liquidation - which would ultimately benefit the bankrupt estate. In arguing this case, the applicants claimed they did not need to show that there *would* definitely be a surplus - only that the *idea* of a surplus would be "more than fanciful".

The second justification put forward by the applicants was a wider 'public interest' argument - i.e. that sharing the information would aid office holders in revealing dishonesty on the part of bankrupts and/or directors of insolvent companies.

Nevertheless, the judge caveated his order with the caution that sharing information that had been compulsorily obtained could only be accepted if one of these two conditions were met.

The judge ordered that the Avonwick disclosure material be shared and approved the Protocol.

Comment

This decision further advances the discussion this ongoing litigation has produced over how office-holders can go about using the data obtained in accordance with their statutory powers. Office-holders will now be permitted to share data obtained if one of the two grounds above is met – for example, that there is a 'real prospect' that a surplus can be attained, and/or whether the context is seen to be in the public interest.

Although this extends a level of autonomy to the office-holders, it is likely directions from the court will still need to be sought in most situations. Although the decision means that in theory the court's permission should not be required in situations where there is the prospect of a surplus, the practical reality is that most comparable circumstances will likely be very complex. Office-holders will need to carefully deliberate whether sharing information will increase the prospects of a surplus for the estate, and think how that case can be made in a convincing manner.

Taking regard to the 'public interest' dispute, the judge held that, as the conspiracy claim and the misfeasance transactions claims made allegations of a fraudulent scheme set up by the bankrupt, permission should be granted. This ground will need to be reviewed on a case by case basis in terms of circumstance and, in practice, may yet again require the court's determination.

Thomas Graham

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