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This term's edition of the Insolvency Bulletin illustrates the wide range of cross-border matters that have recently come before the courts. The *Burgo* case clarified a number of issues relating to the bringing of secondary proceedings under EC Insolvency Regulation (1346/2000), whilst the *Landsbanki* case considered the scope of the EC Directive on the Reorganisation and Winding up of Credit Institutions (2001/24).

Meanwhile, discussion as to the extent of the common law power to assist a foreign court rumbled on. This time, the assistance was to be given by the Bermuda Court to the Cayman Islands Court in the *Singularis* case. In this particular case, it was recognised that a common law power existed to assist a foreign court by ordering the production of oral or documentary information, but it was not a proper use of that power to attempt to correct a limitation on the powers of the foreign court itself. The various opinions of the Privy Council make interesting reading. An article on the Court of Appeal decision, written by Professor Paul Omar of Nottingham Law School, will appear in the first edition of ICR in January 2015.

Also of interest are the *Yukos* and *FHR* cases. In July, the European Court of Human Rights decided that the Yukos shareholders, successors and heirs should be compensated for the losses resulting from Yukos' insolvency following somewhat hefty tax assessments made in 2000 and 2001 by the Russian authorities. Although not strictly an insolvency case, insolvency lawyers will be interested in the clarification given by the Supreme Court in the *FHR European Ventures case*. It is now clear that a bribe or secret commission accepted by an agent will be held on trust for his or her principal.

Having wrapped all that up, there is just time to wish you all the best for the festive season – enjoy the break.

Paula

Paula Moffatt

In this Bulletin…

CROSS-BORDER

Burgo Group SpA v Illochroma SA in liquidation [2014] EU ECJ C-327/13

Executive summary

A preliminary ruling of the ECJ held that, under the Insolvency Regulation: (i) secondary insolvency proceedings are not restricted to establishments without legal personality; (ii) the right to request the opening of secondary proceedings is not restricted to creditors who have their domicile or registered office within the Member State in whose territory the relevant establishment is situated or whose claims arise from the operation of that establishment; and (iii) the appropriateness of bringing secondary proceedings is governed by the national law of the Member State in which the proceedings are sought to be brought, subject to compliance with EU law.

Facts

This was a request for a preliminary ruling as to the interpretation of Articles 3, 16 and 27-29 of Council Regulation (EC) 1346/2000 (the "Insolvency Regulation").

Illochroma SA ("Illochroma") was established in Belgium. In April 2008, the French commercial court placed all the companies in the Illochroma group, including Illochroma, into receivership. In November 2008, Illochroma was put into liquidation by the same French court.

Burgo Group SpA ("Burgo"), was established in Italy. It was owed approximately €360,000 by Illochroma and presented the French Liquidator with a statement of liability for that sum.

The French Liquidator rejected Burgo's claim on the grounds that it had been submitted out of time.

In January 2009, Burgo requested that secondary proceedings be opened in respect of Illochroma in Brussels, before the Belgian commercial court. This request was rejected at first instance and Burgo appealed to the referring court.

The referring court raised three matters for preliminary clarification. First, it noted that the Insolvency Regulation defined "establishment" as "any place where the debtor carries out non-transitory economic activity with human means and goods." This was the situation in the present case, as Illochroma had two establishments in Belgium: it owned a building in Belgium and also bought and sold goods and employed staff there. The respondents in the main proceedings contended, however, that secondary proceedings only applied to establishments without legal personality. Since Illochroma had a registered office in Belgium, it could not be considered to be an establishment within the meaning of the Insolvency Regulation.

Second, the referring court observed that Belgian law enabled any creditor, including a creditor established outside Belgium, to bring an action against a Belgian court for the opening of insolvency proceedings against a debtor. The Liquidator for Illochroma contended, however, that that right was restricted to creditors in the Member State of the court before which the action seeking the opening of secondary proceedings had been brought.

Finally, the referring court noted that the Insolvency Regulation is silent as to whether a request to open secondary proceedings under Article 29 is a right that must be recognised by the court with that jurisdiction, or whether it is a matter of discretion as to whether the court should grant that request.

The Court of Appeal in Brussels stayed the proceedings and referred these issues to the ECJ for a preliminary ruling.

Decision

On the first question, the ECJ held that Article 3(2) of the Insolvency Regulation had to be interpreted to the effect that, where winding up proceedings are opened in respect of a company in a Member State other than that in which it has its registered office, secondary proceedings may be opened in respect of that company in the other Member State in which its registered office is situated and in which it possesses legal personality.

On the second question, the ECJ held that Article 29(b) of the Insolvency Regulation must be interpreted to the effect that the question as to which person or authority is empowered to seek the opening of secondary proceedings must be determined on the basis of the national law of the Member State within the territory of which the opening of such proceedings is sought. The right to seek the opening of secondary proceedings cannot be restricted to creditors who are domiciled or have their registered office within the Member State in whose territory the relevant establishment is situated or to creditors whose claims arise from the operation of that establishment.

On the final question, the ECJ held that the Insolvency Regulation must be interpreted to the effect that, where the main insolvency proceedings are winding up proceedings, the question as to whether the court (being the court before which the action seeking the opening of secondary insolvency proceedings has been brought) may take account of criteria as to the appropriateness of the proceedings, will be governed by the national law of the Member State within the territory of which the opening of the secondary proceedings is sought. However, when establishing the conditions for the opening of secondary proceedings, Member States must comply with EU law and, in particular, its general principles as well as the provisions of that regulation.

Comment

When considering the first issue, the ECJ noted that Article 16(1) requires main proceedings in one Member State to be recognised in all other Member States from the moment that they become effective in the Member State in which they were opened. This has the effect of ensuring that the debtor's centre of main interests ("COMI") cannot be called into question by the courts of other Member States. Article 3(1) envisages that the COMI for the purpose of the Insolvency Regulation may differ from the place of the debtor's registered office. The Article 2(h) definition of "establishment" does not refer to the place of the debtor's registered office or to the legal status of the place in which the operations are carried out. This did not, therefore, rule out the possibility that an establishment may possess legal personality and be situated in the Member State in which the debtor had its registered office, as long as it satisfied the other criteria set out in the definition.

With regard to the second issue, the French Liquidator was, essentially, arguing that only Belgian creditors could seek to establish secondary proceedings in the Belgian court on the grounds that the point of secondary proceedings was to protect local interests. Burgo, an Italian company, argued that this was not necessary, nor was it necessary for them to prove that their claim arose from the operation of the Belgian establishment. The ECJ considered that Article 29(b) made clear that the right to request the opening of secondary proceedings had to be considered from the basis of the national law. Member States were, however, required to ensure that the Insolvency Regulation was effective, bearing in mind its object (*Endress*, C-209/12 EU:C:2013:864). The opening of secondary proceedings was intended to mitigate the universal application of the law of the Member State in which the main proceedings had been opened in order to protect diverse interests, including those other than local interests. Articles 3(2) and (4) of the Insolvency Regulation distinguished between territorial and secondary proceedings: in territorial proceedings, a limitation does exist. The right to request the opening of territorial proceedings is limited to creditors who have their domicile, habitual residence or registered office within the Member State in which the relevant establishment was situated, or whose claims arise from the operation of that establishment (*Zaza Retail,* C-112/10, EU:C:2011:743).

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Landsbanki Íslands hf. and Merrill Lynch International Ltd EFTA Court E-28/13

Executive summary

This case concerned the interpretation of Article 30(1) of EC Directive 2001/24 on the Reorganisation and Winding up of Credit Institutions (the "Directive") which was held to extend to rescission under Icelandic bankruptcy law on the basis of its avoidance rules. A beneficiary which had benefited under an act could, nonetheless, prove that the act in its favour could not be rescinded where the requirements for rescission were not satisfied under the law of the EEA State governing the act.

Facts

Landsbanki Íslands hf. ("LBI") operated as a financial undertaking in Iceland until it failed in October 2008. LBI had issued a number of temporary global notes between 2001 and 2008. These had been lodged with Euroclear Bank SA and Clearstream Banking SA as common depositories and investors could subscribe for bonds. Under the terms of the issue, LBI and its agents were to view those who were registered in the records of the common depositories as owning bonds at any given time. No bonds were issued in physical form to investors who had subscribed for bonds. Merrill Lynch International Ltd ("Merrill Lynch") had subscribed for bonds issued by LBI. The Icelandic court held that the agency agreement, bonds and payment coupons were subject to English law.

Prior to October 2008, LBI had made three payments to Merrill Lynch for bonds due in December 2009, October 2010 and May 2012. In October 2008, the Icelandic Financial Supervisory Authority dismissed LBI's directors and appointed a resolution committee to manage LBI's affairs. It also transferred LBI's activities to another legal entity. LBI subsequently went into winding up proceedings in Iceland in April 2009 under the amended Icelandic Financial Undertakings Act (the "IFU Act"). The reference date for the winding up was 15 November 2008.

The Liquidators of LBI brought a claim against Merrill Lynch seeking rescission of the three payments under the Icelandic Bankruptcy Act (the "IBA"), on the grounds that they were repayments by an insolvent party of debts due prior to their maturity. Under the IFU Act, rescission under the IBA applied to a financial undertaking if its assets did not meet its liabilities.

Counsel for Merrill Lynch contended that the three payments made to it by LBI amounted to a purchase by the plaintiff of its own securities and not the repayment of a debt. Merrill Lynch also contended that under Article 30 of EC Directive 2001/24 on the Reorganisation and Winding up of Credit Institutions (the "Directive"), rescission was only possible if it were permitted under English law, which it was not.

Counsel for LBI rejected this argument on the grounds that Article 30 of the Directive was irrelevant, since the Directive could not overrule Icelandic law.
The District Court accordingly sought an Advisory Opinion first, as to the scope of Article 30 of the Directive and second, as to what the beneficiary of a payment must prove and what standard of proof was required to establish the non-application of the law of the home EEA State.

Decision

The Court held that the expression "voidness, voidability or unenforceability of legal acts" in Article 30 of the Directive referred both to rescission under contract law and to rescission in bankruptcy law on the basis of avoidance rules, such as those contained in the IBU Act. Under the second indent of Article 30(1) of the Directive, the beneficiary must prove that, whether for substantive or procedural reasons, under the law governing the act detrimental to the creditors as a whole, there was no possibility, or no longer a possibility that the act could be challenged. An assessment of the specific act must be undertaken. Even if an act could, in principle, be challenged under the law of the EEA State governing it, it would be sufficient for the beneficiary to prove that the requirements for such a challenge were not fulfilled in the present case.
The question as to whether or not the beneficiary had proved that the law which applied to the act did not allow the act to be challenged should be determined in accordance with the rules of the home EEA State.

Comment

This was a case on transaction avoidance. If the payments made to Merrill Lynch could be rescinded, Merrill Lynch would have to repay the money it had received to the Liquidators. This would have accordingly increased the assets available for the general body of creditors.
As the Court observed in its preliminary remarks, the Directive forms part of the framework for establishing systems of mutual recognition of authorisation and of prudential supervision for credit institutions across the EEA. Under the single licence arrangement, the competent authorities of the home EEA State supervise the credit institution and its branches and its authorisation is valid across the EEA. It would be a matter for the home EEA State administrative or judicial authorities to determine whether a credit institution should be reorganised or wound up (Articles 3 and 9) and the applicable law would be that of the home EEA State unless the Directive otherwise provided (Articles 3(2) and 10(1)). Article 10(2) specifies that the laws of the home EEA State shall determine the rules on voidability or unenforceability of acts detrimental to all the creditors.
Although that seems relatively straightforward, inevitably there will be situations where the effects of home EEA State reorganisation or winding up proceedings (whether procedural or substantive) conflict with the rules applicable to that credit institution in other EEA States. Article 30(1) of the Directive envisages this by providing that the law of the home EEA State does not apply to the rules on voidability or unenforceability of acts detrimental to creditors where the party who has benefited from that act (here Merrill Lynch) can prove: (i) that the act in question was subject to the law of another EEA State (that is, not the home EEA State); and (ii) that the law of that jurisdiction does not enable the act to be challenged.

As the Court explained, the rationale for the rule was to "protect the fair and legitimate expectations of the beneficiary concerning the validity of the act" (para 50), bearing in mind that there would be a retroactive effect if the legal act were to be found invalid.

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Singularis Holdings Limited (Appellant) v PricewaterhouseCoopers (Respondent) [2014] UKPC 36

Executive summary

Although a power existed at common law for the Bermuda Court to assist a foreign insolvency court by ordering the production of oral or documentary information, it was not a proper use of the power to make good a limitation on the powers of that foreign court that existed under its own law.

Facts

Singularis Holdings Limited (the "Company") was incorporated in the Cayman Islands. It had been ordered to be wound up by the Grand Court of the Cayman Islands (the "Cayman Court"). The Liquidators wished to obtain information relating to the Company's affairs from PricewaterhouseCoopers ("PWC"), its former auditors, in either oral or documentary form. The Liquidators believed that information held by PWC would shed light on certain assets that they had otherwise been unable to trace. This position was neither accepted nor disputed by PWC and so the Judicial Board of the Privy Council (the "Board") had proceeded on the basis that it was correct.

The Cayman Court had power under section 103 of the Cayman Islands Companies Law to order any person, whether or not resident on the islands and including its auditors, to "transfer or deliver up to the liquidator any property or documents belonging to the company". The Cayman Court had made such an order against PWC and the Board had been assured that PWC had complied with it.

Although the statutory provision dealt with material belonging to the Company, it did not go far enough for the Liquidators who wanted access to material belonging to the auditors themselves. The Liquidators relied upon the powers conferred on the Supreme Court of Bermuda (the "Bermuda Court") to obtain this information. Section 195 of the Bermuda Companies Act 1981 (the "Bermuda Act") gave the Bermuda Court the power to summon and examine a person holding information about the dealings affairs and property of the company in question and to require the delivery of documents relating to it. This power was, however, only available where the Bermuda Court had ordered a company to be wound up.

At first instance in the present case, the Chief Justice of the Bermuda Court had made an order recognising the status of the Cayman Islands Liquidators. The basis for this was by virtue of their appointment by the Cayman Court. He then exercised what was described as a common law power analogous to the statutory powers under section 195 of the

Bermuda Act to order PWC and one of its officers to produce the same documents that they could have been ordered to produce under section 195 of the Bermuda Act.
The Bermuda Court of Appeal set aside the order on the grounds that it was not an appropriate exercise of discretion because the Bermuda Court should not make an order in support of a Cayman liquidation that could not have been made the Cayman Court itself. They also doubted whether it was possible to make a section 195 order at common law in circumstances where section 195 of the Bermuda Act did not apply.
The Liquidators appealed to the Privy Council. There were two issues.
First, did the Bermuda Court have a common law power to assist a foreign liquidation by ordering the production of information where (i) the Bermuda Court had no power to wind up the overseas company in question; and (ii) its statutory power to order the production of information was limited to cases where a company had been wound up in Bermuda.
Second, if such a power existed, was it exercisable in circumstances where an equivalent order could not have been made by the court in which the foreign liquidation was proceeding?

Decision

The appeal was dismissed. It was the opinion of the Board first, that the principle of modified universalism was part of the common law, but that this was subject to local law and local public policy and, secondly, that the court can only ever act within the limits of its own statutory and common law powers. It was the Board's opinion that a power existed at common law to assist a foreign insolvency court by ordering the production of oral or documentary information, but only in particular circumstances. In the present case, the Cayman Court had no power to require third parties to provide information to office-holders other than information which belonged to the company. It did not appear to the Board to be a proper use of the power of assistance to make good a limitation on the powers of a foreign court of insolvency jurisdiction under its own law. The decision of the Court of Appeal had been reached on this basis and had been correct.

Comment

This case is both significant and long awaited. It addresses the same point that was raised in the case of *PriceWaterhouseCoopers (Bermuda Exempted Partnership No 7420) v Saad Investments Co Ltd*, namely that Liquidators were seeking to obtain material belonging to the auditors themselves and in particular, their working papers.
In the *Singularis* case, the Board was unanimous in concluding that the appeal should be dismissed. Essentially, the Liquidators were forum shopping. Although a common law power existed, it was subject to four limitations. First, it applied only to assisting a foreign court or public officers (in other words, it would not apply to a voluntary liquidation). Second, it was a power of assistance and so could not enable them to do something that was not permitted under the law by which they were appointed. Third, it was available only when it was necessary for the performance of the office-holders' functions. Fourth, the power was subject to the limitation that the order must be consistent with the substantive law and public policy of the assisting court which, in this case, was Bermuda (*Re African Farms* [1906] TS 373, *In Re HIH Casualty and General Insurance Ltd* [2008] WLR 852 and *Rubin v Eurofinance SA* [2013] 1 AC 236.
To say that the Board was unanimous might suggest that this conclusion was reached with minimal discussion, but it was not: the various opinions delivered have resulted in a judgment that runs to the best part of 50 pages. The main reason for this is the discussion

provoked amongst their Lordships as to the extent of the common law power of the Bermudan Court to assist a foreign liquidation. As Lord Neuberger explained, there was consensus that the appeal should be dismissed, but opinion was divided as to whether the appeal should only be dismissed on the grounds (i) that there is no common law power to apply legislation applicable to domestic insolvencies by analogy to foreign insolvencies and that the Bermudan Court should not exercise a common law power where the domestic Cayman Court did not have such power itself; or (ii) that it should be dismissed on the grounds that the common law power did not exist.
Lords Sumption, Collins and Clarke were in the first camp, with Lord Collins' opinion also talking in a review of the scope of judicial law-making powers. Lord Mance, however, took the view that it was not appropriate to extend the common law power to assist a liquidator by ordering information to be provided to an extent that exceeded that which was permissible under current law. He observed that the courts have, generally, been careful to confine remedies to situations where there was a recognisable legal claim to protect. A court therefore had jurisdiction: (i) to protect identifiable property rights; (ii) where there had been a sustainable case of wrong doing, the court would order an asset freezing order (formerly *Mareva* injunction) or a search order (formerly *Anton Piller* order); and (iii) when the principle in *Norwich Pharmacal* applied (*Norwich Pharmacal* was relevant to the discussion because it illustrated the capacity of the common law to develop a power in the court to compel the production of information when this was necessary to give effect to a recognised legal principle).
Lord Neuberger considered that it was illogical to invent a new common law power based on the principle of universality when the courts were withdrawing from its application. He cautioned against the Board determining issues which did not need to be decided to settle a case before it. The Board was agreed that, even if the common law power existed it should not be exercised, making it unnecessary to determine whether the power existed at all. He observed (para 157) that "The extreme version of the "principle of universality" as propounded by Lord Hoffmann in *Cambridge Gas* has… effectively disappeared…. However, as with the Cheshire Cat, the principle's deceptively benevolent smile still appears to linger and it is now invoked to justify the creation of this new common law Power." If required to take a view, he agreed with Lord Mance.

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Stuart Mackellar v David Griffin (1) and Geoff Carton-Kelly (2) [2014] EWHC 2644 (Ch)

Executive summary

Administrators of a British Virgin Island ("BVI") company had been invalidly appointed and there was a useful purpose in the court making a declaration to this effect.

Facts

Westmorland Estates Limited ("WEL") was incorporated in the BVI. WEL had borrowed £43.3 million from Credit Suisse and granted security over its property, which included an office block in Horsham. Following WEL's default under the loan agreement, Credit Suisse purported to appoint administrators under paragraph 14 of Schedule B1 to the Insolvency Act 1986 (the "1986 Act") in June 2012.

The administrators contended that the 1986 Act permitted the appointment since they held a floating charge in respect of "the company's property". Although WEL was not a company registered under the 2006 Companies Act nor was it incorporated in the EEA, they contended that it fell within the definition of a "company not incorporated in an EEA state but having its centre of main interests in a member state other than Denmark" under paragraph 111(1A)(c) of Schedule B1.

In November 2013, a Liquidator was appointed over WEL in the BVI. The Liquidator made two applications to the court. First, he sought recognition of the proceedings under the Cross-Border Insolvency Regulations ("CBIR"). Second, he sought a declaration that the administrators had not been validly appointed, on the grounds that WEL's Centre of Main Interests ("COMI") was not in the UK, or even in an EEA state.

It was not disputed that Article 3(1) of Council Regulation (EC) 1346/2000 (the "Insolvency Regulation") applied to the appointment of the administrators. Article 3(1) states that a company's COMI shall be presumed to be its registered office in the absence of proof to the contrary. On this basis, WEL needed to establish a COMI in England and Wales if the appointment were to be justified under Article 3(1).

The Liquidator based his contention on the statutory presumption, supported by other evidence. Counsel for the administrators resisted the application, on two grounds. The first was that a party had to have a proper purpose for applying for a declaration and that any declaration granted had to serve a useful purpose. The second that WEL's COMI was in the UK.

Decision

The judge held that the proceedings could be recognised under the CBIR on the basis that they were foreign insolvency proceedings and that the liquidator was a foreign representative. He was satisfied that the COMI of WEL was in the BVI at the date of the Liquidator's application. He accordingly made a recognition order.

He held that a useful purpose could be achieved in granting a declaration that the administrators had been invalidly appointed, if the facts supported this conclusion.

On the facts, the COMI of WEL appeared to be in the BVI. He therefore concluded that WEL's administrators had been invalidly appointed and justified the grant of the declaration sought by the Liquidator.

Comment

Counsel for the administrators suggested that no practical or useful purpose could be served by the Liquidator in establishing that the administrators had been invalidly appointed as the outcome for the creditors would have been the same. As a secured creditor, Credit Suisse had been entitled to enforce its security over WEL's assets and, following the sale of the Horsham office block by the administrators, there had still been a shortfall. All that had happened was that the acts had been done by the wrong person: WEL had suffered no loss.

The judge disagreed with this contention. In his view, the Liquidator had to take on an investigative role on appointment and was entitled to establish whether the administrators had been properly appointed. There could be consequences of the invalid appointment and it was important from the perspective of litigation management, to understand the correct position.

In considering WEL's COMI, the judge started from the presumption that the COMI was where the registered office was, that is, in the BVI. He also considered other factors, including a statement in the Credit Suisse loan agreement that WEL's COMI was in the BVI and the fact that none of the statements given in evidence rebutted the presumption. The fact that WEL had property in the UK was, the judge considered, of no particular weight following *Interedil Srl (in liquidation) v Fallimento Interedil Srl* C-396/09 [2012] BLR 1582. The evidence did not establish a case that the COMI was in another EEA jurisdiction, even though some of its activities took place in Dublin, Jersey and Portugal. Even if it had, this would not have assisted matters as, ultimately, the administrators could only be appointed validly if the COMI was in the UK.

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***Re Buccament Bay Resort Ltd, Re Harlequin Property (SVG) Limited* [2014] EWHC 3130 (Ch)**

Executive summary

The court would not exercise its discretion to wind up a foreign company under section 221(1) of the Insolvency Act 1986 (the "1986 Act") as there would be no benefit to the petitioning creditors in doing so.

Facts

Harlequin Property ("Harlequin") and BBL, were both incorporated in Saint Vincent and the Grenadines ("SVG") and part of the Harlequin Group which developed and operated luxury Caribbean resorts. Various investors had paid deposits to secure apartments in a hotel in the Buccament Bay Resort, but title to the apartments had not been transferred to them. The investors brought winding up petitions against BBL and Harlequin under the 1986 Act, having previously served statutory demands for the sums owed. The petitioners claimed approximately £1.2 billion against BBL and £600,000 against Harlequin which debts were largely undisputed.
The issue for the Court was whether it should hear the winding up petitions in view of the fact that neither Harlequin nor BBL were incorporated in England and Wales.

Decision

The judge held that there was no justification for an English law winding up order being made in respect of the two companies. All the assets (except for a claim against the auditors) were in SVG and SVG had a perfectly satisfactory winding up process which was available to the petitioners.

Comment

The judge was at pains to note that, just because an English court could wind up a foreign company as an unregistered company under section 221(1) of the 1986 Act, this did not mean that it should do so. It was a matter of the court's discretion and this could not be exercised unless there was a sufficient connection between the foreign company and England and Wales.
The judge referred to the requirements for making a winding up order in respect of a foreign incorporated company as set out by Knox J in *Re Real Estate Development Co* [1991] BCLC 210 and applied in *Re Latreefers Inc. Stocznia Gdanska SA v Latreefers Inc.*

[1999] 1 BCLC 271. Essentially, there must be a sufficient connection with England (which may or may not consist of assets in the jurisdiction); that there must be a real possibility of benefit for those applying for a winding up order if one is made; and one or more persons interested in the distribution of assets must be persons over whom the court can exercise jurisdiction.
On the facts, whilst the first and third requirements could be satisfied, it was clear that the second requirement could not be: the evidence presented suggested that any English liquidator would have great difficulty in gaining control of the property belonging to Harlequin and BBL. There was, therefore, no benefit to the petitioners from the winding up order being made.

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OAO Neftyanaya Kompaniya Yukos v Russia ECHR Application No 14902/04 Judgment dated 31 July 2014 Strasbourg

Executive summary

The Russian Federation was found to have breached Article 6 of the Convention for the Protection of Human Rights and Fundamental Freedoms (the "Convention") and caused loss to Yukos for which the Yukos shareholders, their legal successors and their heirs should be compensated in proportion to their shareholding in Yukos at the time of its liquidation.

Facts

An adverse tax assessment was made by the Russian Federation ("Russia") in respect of the profits of OAO Neftyanaya Kompaniya Yukos ("Yukos") for the years 2000 and 2001. Russia brought enforcement proceedings against Yukos for the payment of the sums due. Yukos subsequently went into liquidation.
In April 2004, Yukos lodged an application with the European Court of Human Rights (the "Court") against Russia under Article 34 of the Convention.
At a hearing in 2011, the Court held that Yukos had had insufficient time to prepare for the first instance and appellate tax assessment proceedings brought against it by Russia and that this was in breach of Article 6 of the Convention. It held that both the assessment of the penalties relating to the tax assessment made in 2000 and the doubling of the penalties relating to the tax assessment made in 2001, were unlawful and breached Article 1 of Protocol No.1. It also held that Russia had failed to strike a fair balance between the legitimate aim of any enforcement proceedings brought against Yukos and the measures that it had actually employed.
Yukos applied to the Court for compensation from Russia of approximately €38 billion under Article 41 of the Convention and for the payment of its costs.
Yukos asserted that, in accordance with the Court's flexible practice of paying awards made under Article 41, the payment should be made to the Yukos International Foundation ("YIF"). YIF had been incorporated in the Netherlands for the purpose of distributing any funds paid to it to the shareholders of Yukos after creditors had been paid. Payments should be made to the shareholders in accordance with the applicable law and the principles of reasonableness and fairness.
The Russian government contended that the Yukos claim should be rejected since no injured party remained in the case. It also argued that no financial loss had arisen to

Yukos as a consequence of the Russian violations as the outcome would have been the same even if Russia had taken a more flexible and reasoned approach to enforcement and reduced the tax assessments. In its view, Yukos had simply been unable to pay its debts and so had denied that it owed any tax and refused payment. It would, therefore, not be just, fair or equitable for payments to be made under Article 41 to the shareholders.

Decision

The Court found that there had been a violation of Article 6 and that this had caused loss to Yukos. It held that the penalties imposed in the 2000 and 2001 tax assessments had been unlawful. These sums had been paid by Yukos during the enforcement proceedings and, therefore, reflected pecuniary loss for which Yukos should be compensated under Article 41.

It was also the case that the enforcement proceedings had contributed to Yukos's demise as a 7% enforcement fee (which ran into billions of roubles) had been imposed in addition to the tax liability itself.

The Court made a number of adjustments to the figures proposed by Yukos and ultimately assessed the total amount of pecuniary damages payable at approximately €1.87 billion.

The Court unanimously held that the finding of the Article 6 violation constituted just satisfaction for the non-pecuniary damage sustained by Yukos.

It held that it was not appropriate to distribute this amount to YIF as there was no evidence as to whom would benefit from the award. As Yukos had ceased to exist, the Court held, by a majority of five votes to two, that the award should be paid to the Yukos shareholders, their legal successors and their heirs in proportion to the shareholding in Yukos at the time of its liquidation. Costs were payable by the Russian State.

Comment

In order for the Court to be able to compensate Yukos, it had to establish that there was a causal link between the Article 6 violation and the pecuniary damage alleged to have been sustained by Yukos. The Court found that the Russian government's contention that Yukos owed debts amounting to US$ 8 billion at the time of its liquidation was purely speculative. The existence and scale of the allegedly unmet liabilities referred to by the Russian government was, at least partly, due to the method's chosen by the Russian authorities to recover Yukos's tax liabilities. Notwithstanding the risk that some of its liabilities would remain unmet, they had nonetheless chosen to auction Yukos's main production unit and wind it up.

What is interesting to the insolvency lawyer in this case, is the fact that it was the shareholders and their legal successors who were compensated, albeit in what is a highly unusual case. For this reason, it is worth looking at the (partly) dissenting judgments of Judge Bushev (the Russian judge) and Judge Hajiyev (the Azerbaijan judge).

They did not consider the shareholders to be "victims" of the breach and opined that case law only permitted heirs and successors (here the heirs and successors of the "victim" shareholders) to be compensated in exceptional circumstances. This would require the company (Yukos) to have retained legal personality on the date on which the award was made. They opined that causality had not been established and maintained three other objections to the decision.

First, they were not satisfied that an exception to the principle of "direct effect" had been established in respect of the Yukos shareholders. This required the applicant to be directly affected by the act or omission in question. As they pointed out (para 1.1 of the dissenting judgment), "Shareholders are normally considered as having no additional privileges in relation to other stakeholders with regard to the distribution of a company's assets in the event of bankruptcy". In their view, the fact that the shareholders are the last in the line of stakeholders to be paid on a company's insolvency would be indicative of their remoteness. Whilst an exception could be made in the case of a shareholder exercising power in order to manage a company, this could not realistically be the case for the fifty thousand Yukos shareholders. It was, therefore, difficult to see how they had a personal and specific link with Yukos.

Their second objection was that the Yukos shareholders' right to compensation did not exist. The domestic court had determined that Yukos had a number of diverse creditors and had left liabilities. The majority decision had assumed that any liabilities to creditors had ceased when the company went into liquidation (which was contradicted by the finding of the domestic court). In their view, if the company's liabilities had ceased to exist on liquidation and subsequent termination, then this must include any liabilities to their shareholders as well as any rights to compensation. Alternatively, if it was a question of compensating the shareholders for the share price before liquidation, it was not normally the case that there was a direct link between the value a company's assets (which here could include the amount that had been confiscated) and its share price; other factors would come into play. The majority decision that awarded the Yukos shareholders a property right in the company's assets was not, in their opinion, correct.

Finally, they contended that it was not clear that the individual shareholders had sought protection under the Convention.

The arguments of the dissenting judges may have some merit. It is a murky matter and whilst the court proceedings provide transparency on some aspects of the case, who knows what shenanigans lies hidden. It is enough to remark that the dissenting judgment suggests that some of Yukos's activities were illegal and that it had been besieged by management problems for years. The shareholders and their successors will receive a windfall (if Russia ever pays up) when, possibly, other creditors (excluding the Russian tax authorities) may not have been paid in full, which flies in the face of what should happen in any winding up, whether solvent or insolvent.

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FHR European Ventures LLP and others (Respondents) v Cedar Capital Partners LLC (Appellant) [2014] UKSC 45

Executive summary

The Supreme Court held that a bribe or secret commission accepted by an agent is held on trust for his principal.

Facts

In December 2004, FHR European Ventures LLP ("FHR") bought the issued share capital of Monte Carlo Grand Hotel SAM from Monte Carlo Grand Hotel Ltd (the "Vendor"). The purchase price was €211.5 million and was a joint venture between FHR and others (the "Claimants"). Cedar Capital Partners LLC ("Cedar") acted as the Claimants' agent in negotiating the purchase, but had also entered into an agreement with the Vendor that, on the successful completion of the sale, the Vendor would pay Cedar €10 million. This sum was paid to Cedar in January 2005.

In 2009, the Claimants began proceedings for the recovery of the €10 million from Cedar and others on the grounds that Cedar had not made proper disclosure of its agreement with the Vendor. At first instance, the claim was upheld, with the judge holding that Cedar had failed to make proper disclosure.
The appeal concerned the order made in respect of the judgment. At first instance, the judge held that: (i) Cedar was in breach of its fiduciary duty for having failed to obtain the Claimants' fully informed consent in respect of the €10 million; (ii) Cedar should pay that sum to the Claimants; but (iii) the Claimants did not have a proprietary remedy in respect of the monies.
The Claimants appealed to the Court of Appeal on the third point only, contending that they did have a proprietary remedy. The Court of Appeal upheld the appeal and made an order which included a declaration that Cedar held the €10 million on constructive trust for the Claimants absolutely.
Cedar appealed to the Supreme Court.

Decision

The Supreme Court dismissed the appeal and held that a bribe or secret commission accepted by an agent is held on trust for his principal. The law had taken a wrong turn in *Heiron* and *Lister v Stubbs.* This meant that any subsequent decisions insofar as they relied on or followed *Heiron* and *Lister* should be treated as overruled. This conclusion was not affected by the decision in *Tyrrell v Bank of London* (1862) 10 HL Cas 26, which was disapproved.

Comment

This decision is relevant for insolvency lawyers, because, as Lord Neuberger stated in his judgment "if the agent becomes insolvent, a proprietary claim would effectively give the principal priority over the agent's unsecured creditors, whereas the principal would rank *pari passu* i.e. equally with other unsecured creditors if he only has a claim for compensation" (para 1).
It also makes life a lot clearer for those of who have the pleasure of teaching equity and trusts. As Lord Neuberger also pointed out, the matter in issue is one which has resulted in inconsistent judicial decisions over the last 200 years.
Lord Neuberger reviewed the authorities in some detail. He stated three principles, which he referred to as "the classic summary of the law" from *Bristol and West Building Society v Mothew* [1998] Ch1, 18. None of these were in doubt. The first is that an agent owes a duty to his principal, because the circumstances in which the agent acts give rise to a "relationship of trust and confidence". The second principle reiterates the judgment in *Boardman v Phipps* [1967] 2 AC 46, 123 that an agent must "not make a profit out his trust" and "must not place himself in a position in which his duty and his interest may conflict". The third is that an agent who puts himself into a position of potential conflict without the informed consent of both principals, is in breach of his obligation of undivided loyalty: "his duty to one principal *may* conflict with his duty to the other". In this context, informed consent requires full disclosure (*Dunne v English* (1874) LR 18 Eq 524, 523).
Where an agent profits from his position, he must account to his principal (*Regal (Hastings) Ltd v Gulliver (Note)* (1942) [1967] 2 AC 134), which is a purely personal remedy. The matter before the court concerned the limits of the rule that a benefit acquired by an agent will be considered to be beneficially owned by the principal if that benefit arose from the agent's fiduciary role or as a consequence of an opportunity thrown up by the role. This

is a proprietary remedy which has been applied even where it seemed "hard" to do so and where there was no question of fraud (as in *Keech v Sandford* (726) Sel Cas Ch 61). Lord Neuberger phrased the question for the court as being to consider how far the rule should apply in cases where the benefit was a bribe or secret commission obtained by an agent in breach of his fiduciary duty to his principal (para 9)?

Counsel for the appellant contended that the rule did not apply to a bribe or secret commission paid to an agent, since this could not be described as the property of the principal (an argument apparently supported by Professor Sir Roy Goode in *Proprietary Restitutionary Claims* in *"Restitution"* (1998) Ed Cornish). The respondent claimed that the rule did apply in such a case, because the agent held any benefit arising from a breach of fiduciary duty on trust for his principal (a view supported by Lord Millett in *Bribes and Secret Commissions* [1993] Rest LR 7).

Lord Neuberger concluded from his review of the cases that the majority were consistent with the position that the rule did apply to bribes or secret commissions paid to an agent. In other words, any monies received were held on trust for the principal by the agent, rather than being monies for which the principal was required to account. There were, however, a number of appellate authorities that were inconsistent with this view. These included the House of Lords case *Tyrrell v Bank of London* and the Court of Appeal case *Metropolitan Bank v Heiron* (1880) which was followed in *Lister & Co v Stubbs* (1890) and a series of other cases. Ultimately, he concluded that it was "not possible to identify any plainly right or plainly wrong answer to the issue of the extent of the Rule, as a matter of pure legal authority" (para 32).

Instead, he considered that the extent of the rule had to be determined through arguments based on principle and practicality. He considered that, whilst there was some merit in the appellants' contention that there could be potential prejudice to the agent's unsecured creditors if any bribes or secret commissions were deemed to be held on trust for the principal, this was balanced by the fact that it appears just that a principal should be able to trace the proceeds of a bribe or commission into other assets and follow them into the hands of knowing recipients. He was also swayed by the comments made by Lord Templeman in *Attorney General for Hong Kong v Reid* [1994] 1 AC 234 as to the objectionable nature of bribes and secret commissions (on the grounds that they undermine trust in the commercial world) as well as the position taken on this issue in other common law jurisdictions.

He therefore upheld the respondent's claim that bribes and secret commissions paid to an agent are held on trust by that agent for his principal. In reaching this conclusion, the Court disapproved *Tyrell* on the grounds that it was inconsistent with the majority of cases decided both before and after it. The Court held that the law had taken a wrong turn in *Heiron* and *Lister* and any subsequent decisions that had relied on or followed either of those cases should be overruled.

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