Nottingham Law School

Centre for Business and Insolvency Law

Insolvency Bulletin
Autumn 2015
Volume 11

Welcome to the Autumn 2015 edition of the Bulletin. This issue covers a wide range of cross-border cases that span the UNCITRAL Model Law, the EC Insolvency Regulation and the extra-territorial effect of various provisions of the Insolvency Act 1986.

The *Sanko* case considered the recognition of a foreign representative under the Cross-Border Insolvency Regulations and the *Olympic Airline* case saw the Supreme Court grappling with the meaning of "establishment" for the purposes of the EC Regulation. The Supreme Court was also busy contemplating (amongst other things) the extra-territorial effect of section 213 Insolvency Act in *Jetivia* and their Lordships' decision was considered shortly thereafter in both the *Sahaviriya Steel* case (which concerned section 233) and *MF Global* (section 236). The jurisdiction of the English court to sanction Companies Act schemes of arrangement involving companies with little apparent connection to the UK is considered once again in *Re Van Gansewinkel Groep* and *DTEK Finance*, both cases involving Dutch companies.

On a more technical note, the *Lehmans* "Waterfall" judgment is considered along with some knotty points in the LBIE administration on the interpretation of Insolvency Rule 2.88.

This term has seen a new approach to the production of the Bulletin with three of our current LLM students writing case reports and offering their comments. We are delighted to be able to include their contributions and hope to continue this practice in future editions. You can read their profiles at the end of the Bulletin.

It only remains for me to wish you all the very best for the Festive Season and to offer you all good wishes for 2016.

Paula

Paula Moffatt

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CROSS-BORDER: MODEL LAW

Re Sanko Steamship Co Ltd; Sanko Steamship Co Ltd and other v Glencore Ltd [2015] EWHC 1031

Executive summary

An individual could not be recognised as a foreign representative under Article 17(4) of the Cross-Border Insolvency Regulations 2006 SI 2006/1030 (the "CBIR") in circumstances where proceedings that had previously been recognised as foreign main proceedings had been terminated.

Facts

Sanko Steamship Co Ltd ("Sanko") was a company incorporated in Japan with its head office in Tokyo. It owned and operated cargo ships including the Vessel. In April 2012 Glencore Ltd ("Glencore") entered into a contract with Sanko for the carriage of Cargo from Bulgaria to New Orleans. Delivery of the Cargo was delayed for three months and it was finally delivered in early September 2012. Glencore claimed that this was in breach of the contract for carriage and that this had caused it financial losses amounting to US$3 million.

During this period, Sanko was in financial difficulties and had entered into insolvency proceedings in Japan for the purposes of restructuring its business. These were implemented under the Japanese Corporate Reorganisation Act through a Trustee and were supervised by the Japanese court. In July 2012, the Japanese proceedings were recognised in England as the foreign main proceedings under the CBIR. The Japanese Reorganisation Plan (the "Plan") was subsequently approved by the Japanese court in October 2013.

Glencore had submitted its claims in the insolvency in September 2012, but these were rejected by the Trustee in November 2012. Glencore later petitioned the Japanese court, challenging the rejections.

The Vessel was sold in 2014 and the proceeds paid into court in England. It was not disputed that, under the Plan, if Glencore's claims were established, they would be satisfied from the proceeds of sale. Glencore filed a caution against the release of proceeds in the sum of its claim to the Trustee on the grounds that they would be paid into a mixed account in Japan for the benefit of all secured and unsecured creditors with no specific sum allocated to meet the Glencore claim.

In November 2014, the English court agreed to release the proceeds to the Trustee provided that the Trustee held the money in a separate US Dollar account, pending determination of Glencore's claim. In December 2014, the Japanese Reorganisation proceedings were terminated (on the grounds that it was two thirds complete and no default had occurred) and the Trustee informed the English court that although he was no longer formally the Trustee, he was the Representative Director of Sanko and responsible for the implementation of the rest of the Plan under Japanese law.

The former Trustee therefore applied to the English court for recognition of his status as foreign representative of Sanko under Article 17(4) of the CBIR (the "Recognition Application"). He also applied to the court for the proceeds to be transferred to him in his capacity as Representative Director under Article 21(2) of the CBIR (the "Remission Application").

Decision

The Recognition Application was dismissed. There was no proper basis on which the court could accept that the Japanese proceedings continued to exist and, in the absence of expert opinion, the court could not accept that the Representative Director had ongoing obligations to the Japanese Court. The Representative Director could not, therefore, be recognised as a foreign representative.

With regard to the Remission Application, the court held that it must both respect and assist the Japanese court which was the forum chosen by the parties and which would determine entitlement to the funds. An order was made for the funds to be paid into a US Dollar account in the joint names of the parties' solicitors, subject to various undertakings including one from Glencore to apply to the Japanese court for an order that funds be preserved pending the outcome of its petition.

Comment

The Japanese Reorganisation Proceedings had been recognised by the English court as foreign main proceedings. When these came to an end, Glencore argued that there were no foreign main proceedings to be recognised, which meant that the former Trustee could not be recognised as a foreign representative in his new capacity of Representative Director of Sanko.

Article 17(4) of the CBIR enables recognition of foreign main proceedings to be modified or terminated in circumstances where the grounds for granting recognition have fully or partly ceased to exist. The former Trustee argued that the Japanese proceedings had only partly ceased to exist, as he would be responsible for implementing the remainder of the Plan in his new capacity of Representative Director, albeit without the supervision of the Japanese Court. The English court could not accept this argument, following paragraph 23 of the Guide to Enactment of the UNCITRAL Model Law on Cross-Border Insolvency.

Although the guidance was not exhaustive, it indicated that, in order for there to be foreign proceedings, the debtor's assets needed to be controlled either by the relevant court or otherwise be under the supervision of an independent third party (para 28). In this case, the English court had been informed that the Japanese Reorganisation had terminated and it was not clear that the Japanese court had any further involvement in the implementation of the Plan other than an expectation that it would happen. The English court therefore rejected the former Trustee's application.

The particular difficulty for Glencore was that if the funds were released to the former Trustee, there was no guarantee that any part of them would be set aside in Japan pending the outcome of the Glencore claim in the Japanese court. The judge noted that the English court has a long established practice of preserving property subject to proprietary claims (para 71) but also recognised that simply leaving the funds in court in England would mean either tolerating or encouraging delay which was "a hallmark of injustice" (para 72). The terms of the court order were therefore directed at ensuring that the Japanese proceedings were actively pursued by Glencore.

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CROSS-BORDER: EC REGULATION

The Trustees of the Olympic Airlines SA Pension and Life Assurance Scheme v Olympic Airlines SA [2015] UKSC 27

Executive summary

The mere internal administration of the winding up of a company is insufficient to satisfy the test for the existence of an establishment under Article 2(h) of the EU Regulation 1346/2000 on Insolvency Proceedings (the "Insolvency Regulation") for the purposes of establishing jurisdiction to begin secondary insolvency proceedings in another Member State.

Facts

In October 2009, Olympic Airlines SA ("Olympic") went into liquidation proceedings in Greece, where it had its centre of main interests ("COMI"). Olympic also operated in the UK and terminated the employment of its remaining UK head office staff in July 2010. Olympic had established a pension scheme for employees which was required to be wound up in the event of Olympic's liquidation. Following its winding up, a deficit of approximately £16 million was discovered, which Olympic was required to make good under s75 Pensions Act 1995.

As Olympic was unable to meet its pension scheme liability, the pension fund trustees presented a winding up petition against Olympic in England in July 2010. This was necessary to enable the scheme to benefit from entry into the Pension Protection Fund ("PFF") under s.127 of the Pensions Act 2004, since one of the conditions for entry into the PFF was evidence of occurrence of a "qualifying insolvency event".

The issue arose as to whether Olympic had an establishment in the UK at the date of the presentation of the winding up petition in July 2010 for the purposes of bringing secondary winding up proceedings in England under Article 3 (3) of the Insolvency Regulation. This depended upon whether Olympic was carrying out "a non-transitory economic activity with human means and goods" in England for the purposes of Article 2(h) of the Insolvency Regulation at the time that the trustees bought the petition in July 2010.

Although the English court had jurisdiction to wind up a foreign company such as Olympic under section 221 Insolvency Act 1986, because it had its COMI in another Member State, the exercise of this power was constrained by Article 3 of the Insolvency Regulation. Article 3(2) only permitted the opening of secondary insolvency proceedings in England if it could be shown that Olympic had an establishment there.

Decision

The Supreme Court unanimously dismissed the trustee's appeal, upholding the decision of the Court of Appeal. The judgment was delivered by Lord Sumption. The process of the administration of Olympic's winding up in its London office was not "economic activity" for the purposes of demonstrating an establishment under Article 2(h) of the Insolvency Regulation.

Comment

This case has provided clarification and guidance on the term "establishment". The existence of an establishment is essential for secondary insolvency proceedings be opened.

In determining the meaning of establishment, the Supreme Court relied on the Virgos-Schmit Report (OJL 6500/96). The Supreme Court held that the definition of "economic activity" had to consist of more than the activity involved in winding up the company's affairs (para 7). In the present case, the three remaining employees retained by Olympic in its UK head office in London, were on short-term, *ad hoc* contracts (para 7). The activities carried out by the remaining UK employees after commercial operations had ceased were of such manner that the London office only amounted to "a purely occasional place of operations" and thus could not be classified as an establishment (para 9). Illustration of the threshold set when referring to an involvement of activity that is more than that of affairs conducted during a winding up may be found in *Shierson v Vlieland-*

Boddy [2005] 1 WLR 3966. In that case , the COMI was in Spain but the company let and managed premises in England which the Court of Appeal found to be sufficient for the existence of an establishment.

With regards to whether a second insolvency proceeding could be initiated upon the basis of the presence of goods, the ECJ decision in (Case C-396/09) *Interedil Srl (in liquidation) v Fallimento Interedil Srl* [2011] ECR I-9939; [2012] BUS LR 1582 was considered. *Interedil* determined first, that the presence of goods alone does not satisfy the requirements for an establishment and second, that a minimum level of organisation must be apparent. This is consistent with *Re Office Metro Ltd* [2012] BCC 829 where secondary proceedings were denied against an English company whose COMI was in Luxembourg where the nature of the activities carried out in the office in England were deemed not to be economic.

The Supreme Court considered that the definition of establishment in Article 2(h) should be read as whole and not in a fragmented manner (which was the approach of the High Court in the first instance). Activity amounting to internal administration alone cannot be deemed sufficient and it appears that activity involving a third party may also be necessary (para 14). The court's emphasis on the need to show that there are external activities taking place follows from the rationale that opening insolvency proceedings in a foreign territory only makes sense if the company in question (here Olympic) possesses sufficient assets within that jurisdiction (here, the UK).

Kazuhisa Deguchi, NLS LLM Student (Human Rights).

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CROSS-BORDER: SCHEMES OF ARRANGEMENT

Re Van Gansewinkel Groep B.V and others [2015] EWHC 2151 (Ch)

Executive summary

The English court had jurisdiction to sanction certain inter-conditional schemes of arrangement in respect of six foreign companies even though none of them had a centre of main interests ("COMI") or establishment in England and Wales on the grounds that at least one creditor with a claim was domiciled in England for the purposes of Article 8(1) of the Recast EU Judgments Regulation (1215/2015) ("Recast JR").

Facts

Van Gansewinkel Groep B.V ("VGG") was the management holding company for a waste management Group operating across the Netherlands, Belgium and Luxembourg. The Group came under severe financial difficulties when its revenues fell as a result of declining waste volumes and price competition and it became unable to meet its obligations under its facilities agreements. As part of its restructuring arrangements, it was proposed that VGG and five other Group companies (the "Scheme Companies") each enter into separate, but inter-conditional, English law schemes of arrangement (the "Schemes") with their creditors.

The Schemes were approved by the Scheme Creditors at the convening meeting in June 2015 and the Scheme Companies subsequently applied to the English court for the Schemes to be sanctioned under Part 26 of the Companies Act 2006. Five of the Scheme Companies had their centre of main interest ("COMI") in the Netherlands, whilst the sixth had its COMI in Belgium. None of the Scheme Companies had any significant assets in England, although they had a number of creditors there. All of the facilities agreements were governed by English law.

At the sanction hearing, the court considered its jurisdiction to sanction the Schemes under either the EC Regulation on Insolvency Proceedings 1346/2000 (the "Insolvency Regulation") or the Recast JR.

Decision

The court held that it had jurisdiction to sanction the Schemes pursuant to Article 8(1) of the Recast JR. Even though none of the Scheme Companies had a COMI in England and Wales, the fact that they had creditors located there was sufficient to establish jurisdiction.

Comment

The present case raised jurisdictional issues which the court needed to address under either the Insolvency Regulation or the Recast JR. While the case adds to the jurisprudence on the jurisdiction of the English courts to sanction schemes of arrangement, it does not break any new ground since the court followed previous authorities, notably *Re Rodenstock GmbH* [2011] EWHC 1104 (Ch).

Before considering the application of the Recast JR, the court first considered the question of jurisdiction under the Insolvency Regulation. The Insolvency Regulation prevents a winding up order from being made by the court unless the company in question has its COMI or an establishment in England (see the *Olympic Airlines* case above for a discussion of the meaning of establishment). Following *Re Rodenstock*, the court determined that the Insolvency Regulation did not restrict the jurisdiction of the court with regard to schemes arrangement. That case prescribed a purposive interpretation of Insolvency Regulation, determining that it was never intended to limit the jurisdiction of English courts as schemes of arrangement were not "collective insolvency proceedings" for the purposes of the Insolvency Regulation and so fell outside its ambit.

Following *Re Rodenstock*, the court held that the Schemes would fall under Article 1(1) of the Recast JR as "civil and commercial matters, whatever the nature of the court or tribunal". The exclusion from the application of the Recast JR of "proceedings relating to the winding up of insolvent companies…" had been introduced to avoid overlap between the Insolvency Regulation and the Recast JR. This meant that, if schemes of arrangement did not fall within the scope of the Insolvency Regulation, they must fall within the scope of the Recast JR.

Since the Recast JR had the general effect of allocating jurisdiction on the basis of the domicile of the defendant in the relevant proceedings, the court had to decide which of its provisions would justify it in assuming jurisdiction in the context of the Schemes. It had been established in *Re Rodenstock* that, for the purposes of schemes of arrangement, creditors are regarded as defendants who have a claim against the scheme; thus if the scheme is approved, they are bound by it. Counsel for the Group outlined three possibilities for determining jurisdiction.

Counsel's first submission was that the exclusive jurisdiction clause in the facilities agreement meant that the creditors had agreed to submit to the laws of England and Wales. If this was the case, then even though the Recast JR requires defendants to be sued in their Member State of domicile under Article 4(1), they would fall within the exception under Article 25(1) which permits a Member State to exercise its jurisdiction where the parties to the dispute have contractually agreed to submit to it. The court rejected this argument; only the Scheme Companies were submitting to the jurisdiction of England and Wales. The creditors only needed to do so if it was for their benefit.

The second submission was that Article 8(1) of the Recast JR enabled a person domiciled in one Member State to be sued in another Member State, as long as any one of his joint defendants was also domiciled in that Member State. For this to apply, the defendants' claims had to be closely related to make it expedient to determine them together. The court accepted this submission; it held that there was no requirement for 50% of scheme creditors to have their domicile in England, as was found in *Re Rodenstock*. As long as one creditor was domiciled in England, it was materially significant. In the instant case, 15 out of 106 scheme creditors were domiciled in England, representing claims totalling $135 million. Their claims were therefore far from immaterial and large enough to satisfy the requirement for expediency.

The final submission was that, following the argument of Briggs J at paragraph 61 of *Re Rodenstock*, the English court could simply apply its jurisdiction to consider the Schemes by analogy with Article 6 of Recast JR. Having established jurisdiction on the basis of the second submission, the court did not think it necessary to consider this argument, citing its lack of development in the cases succeeding *Re Rodenstock*.

An interesting part of the judgment related to Snowden J's recommendations on the procedural aspects of schemes of arrangements, which should prove useful to practitioners. The recommendations required the companies proposing the schemes of arrangement to present to the court all matters relevant to jurisdiction and the exercise of its discretion. This is irrespective of whether the scheme is being opposed by the creditors or not.

Snowden J also expressed his dissatisfaction with VGG's Explanatory Statement to its creditors which, he considered, lacked substantive material supporting VGG's reasons for entering into the schemes of arrangement. It was suggested that, in future, where a scheme of arrangement is being promoted as a favourable alternative to formal insolvency procedures, in order for the companies to seek consent from creditors and the sanction of the court, the companies must provide greater information, both in the Explanatory Statement and in the evidence presented before the court. This information would be crucial in the event of a challenge to the scheme.

Muhammad Furqan Haider, NLS LLM Student (Corporate and Insolvency Law).

Editor's note

The editor is delighted to note that the expert evidence of Professor Michael Veder, Professor of Insolvency Law at the University of Radboud in the Netherlands and Visiting Professor at NLS was provided to the court and cited at para 21 of the judgment as follows: "Although a consultation is currently under way in The Netherlands in response to a recommendation of the European Commission that Member States of the EU should introduce a procedure similar to the scheme of arrangement into their national law, Dutch law does not yet provide a rescue procedure equivalent to a scheme of arrangement that could be used to bind a dissenting minority of creditors of a company outside a formal insolvency proceeding."

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Re DTEK Finance B.V [2015] EWHC 1164 (Ch)

Executive Summary

In a scheme of arrangement involving a foreign company, the requirement for a "sufficient connection" with England was satisfied where the law governing the debt instrument was English law, even where the governing law had been changed shortly before the sanction hearing.

Facts

DTEK Finance B.V ("DTEK") was a company incorporated in Netherlands. It was part of a group of companies operating an energy-generating business in Ukraine and elsewhere in Europe. DTEK's function within the group was to raise finance in capital markets.

In 2010, DTEK issued loan notes which were due in April 2015 (the "2015 Notes"). The 2015 Notes were unsecured but guaranteed by other companies in the group. Several of the guarantees were governed by English law.

The group suffered severe financial difficulties as a consequence of the conflict in Ukraine and decided to undertake a group wide restructuring process. Without a restructuring, DTEK would be unable to meet its obligations under the 2015 Notes. DTEK therefore determined to enter into a scheme of arrangement (the "Scheme") with the noteholders as a first step in the wider restructuring. Under the terms of the Scheme, DTEK would acquire the 2015 Notes from the creditors and cancel them in return for issuing new notes with a maturity date of 2018.

When the 2015 Notes were issued, they were governed by New York law. DTEK obtained the approval of over 90% of the noteholders (as was required by New York law) to change the governing of the 2015 Notes to English law.

DETK applied to the court to sanction the Scheme under section 899 of the Companies Act 2006. The court was invited to consider (amongst other things) whether it had jurisdiction to sanction the Scheme.

Decision

It was held that there was sufficient connection between DTEK and the English court for it to have jurisdiction to sanction the Scheme as the governing law of the loan notes was English law. It did not matter that the governing law of the loan notes had been changed shortly before the sanction hearing (following *Re APCOA Parking Holdings GmbH* [2014] EWHC 3849 (Ch)).

Comment

This case further clarifies the law in relation to a foreign company having a sufficient connection with England for the purposes of sanctioning a scheme of arrangement. It was admitted by DTEK that the law governing the 2015 Notes was only changed to create a link between the company and the English court in order for the Scheme to be sanctioned. The judge ruled that this did not create any less sufficient connection. She reached this conclusion by following the reasoning of Hildyard J in *Re APCOA*; in that case, the judge was satisfied that the validity of the change of governing law was not in question. He distinguished between experienced business people and consumers, holding that experienced business people should be presumed to be aware of the implications of a contractual provision in the loan agreement allowing for a future change to governing law.

In the DTEK case, the indenture governing the 2015 Notes had always included a provision for the change of governing law and was therefore part of the bargain that the noteholders had signed up to. The validity of the change was not questioned in any of the expert New York law opinions provided in the case. The judge also stated that the choice of English law was not an alien or indiscriminate choice of law, but was one commonly used in debt obligations in the capital markets. The fact that some of the noteholders were resident in England and that the 2015 Notes were traded on London Stock Exchange provided additional support for a sufficient connection to be found.

The Court also ruled that three other circumstances were sufficient to provide a sufficient connection to England. These included the fact that the guarantees given in respect of the loan notes were governed by English law; the fact that DTEK had moved its centre of main operations to England; and the fact that DTEK had substantial assets in England, mainly cash deposits in a London bank account.

It seems perfectly sensible for this approach to be taken to effect a restructuring in a case such as this where the overwhelming majority of the relevant parties has agreed.

Muhammad Furqan Haider, NLS LLM Student (Corporate and Insolvency Law)

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CROSS-BORDER: EXTRA-TERRITORIAL EFFECT OF INSOLVENCY ACT 1986

Jetivia SA and another v Bilta (UK) Ltd and others **[2015] UKSC 23**

Executive Summary

Where directors of a defendant company had acted wrongfully by taking part in an unlawful conspiracy, the directors could not rely on the principle that no claim could be brought against them because of the illegal actions of the company, since the company was the victim of a legal wrong between it and the directors. Section 213 of the Insolvency Act 1986 ("the 1986 Act") was confirmed to have extra-territorial effect.

Facts

Bilta was an English company wound up compulsorily in 2009 following the presentation of a petition by HMRC. The liquidators brought proceedings against both directors, Mr Chopra ("C") (who was also the sole shareholder) and Mr Nazir ("N"), as well as Jetivia SA ("JSA"), a Swiss company, and its chief executive, Mr Brunschweier ("B"). It was argued that the four defendants unlawfully conspired to injure Bilta by a fraudulent scheme. This involved C and N breaching their fiduciary duties, with JSA and B dishonestly assisting them. The liquidators sought damages in tort from all four defendants, compensation based on a constructive trust from JSA and B and a contribution under section 213 of the 1986 Act also from all four of the defendants.

JSA and B applied to strike out Bilta's claim. They contended that Bilta could not maintain a claim against them under the principle that a wrongdoer cannot base an action on his wrong (the illegality defence). As C and N were the sole directors, and C was the sole shareholder, their wrongdoings should be transferred to the company. JSA's and B's contention followed that any knowing assistance on their behalf, as agents, should be attributed to the company. It was also argued that section 213 could not be invoked extra-territorially, JSA being domiciled in Switzerland and B in France. The application, which was dismissed at first instance ([2012] EWHC 2163 (Ch)), was upheld by the Court of Appeal ([2013] EWCA Civ 968). JSA and B appealed to the Supreme Court.

Decision

The seven-judge Supreme Court unanimously dismissed the appeal (Lords Neuberger, Mance, Clarke, Sumption, Carnwath, Toulson and Hodge) holding that the directors could not rely upon their own wrong as a defence to the action and that section 213 Insolvency Act 1986 has extra-territorial effect.

Comment

The applicants' initial claim was based on the principle of *ex turpi causa non oritur actio.* Also known as the defence of illegality, this doctrine states that a plaintiff will not be permitted to pursue a cause of action which arises in relation to his own wrong doing. In this case, the defence of illegality relied upon by the directors and JSA was rejected by the court.

Lords Toulson and Hodge considered sections 172 and 180(5) of the Companies Act 2006 which govern the duty to promote the success of the company and the general fiduciary duties of directors, respectively. If the misconduct of C and N as directors could be imputed to the company, then the company would not be able to make a claim for breach of such duties. They observed, however, that this would "make a nonsense of the principle...developed for the protection of the creditors of an insolvent company" (para 128). They also held that it would be contrary to public policy (para 129). The fact that the directors were in sole control of the company meant, if anything, that their legal duty to protect creditors should be increased. Lord Neuberger quoted and applied the test set out by Lord Hoffmann in *Meridian Global Funds Management Asia Ltd v Securities Commission* [1995] 2 AC 500 at 507, which is that it is clear "from the language of the rule…and its content and policy that the act (or knowledge or state of mind)…was *for this purpose* (sic) [not] intended to count as the act *etc*. of the company".

Lord Sumption also agreed. He stated that "the state of mind" attributed to a company is that of its directing organ under its constitution, that is, the board of directors and, at certain times, its shareholders (para 67). He also referred to Lord Hoffmann's dicta in *Meridian Global Funds* and observed that this primary rule along with the principles of agency and vicarious liability were usually sufficient in determining a company's rights and duties. They were not, however, sufficient when the law required that a certain state of mind should strictly be that of the company as in the present case where there had been a breach of duty; in such a case, the law excluded attribution. Lord Sumption noted that this was often referred to as the "fraud exception", but as it is not limited to fraud, he preferred the phrase "breach of duty exception", following a series of precedents, including *Re Hampshire Land* [1896] 2 Ch 743, *Houghton & Co v Northard, Lowe & Wills* [1928] and *Belmont Finance Ltd v Williams Furniture Ltd* [1979] Ch 250.

It was also established by the court that section 213 of the 1986 Act had extra-territorial effect. Lord Sumption based his decision on the English courts' claim to worldwide jurisdiction when winding up a company. Though not recognised by all countries, it is so recognised by the Member States of the European Union in accordance with Articles 3 and 16 of the EC Insolvency Regulation (1346/2000). This was confirmed by the CJEU in *Schmid v Hertel* [2014] WLR 633. Section 238 of the 1986 Act had previously been held not to be limited to the jurisdiction of the UK by the Court of Appeal in *Re Paramount Airways Ltd* [1993] Ch 223. In that case, it was held by Nicholls VC that the patterns of cross-border business in modern times weaken the presumption of territorial limitations and that the absence of any test in the statute suggests that Parliament did not intend such a limitation. Lord Sumption approved this dicta and applied it to section 213 of the 1986 Act. Lords Toulson and Hodge held that, whilst there is a principle that a UK statute applies only to UK citizens or non-citizens within the UK, an intention of extra-territoriality can be implied if the purpose of the legislation could not otherwise be achieved. They also looked at the context of modern technology, where cross-border companies and persons can communicate, travel and transfer money with ease. Fraud which would have previously only occurred in the UK can now easily be committed abroad. The law would be "seriously handicapped" (para 213) if it did not have extra-territorial effect.

The decision of the Supreme Court was largely clarificatory. The dismissal of the illegality defence showed approval for over century's worth of precedents. The confirmation of the legislation's extra-territorial effect is, perhaps, of greater importance. Whilst this decision also follows an existing principle, it is one that has been established much more recently and has not been approved beyond the Court of Appeal. The unanimous decision of the Supreme Court will go a long way in solidifying its legal position.

Paul Barry, NLS LLM Student (Sports Law).

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Official Receiver v Sahaviriya Steel Industries Public Company Ltd **[2015] EWHC 2877 (Ch)**

Executive Summary

Despite the fact that the extra-territorial effect of section 233 Insolvency Act 1986 (the "1986 Act") had not been considered by an English court, a section 233 order enforceable outside the jurisdiction was made on the grounds that there was a serious issue to be tried on this point and that the matter was analogous to that in *Jetivia v Bilta* [2015] UKSC 23.

Facts

Sahaviriya Steel Industries Public Company Ltd ("SSI") was a Thai-based company which became insolvent following an economic downturn. SSI was the parent company of UK company Sahaviriya Steel Industries UK Ltd ("SSI UK") which manufactured steel slabs in Redcar.

The judge had previously granted permission to SSI UK to expend funds in order to keep its business in operation, following the presentation of a winding up petition against it (*Sahaviriya Steel Industries UK Limited v Hewden Stuart Limited* [2015] EWHC 2726 (Ch)). Permission had been granted on the basis that a business rescue might be possible. Due to the commercial sensitivity of the negotiations, the judge had heard the application in private. SSI UK subsequently went into liquidation and the Official Receiver ("OR") was appointed as liquidator. It became clear that access to the IT system would be essential for the safe winding up of SSI UK.

In the present case, the OR sought an order from the court under either section 233 or section 236 of the Insolvency Act 1986 (the "1986 Act") to ensure that SSI would maintain SSI UK's access to the IT system. The OR also sought an order for the full hearing to take place in private, permission to serve the application out of jurisdiction and permission for the service to take place by alternative means.

Decision

The court directed that the hearing take place in private and granted permission for the application to be served outside the jurisdiction. It also made an order under section 233 which was enforceable outside the jurisdiction on the basis first, that permission of the court was granted (which it was, in relation to Thailand only) and second, that an order permitting enforcement was obtained from the relevant local court.

Comment

The OR gave two reasons why the application should be heard in private. The first was that the hearing would reveal information which might adversely affect the applicant's negotiating power with regard to selling the company's business. The second was that technical work on the plant would involve potential risks which could cause unnecessary concerns locally if misreported. The judge was not persuaded by the first ground, but was by the second. If the hearing were not in private, the applicant may have felt restricted in giving a frank disclosure of the potential risks (para 4).

The court was satisfied that it had jurisdiction to serve applications under sections 233 or 236 extra-territorially if the circumstances justified the making of the order. This was derived from CPR rule 6.38, the effect of which was to apply the rules set out in CPR Part 6 Practice Direction 6B, Service Out of the Jurisdiction (para 6).

It was held that the OR had established a "strong prima facie case" that it was entitled to section 233 relief (para 8). Although the question of the extra-territorial effect of section 233 had not been considered by an English court before, the judge considered that there was a serious issue to tried on this point. He considered that the issue was analogous to those in *Jetivia v Bilta* [2015] UKSC 23 and *Re Paramount Airway Ltd* [1993] Ch 223 where sections 213 (fraudulent trading) and 238 (transactions at an undervalue) of the 1986 Act were (respectively) deemed not to have any express limits on their territorial application (para 9).

In deciding that the English court was the most appropriate forum for the determination of the application, the judge based his decision on the following factors. First, it was unclear whether the applicant could bring a case in Thailand which would have a similar effect to section 233, as there was no evidence that Thai insolvency law had such a provision. Second, the insolvency of SSI UK was taking place exclusively in England and Wales. Third, although giving the legislation extra-territorial effect might ordinarily be an unreasonable claim of jurisdiction, it was satisfactorily mitigated by limiting its enforceability to cases where it was permitted by both the English court and the courts of the country in question.

The claim for interim relief under section 236 was rejected. It was far less clear whether section 236 had extra-territorial effect as there were conflicting High Court judgments on the point (for the most recent case, see *MF Global UK Limited (in special administration) and in the matter of the Investment Bank Special Administration Regulations 2011* in this

Bulletin). The judge felt that it was appropriate to allow the application to be served out of the jurisdiction, but not without notice. The court also granted permission for the application to be served by alternative means. It was argued by the applicant that if it were done according to the rules in Thailand, it would cause a delay of months. English law permits such service by alternative means provided that the law in the other country does not positively prohibit it. As there was no evidence that it was unlawful under Thai law, this was also accepted. The court was also satisfied that it would provide the Respondent with speedy notice of the application, which would allow it to respond earlier.

Paul Barry, NLS LLM Student (Sports Law).

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INSOLVENT INVESTMENT BANKS

Re Lehman Brothers International (Europe) (in administration) [2015] EWCA Civ 485

Executive summary

The payment of subordinated debt ranks behind the payment of statutory interest and non-provable liabilities in an insolvency; currency conversion claims should be regarded as non-provable liabilities which should be dealt with in the event of a surplus after payment of provable debts and statutory interest.

Facts

Lehman Brothers International (Europe) Limited ("LBIE") went into administration in the UK in September 2008 and its ultimate parent, Lehman Brothers Holdings Inc ("LBHI") went into Chapter 11 bankruptcy proceedings in the US Bankruptcy Court for the Southern District of New York at the same time. LBIE was originally incorporated as a company limited by shares, but was re-registered as an unlimited company in 1992 for US tax purposes, as losses in LBIE could be set off against profits in its parent company.

LBIE had issued ordinary shares, Class A redeemable preference shares and Class B redeemable shares all of which were held by Lehman Brothers Holdings Intermediate 2 Ltd ("LBHI2") other than one, ordinary share which was held by Lehman Brothers Limited ("LBL"). LBHI2 had no function other than to act as the intermediate holding company for LBIE and LBL was the service company for group operations in the UK, Europe and the Middle East, acting as the principal employer, maintaining the IT systems and leasing the group's premises.

In November 2012, a distribution had been made to the unsecured, non-preferential creditors of LBIE under paragraph 65 of Schedule B1 to the Insolvency Act 1986 with the permission of the court.

LBHI was an indirect creditor of many companies within the Lehman group and was primarily interested in LBHI2's right to recover subordinated loans made by it to LBIE and issues relating to those subordinated loans. The subordinated loans had formed part of LBIE's regulatory capital under the capital adequacy rules that apply to banks for the purposes of managing their risk exposures. LBHI, LBL and LBHI2 began proceedings in 2013 seeking the decision of the court on a number of issues.

Only three issues are considered in detail here as they are the issues which were considered in greatest detail in the judgment.

In the first issue, the appellants appealed against the decision that the subordinated debt owed by LBIE to LBHI2 ranked after non-provable liabilities.

The second issue concerned the fact that many of LBIE's creditors were owed debts payable in foreign currencies, which were the currencies of their accounts. Because the administration was taking place in England, payments made to these creditors would be in sterling on the basis of the currency conversion rate prevailing at the date of the administration. A number of creditors would receive a reduced amount as a consequence of depreciation and wished to bring currency conversion claims. At first instance, the judge held that these were non-provable liabilities and the appellants appealed.

The third issue concerned the obligation of members to contribute under section 74(1) of the 1986 Act.

Decision

Issue 1: the Court of Appeal unanimously dismissed the appeal holding that subordinated debt is repayable subject to certain contingencies that include the payment of statutory interest and the payment of non-provable liabilities.

Issue 2: the Court of Appeal dismissed the appeal holding that amounts unpaid as a result of the depreciation of the value of sterling could be recoverable as a non-provable claim in the insolvency (Lewison LJ dissenting).

Issue 3: the Court of Appeal dismissed the appeal holding that the section 74(1) obligation of contributories extended to statutory interest and non-provable liabilities. It also held that the contingent liability for calls was capable of proof as a debt in the administration or liquidation of a member.

Comment

This case addressed some highly technical (and sometimes hypothetical) points relating to the priority of certain interests on insolvency. The starting point for the Court of Appeal was the "waterfall" outlined by Lord Neuberger in *Re Nortel GmbH* [2013] UKSC 52 which established the following order of priority on administration or liquidation:

1. Fixed charge creditors;
2. Expenses of the insolvency proceedings;
3. Preferential creditors;
4. Floating charge creditors;
5. Unsecured provable debts;
6. Statutory interest;
7. Non-provable liabilities; and
8. Shareholders.

The difficulty for the court was that no reference was made in the list to subordinated debt. Other difficulties had arisen in the administration which related to the treatment of currency conversion claims and how any claims made against a contributory should be treated (whether as provable debts or non-provable liabilities) as their treatment had a direct impact on where they would fit in to the established order of priorities.

It was clear from the Nortel case that, when read together, Insolvency Rules 5.73 (the requirement to prove a debt) and 13.12 (which defines "debt" and "liability") were very wide. The court noted that both the legislature and the judiciary had taken an approach that sought to limit the classes of claims which were non-provable (para 25). The court was satisfied that LBHI2 was a subordinated creditor rather than merely a member of LBIE and that the subordination agreement did not prohibit LBHI2 from lodging a proof of debt on LBIE's insolvency. The court also held that the subordinated debt was a contingent debt in that repayment was not due until certain conditions had been satisfied. On this basis, it would be correct for the administrator to value the claim at "nil" when the proof was lodged and revalue it on the satisfaction of the contingencies.

The contingencies on which the subordinated debt should become repayable were then considered. It was held that, as statutory interest is payable only because of section 189 of the 1986 Act (liquidation) or Insolvency Rule 2.88(7) (administration), it formed part of the insolvency code. Under these provisions, surplus remaining after the payment of proved debts has to be applied in the payment of interest on those debts for the period between the commencement of the administration or liquidation and the date of their payment. This interest is paid in priority to any other payments. It was the view of the court that repayment of the subordinated debt was contingent upon (and would therefore rank behind) the payment of statutory interest (para 57). The court also agreed with the first instance judge that, once established outside the debtor's insolvency, non-provable claims were payable within it.

Briggs LJ considered the currency conversion claims. The conversion of foreign currency debts into sterling at the cut-off date was essential for the purposes of proof and for set-off. In his judgment, nothing prevented a foreign currency creditor from reverting to its contractual rights in the event of a surplus after the payment of proved claims and statutory interest (para 136) and asking for its claim to be treated as a non-provable liability. He noted the injustice for those creditors of LBIE with claims in US Dollars, as the shortfall in payment to them as a consequence of the cut-off date for currency conversion amounted to £1.3 billion and there was money available from which to pay them. Taking this approach did not affect the *pari passu* approach to the distribution of assets against provable debts.

The last issue considered in this report is that of the discussion around the fact that LBIE was an unlimited company and the circumstances in which calls could be made upon contributories under section 74(1) of the 1986 Act. In the present case, two of the issues raised on appeal had fallen away because it was accepted that the application of set-off ousted the contributory rule. Briggs LJ considered the development of the system of calls upon contributories, however, tracing it to the 1862 Companies Act. He explained that the making of calls was a "substitute for direct enforcement by creditors against members, but was in no way intended to limit the extent of members' liability" (para 182). In considering the extent of any call, he noted that it had always been a duty of the liquidator to pay non-provable liabilities where assets were available to do so. As members of a company were not entitled to its assets in priority to creditors with non-provable claims (whether in a voluntary or compulsory winding up) they would be liable as contributories for such claims (para 189). As statutory interest was a liability of the company, contributories would also be liable in respect of it. In his judgment, "the policy that the members of an unlimited company are required to make their resources available to the fullest possible extent to ensure that their company discharges its liabilities means that it is not inconsistent for that policy objective to be achieved, in relation to an insolvent contributory… by recognising that its future or contingent liability to meet a call is a provable liability" (para 232).

Considering the seriousness of the failure of Lehmans, it is remarkable that there is even a possibility that payments may be made to subordinated creditors.

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In the matter of Lehman Brothers International (Europe) (in administration) [2015] EWHC 2269 (Ch)

Executive summary

Under rule 2.88 of the Insolvency Rules, where proved debts had been paid in full and there was a surplus available, creditors would receive interest on their proved debts for the periods commencing with the start of the administration for as long as the proved debts were outstanding.

Facts

As a consequence of *Re Lehman Brothers International (Europe) (in administration)* [2015] EWCA Civ 485 (the "Waterfall" case, above), a number of issues arose between different groups of unsecured creditors. Broadly, the ordinary, unsecured creditors wanted to maximise the amount of statutory interest payable under rule 2.88 of the Insolvency Rules 1986, whilst the holders of subordinated debt (who ranked after the payment of statutory interest and non-provable claims) wanted to minimise it.

The first issue was as to the interpretation of Rule 2.88.

The second issue was whether creditors who were entitled to statutory interest or to a currency conversion claim or other non-provable claim were also entitled to compensation for the delay in discharging their claims and, if so, what form that compensation should take (that is, whether it should be in the form of interest at the Judgments Act rate or damages for loss or restitution).

The third issue (issue four in the application notice) concerned the interpretation of rule 2.88(9) and the words "the rate applicable to the debt apart from the administration".

Decision

It was held that the proper application of rule 2.88 meant that, where proved debts had been paid in full and there was a surplus available, creditors would receive interest on their proved debts for the periods commencing with the start of the administration for as long as the proved debts were outstanding.

With regard to the second issue, it was held that rule 2.88 represented the complete code for the payment of post-administration interest. Rule 2.88 did not stipulate when the interest payment would be made, nor did the legislation make any provision for the payment of interest on statutory interest or on non-provable claims.

On the third issue, it was held that a proper interpretation of the words "the rate applicable to the debt apart from the administration" in rule 2.88(9) did not include interest on a judgment entered after the administration had commenced.

On the remaining issues, it was held first, that statutory interest was payable on future debts and on the amount admitted to proof in respect of contingent debts from the date of the commencement of the administration; and second that the calculation of currency conversion claims should not take into account the statutory interest paid to the relevant creditor.

Comment

The interpretation of rule 2.88 was critically important in this case, since statutory interest was payable at the higher of the Judgments Act rate (8%) and the rate of interest to which the creditor would otherwise have been entitled in the market place, which would have been extremely low. Much of the discussion revolved around the case of *Bower v Marris* (1851) Cr & P 351, but the judge rejected arguments flowing from this case on the grounds that the Insolvency Act 1986 had introduced a new approach to the treatment of interest which superseded any other interpretations (para 128).

The primary focus of the discussion was on the terms of rule 2.88(7)-(9). Rule 2.88(7) directs the administrator to apply any surplus "remaining after payment of the debts proved". It was held that this provision operates on the basis that proved debts must first have been paid before statutory interest can be paid. The judge was clear that it did not matter for the purposes of this provision that it might have the effect of depriving a creditor of rights to recover the full amount due from a co-obligor if the proved debts were treated as being paid in full (para 134).

The administrator is then directed to pay interest "in respect of the periods during which they have been outstanding since the company entered administration". The plural "periods" is relevant for cases where there is more than one distribution, so that interest cannot be paid in respect of a period after a distribution has been made. These provisions established "a straightforward regime" for the payment of statutory interest.

The second issue concerned the matter of interest being payable on statutory interest or otherwise payable on non-provable claims. The judge was clear that there were no provisions that addressed the former and that to the extent that interest was payable on non-provable claims it should be determined by reference to the underlying contract and so form part of the non-provable claim submitted to the administrators.

The third issue concerned the application of rule 2.88(9) in circumstances where a foreign judgment rate of interest which was higher than the English judgment rate applied. The judge held that the words "the rate applicable to the debt apart from the administration" did not include interest on a judgment entered after the commencement of the administration (para 183).

In the matter of MF Global UK Limited (in special administration) and in the matter of the Investment Bank Special Administration Regulations 2011 [2015] EWHC 2319 (Ch)

Executive summary

A request could not be made for a responsible officer of a French company to be examined under the Evidence Regulation (EC Regulation 1206/2001) as the court was not satisfied that the evidence to be obtained was to be used in judicial proceedings which would result in a decision; section 236 Insolvency Act 1986 (the "1986 Act") did not have territorial effect.

Facts

MF Global UK Limited ("MF Global") was a London based broker-dealer and a member of the MF Global group which operated primarily in London and New York. MF Global and other group companies entered into insolvency proceedings in England and the United States on 31 October 2011. The administrators of MF Global were appointed under the Investment Bank Special Administration Regulations 2011 (SI 2011/245) (the "IBR"). Other than section 236(1), both sections 236 and 237 Insolvency Act 1986 (the "1986 Act") applied under the IBR.

The administrators applied for section 236 and 237 orders against LCH Clearnet Limited ("LCH UK") and LCH Clearnet SA ("LCH France"). LCH Clearnet operated securities clearing houses in England France. When MF Global went into administration, it had several large open positions with the respondents. The appointment of the administrators was an event of default under MF Global's contracts with the respondents which enabled them to close out MF Global's open positions.

Although significant losses were anticipated by the administrators in closing out the open positions, they contended that the losses actually suffered were excessive. The administrators therefore sought a section 236 order for the production of information relating to the processes the respondents used to close out MF Global's open positions after MF Global entered administration. They also sought a section 237(3) order for the court to issue a request to the French Court under the Evidence Regulation for a responsible officer of LCH France to be examined under sections 236 and 237 and to provide certain documentation to the administrators.

Decision

The application for the section 236 order against LCH France was rejected as the court held that section 236 of the 1986 Act did not have extra-territorial effect. The court also rejected the application for the section 237 order as the request could not be made under the Evidence Regulation, since the requirement for the evidence to be used in judicial proceedings which would result in a decision was not satisfied.

Although the court had jurisdiction to make a section 236 order against LCH UK, the court refused to make the order on the basis that it was not satisfied that there was a matter which required investigation.

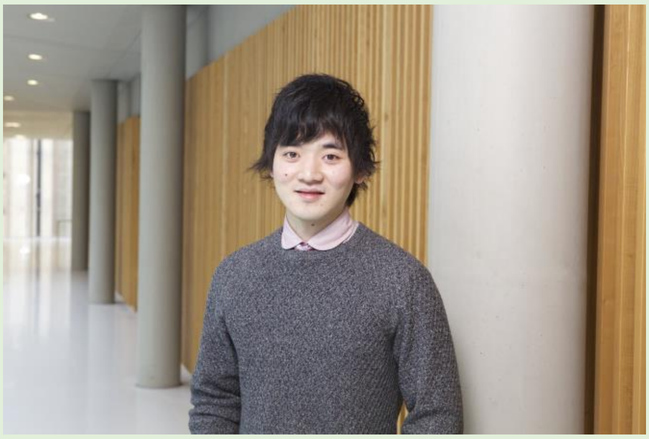
Comment

It should be mentioned at the outset that, because this was an investment bank administration, the Insolvency Regulation (EC Regulation 1346/2000) did not apply under the Article 1.2 exclusion.

When MF Global went into administration, it did so at a time when the Greek sovereign debt crisis was at its height and the markets were extremely volatile. The administrators knew that they would make a loss when the positions were closed. Nonetheless, they were concerned that MF Global's loss had amounted to €422 million. This figure was almost double the loss that MF Global would have suffered had the sales been made at the prices quoted by Bloomberg at the time (€241 million). A particularly big loss was suffered as a consequence of the sale of €2.2 billion Italian bonds which obtained a significantly lower price than a further parcel of the same bonds sold the next day. The administrators wanted to obtain information from the clearing house to determine whether the LCH entities had failed to close out the deals in accordance with their duty of care.

No action could be taken against LCH France, since it was a prerequisite that any evidence obtained must be used in judicial proceedings that had either been commenced or contemplated that would result in a decision. Here, the administrators were only considering their position (para 39).

With regard to LCH UK, it was accepted that section 236 applied. Before a court can make a section 236 order, however, it must be satisfied that there is something which requires investigation. The judge held that this was not satisfied on the facts. As he pointed out, the market was essentially flooded when the Italian bonds came up for sale. The date on which the bulk of the Italian bonds was sold was a day on which highly significant events relating to the euro were taking place on an almost hourly basis. On these grounds he did not consider that there was sufficient difference in the prices paid for the Italian bonds on the two days in question to justify making the order.



Kazuhisa Deguchi

I studied for my LLB at Keele University with one of my modules in the final year being Company Law. I am now studying for an LLM in Human Rights Law at Nottingham Trent University and I hope to work for the UN in the future. I have maintained my interest in company law by undertaking a free-standing elective in Corporate Rescue.

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I studied law Nottingham Trent University and am now studying for an LLM in Corporate and Insolvency Law at Nottingham Trent University. My interest in corporate insolvency law was sparked by studying it briefly at undergraduate level. In future, I would like to practise in the field of corporate law.

Paul Barry

I completed my primary BCL (Law and Irish) degree in University College Cork, graduating with a first class honours degree with a high first in the Company Law module. I am currently studying for an LLM in Sports Law and have a particular interest in the relationship between insolvency law and football clubs in the UK and Ireland. I have previously worked as a paralegal in a commercial law firm in Cork. Next year, I will begin a traineeship with Arthur Cox, one of Ireland's leading law firms.