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CASE REVIEW SECTION

Gas and Electricity Markets Authority v GB Energy Supply Limited [2016] EWHC 3341 (Ch)

Madeleine Jones, Barrister, South Square, London, UK

This was an urgent out-of-hours application heard by telephone by the Honourable Mr Justice Birss.

The applicant was the Gas and Electricity Markets Authority (the 'Authority'). The Authority is the independent regulator for the gas and electricity markets and was established by the Utilities Act 2000. Section 3A of the Electricity Act 1989 and section 4AA of the Gas Act 1985 provide that the principal objective of the Authority when carrying out its functions is to protect the interests of existing and future electricity and gas consumers.

The Authority's application related to an energy supply company, GB Energy Supply Ltd ('GB'). GB supplied electricity under an Electricity Supply Licence, in accordance with the statutory regime governing such supply. GB appeared to the Authority to be unable to pay its debts. In these circumstances, the Authority had the power to revoke the licence and establish a Supplier of Last Resort to replace the company. The company's contracts would be transferred or deemed to have become contracts with this supplier.

The Authority therefore asked the court to make a declaration that the respondent energy supplier was unable to pay its debts. The Authority put forward a witness statement in support of the application, in which it explained that GB had notified the Authority in October 2016 that the company anticipated being in financial difficulties in mid December of that year.

The Authority's witness statement gave an explanation of the nature of the energy market. This is the market on which energy consumers, or retail suppliers to energy consumers, buy the energy they need wholesale. Market participants balance their own physical and traded positions. If there is an imbalance between these, market participants must trade out of this.

The System Operator ('SO', for electricity, National Grid Electricity Transmission) has a residual role, resolving any imbalances that remain after the market has run its course.

The Authority also put before the Court a witness statement made by the CEO of GB, sworn in support of a pending application by the company issued in the Leeds District Registry of the High Court for permission to pass a resolution for voluntary winding up.

The witness statement explained the nature of GB's business, and set out details of the company's financial difficulties. It stated that GB did not produce energy itself, but purchased energy on the market and supplied this to consumers. It stated that as a result of its financial difficulties, it was unlikely to be able to enter into any further transactions with other energy market participants in order to purchase sufficient energy to balance its outflow requirements and that a provider of call centre services to the company was threatening to withdraw its services at short notice.

The Authority also put before the court a letter from GB's advisors and proposed liquidators, BDO LLP, dated 26 November 2016, stating their professional opinion is that the company is insolvent within the meaning of section 123 of the Insolvency Act 1986 both on a cash-flow and balance sheet basis.

Under section 161 of the Energy Act 2004 (applied pursuant to section 96 of the Energy Act 2011) an energy supply company may not pass a resolution for a voluntary winding up without permission of the court. This permission can be obtained only on an application made on notice to the Secretary of State and the Authority, and after at least 14 days must have elapsed since service of the last of these notices. Other provisions of the act impose equivalent 14 day periods in respect of other insolvency procedures. GB was the first energy supply company to become insolvent since the regime came into force.

The Authority considered that waiting for 14 days to elapse before it revoked GB's energy supply licence and granted a licence to a supplier of last resort would cause significant difficulties, in two respects.

Firstly, there was the impact upon the energy market and its participants. For long as a company has an energy supply licence it remains liable for the supply of energy to its customers and for the cost of that supply together with the cost for compliance with other industry and environmental and social schemes. In the event that GB could not balance its own position on the energy market, the SO carry would GB out its balancing role, which would involve imposing a price upon GB that would be likely to be higher than that which GB would pay on the market. If, as was likely, GB could not pay this price, these increased costs (which might

amount to more than £6m) would have to be taken up by other market participants. This in turn might cause financial difficulties for other energy suppliers, particularly small energy suppliers.

The Authority is very concerned about the possible impact on other small energy supply companies of the effect of spreading costs of that magnitude across the industry. In other words, the Authority's concern is that the company's financial difficulties carry a severe risk of a knock-on effect to the financial position of other small energy supply companies in the market if the company remains in the market for a further 14 days. Any impact upon these smaller companies which resulted in further insolvency proceedings would ultimately be bad for the consumer, as it would decrease competition on the energy market leading to increased costs for customers. It had been the Authority's express policy to encourage competition in a market that had traditionally been dominated by just six companies.

Secondly, the Authority considers that failing urgently to intervene and allowing GB to trade for two more weeks would materially damage consumer trust and confidence in the energy market. This was so particularly because of the threats by the company's call centre provider to withdraw its services. If this came to pass, customers who had heard about GB's impending insolvency would be unable to contact the company for information about the impact of this on their supply, and at the same time it would be impossible for the Authority to put in place a Supplier of Last Resort to move customers to a new supplier. Such a situation would attract significant negative media attention and might ultimately lead to a breakdown in trust in the market, particularly as regards smaller suppliers.

Again, this would prove a challenge to the market as a whole, as it might provoke customers to switch back to the six former regional monopolies, believing these to be less risky. This would also have a destablising effect on the finances of the smaller suppliers which would be detrimental to the consumer's interests in the entire UK retail energy market.

These were the reasons for which the Authority sought a declaration concerning the financial state of the company. The grounds upon which the Authority relied were simply that the company was unable to pay its debts within the meaning of the Insolvency Act 1986, as modified by the provisions of the Standard Supply Licence.

The Standard Supply Licence contains a term at Schedule 2(1)(f) that:

> '(1) The Authority may at any time revoke the licence by giving no less than 30 days' notice (24 hours' notice, in the case of a revocation under sub-paragraph 1(f)) in writing to the licensee:
>
> …
>
> (f) if the licensee:
>
> (i) is unable to pay its debts within the meaning of section 123 (1) or (2) of the Insolvency Act 1986 , but subject to paragraphs 2 and 3 of this schedule) or has any voluntary arrangement proposed in relation to it under section 1 of that Act or enters into any scheme of arrangement (other than for the purpose of reconstruction or amalgamation upon terms and within such period as may previously have been approved in writing by the Authority).'

Paragraphs 2 and 3 of the Schedule provide as follows

> '2. For the purposes of sub-paragraph 1 (f)(1), section 123 (1) (a) of the Insolvency Act 1986 shall have effect as if for "£750" there was substituted "£100,000"'
>
> 3. The licensee shall not be deemed to be unable to pay its debts for the purposes of sub-paragraph 1(f) (i) if any such demand as is mentioned in section 123(1)(a) of the Insolvency Act 1986 is being contested in good faith by the licensee with recourse to all appropriate measures and procedures or if any such demand is satisfied before the expiration of such period as may be stated in any notice given by the Authority under paragraph 1.'

Thus, if GB were unable to pay its debts in accordance with Schedule 2(1)(f) of its licence, the Authority was entitled to revoke the licence. The Standard Supply Licence further contains a term at condition 8 entitling the Authority to appoint a Supplier of Last Resort upon revocation of the failed supplier's licence. This is electricity supplier licence-holder which the Authority directs to take overall responsibility for the failed supplier's customers.

Birss J was satisfied that the Authority had shown that the court should grant the application.

It was clear from the statutory regime that this approach (ie revoking the licence under Schedule 2(1)(f) and appointing a supplier of last resort) was lawfully to the Authority. He also considered that the Authority was best placed to assess the most appropriate steps to take to fulfil its statutory objectives, and that the evidence showed that the Authority had considered the matter and concluded that this was the best approach. He also relied on the fact that the Authority had published guidelines which indicated that this is approach it would take in these circumstances and so market participants and the public can have a legitimate expectation that this is what the Authority would do: [40].

He further stated that he took into account the question of whether the application was capable of having the result sought by the Authority. He found that the terms of the Licence made clear that it was: [41].

He also considered whether it was proper for the Court to deal with this matter on an out of hours

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urgent application and in a hearing conducted by telephone, on a Part 8 Claim which would not be issued until Monday.

He found that the Court has jurisdiction to deal with the application on the basis of undertakings provided by the Claimant to issue and serve the Claim Form and confirm the truth of the evidence in the witness statement: [42].

He considered that an interim declaration would not be appropriate, as the consequences that the declaration was intended to have made it important that the matter is dealt with on its merits as a final matter: [43].

Although the general rule is that trials are to be in public (CPR r39.2) and none of express exceptions in r39.2(3) or the exceptions in PD 39A para 1.5 applied, it was nonetheless appropriate to deal with the matter by telephone. The urgency of the matter meant it needed to be dealt with on Saturday evening and the matter would not have been in any real sense if it had been dealt with in a court room on Saturday evening than it was in the telephone hearing. The public would have no notice that anything was taking place either way, and either way the recording of the hearing and the judgment would be made public. Thus the cost, inconvenience and delay associated with convening a hearing in court would be disproportionate to any benefit this would have brought: [44].

In conclusion, Birss J was satisfied by the Authority's evidence on urgency and on the risk to the commercial energy market and the risk to consumer confidence in the retail energy market. He relied particularly on the fact that GB's insolvency was not disputed and its directors were anxious to cooperate with the Authority: [45].

He also observed that it was the Authority which had taken the view that it is not its function to determine if the supplier is 'unable to pay its debts' and so had sought a declaration to this effect from the court before deciding whether to revoke a licence. He stated that where the Authority relied on s123(1)(e) or s123(2) as the basis for the company being unable to pay its debts, a court decision would indeed be necessary. However, he considered that in respect of the other limbs of s123(1), he could not say whether a court declaration would be required, not having heard full argument on this point: [47].

He noted in conclusion that he was satisfied the GB was insolvent and that its situation over the last 24 ours had deteriorated rapidly so that all bidders had withdrawn from a proposed sale process, and that it would likely cease to have enough cash to function as early as Monday 28th November 2016: [50]. Having been satisfied on both the substantive and procedural propriety of the application, he made a final declaration that GB was unable to pay its debts, that the condition set out in Schedule 2 (1)(f)(i) of each of the licences was satisfied and that the latter followed from the former.

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CASE REVIEW SECTION

Re Lehman Brothers Holdings Intermediate 2 Limited (in administration) [2017] EWHC 2032 (Ch); *Re Lehman Brothers Europe Limited (in administration)* [2017] EWHC 2031 (Ch)

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Introduction

The High Court considered, in two related decisions handed down on the same day, (i) whether to give directions to administrators of various Lehman group companies authorising a settlement of the Waterfall III litigation in *Re Lehman Brothers Holdings Intermediate 2 Limited (in administration)* [2017] EWHC 2032 (Ch), and (ii) whether to approve a mechanism designed to enable one of the companies in administration to distribute to members (as distinct from creditors) without converting the administration into a liquidation in *Re Lehman Brothers Europe Limited (in administration)* [2017] EWHC 2031 (Ch).

Re Lehman Brothers Holdings Intermediate 2 Limited (in administration) [2017] EWHC 2032 (Ch)

Factual background

Following the collapse of the Lehman Group in 2008, a substantial surplus, estimated at between GBP 7 billion and GBP 8 billion, has arisen in the administration of Lehman Brothers International (Europe) ('LBIE').

There has been a substantial number of high profile applications to the court, known as the 'Waterfall' applications, for the purposes of determining issues between the various stakeholders as to their respective entitlements to the surplus, as well as related issues.

Pending the resolution of a number of legal issues still in dispute in the various Waterfall proceedings, this has meant that the administrators of the relevant Lehman group entities have been unable to make further distributions.

The present decision was made in the context of a further application known as the 'Waterfall III' application (the 'Application'). The Application sought directions from the Court to resolve a number of inter-company positions between the various companies within the group, and in particular whether the obligations of Lehman Brothers Holding Intermediate 2 Limited (in administration) ('LBHI2') and Lehman Brothers Limited (in administration) ('LBL') to contribute to the assets of LBIE extended to a contribution to enable LBIE to pay an unsecured subordinated claim in respect of certain sums advanced to LBIE. However, following the Supreme Court's decision in *Re Lehman Brothers International (Europe) (in administration)* [2017] UKSC 38, as handed down on 17 May 2017, it became considerably less likely that the issues the application aimed to resolve would in fact arise, namely that LBIE could bring a contribution claim against LBL or LBHI2.

Consequently, this was a powerful impetus for the administrators of the various estates concerned to enter negotiations which have led to a proposed settlement (the 'Proposed Settlement'). In particular, the Proposed Settlement provided for the settlement of the intra-Lehman Group contribution and recharge claims which were the subject of Waterfall III, with a view to bringing that application to an end. In commercial terms, one of the most important features of the Proposed Settlement was that it would enable LBHI2 and LBL (in their capacity as members of LBIE) to make contributions to their unsecured creditors without reserving for any future contribution claim.

Accordingly, the administrators of the various estates concerned applied to the court for directions that the relevant applicants be at liberty to enter into and perform the transaction documents forming the Proposed Settlement.

The relevant legal principles

The relevant legal principles to be applied by Hildyard J in this case were recently summarised by Snowden J in *Re Nortel Networks UK Ltd* [2016] EWHC 2769 (Ch) which gathered together guidance provided in earlier cases. In summary, administrators are generally expected to exercise their own judgment in commercial matters rather than to rely on the approval or endorsements of the court to their proposed course of action. However, where a decision of the administrators is seen as particularly 'momentous', the court can be asked to give the administrators a direction permitting them

to proceed with such a decision. In such an event, the court should be concerned to ensure that the proposed exercise is within the administrator's power, that the administrator genuinely holds the view that what he proposes will be for the benefit of the company and its creditors, and that the administrator is acting rationally and without being affected by a conflict of interest in reaching that view.

It was noted by Hildyard J that the court's function 'is not to determine, and could not sensibly extend to determining, whether the settlement proposed is the best available, or might be improved in some way', with the court's focus being 'on the rationality and propriety of what is proposed, and on being satisfied that it is not infected by some conflict of interest affecting any of its proponents.

The decision

Hildyard J observed that the entry into settlement agreements and compromises is within the powers of administrators pursuant to paragraph 60 of Schedule B1 and paragraph 18 of Schedule 1 to the Insolvency Act 1986 ('IA 1986'). This meant that it was within the applicants' powers to cause the relevant Lehman entities to enter into the Proposed Settlement.

Further, given 'the size and complexity of the claims involved, the unique nature of the Lehman Group administrators and the long-running and complicated disputes that they had given rise to', Hildyard J was satisfied that the Proposed Settlement was a 'momentous' decision for the applicants, so as to justify seeking directions from the court.

Hildyard J further satisfied himself, by reference to the relevant witness evidence provided, that he was in no doubt of the administrators' views that the Proposed Settlement was advantageous to the relevant companies over which they presided as well as to the creditors of those companies, and that this view was genuinely held, rational and reached free from any conflicts of interest.

As to this, Hildyard J gave due consideration to both the advantages and disadvantages of the Proposed Settlement. In particular, he noted that the common feature between all applicants as to the merits of the Proposed Settlement was the view that a contribution claim by LBIE against either LBHI2 or LBL was now highly unlikely. He also observed the steps taken to mitigate any conflicts of interest, with each of the parties having authorised a single administrator to take primary responsibility for negotiations of the Proposed Settlement on its behalf and to determine whether it benefitted the creditors of the party separately.

On this basis, Hildyard J granted the applications for directions as sought in respect of the Proposed Settlement, remarking that 'considerable thought ha[d] been put into developing the Proposed Settlement over a period of several months by professional administrators with the benefit of professional legal advice', taking comfort from the fact that no creditor had expressed any objection to the Proposed Settlement despite being given ample opportunity to do so.

Comment

The judgment serves to demonstrate that in certain circumstances, insolvency practitioners can seek directions from the court when making decisions, which can provide an element of protection from subsequent challenge to that decision. However, this is only appropriate in circumstances involving a 'momentous' decision, with the court's role being to assess the 'rationality and propriety of what is proposed' rather than 'double-guess[ing]' the decision and determining if it might be the best available. Ultimately therefore, discretion to enter into commercial arrangements remains with the insolvency practitioner, it not being the place of the court to assess the merits of any proposal.

Re Lehman Brothers Europe Limited (in administration) [2017] EWHC 2031 (Ch)

Factual background

In light of the Proposed Settlement, the joint administrators of Lehman Brothers Europe Limited (in administration) ('LBEL') applied for directions from the court that would enable a distribution to be made to its sole member, Lehman Brothers Holdings (in administration) ('LBH'). The joint administrators of LBH also applied for directions in respect of their role in the prospective distribution (together the 'Application').

The Application was deemed necessary in light of (i) the absence of any express statutory mandate or power in the insolvency legislation for distributions to members (as distinct from creditors) within an administration, and (ii) a short judgment of Briggs J (as he was then) in *Re Lehman Brothers Europe Limited* (unreported, 25 June 2012) where it was held that the statutory administration regime does not permit administrators to make distributions (at least directly) to a company's members.

Whilst members are entitled to receive distributions in winding-up, it was thought that placing LBEL in liquidation proceedings would be both costly and timely, have adverse tax consequences, and have possible repercussions for the settlement of Waterfall III.

Accordingly, the LBEL administrators devised a scheme to circumvent these problems, with a proposal for the appointment of a director, who together with LBH as LBEL's member, would be empowered by the administrators to implement a capital reduction under Part 17 of the Companies Act 2006 ('CA 2006') (the

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'Proposal'). This would allow the proceeds to be paid over to LBH, and would, it was suggested, be treated as income, rather than capital, for tax purposes.

The question for Hildyard J was therefore whether the LBEL administrators could procure the payment of the distribution through the Proposal, or whether LBEL would first have to be placed into liquidation before any such distribution could be made.

The decision

Having required notifications to be given to the tax authorities to allow opposition or comments on the Proposal to be raised, Hildyard J permitted LBEL's administrators to proceed to implement the Proposal as devised. In doing so, Hildyard J addressed each of the four potential issues raised by LBEL.

Firstly, whether the court should approve a procedure which is not set out in statute and which has been specifically designed to overcome its absence. Given the relevance of the Briggs J decision, this was the most significant issue. Hildyard J noted that the IA 1986 provided two clear routes to achieve a distribution of surplus assets to members at the end of an administration (i) through the administrator terminating the administration pursuant to paragraph 80 of Schedule B1, enabling liquidation to commence, and (ii) through the administrator converting the administration to a creditors' voluntary liquidation pursuant to paragraph 83 of Schedule B1. The resulting question was whether this prevented other routes from also being pursued.

As to this, the LBEL administrators contended that the court should not infer that there was a bar against another route for achieving distribution to members outside liquidation for the following reasons: (i) there was no policy reason against distributions to members in an administration, (ii) the IA 1986 Act did enable administrators to appoint directors and to consent to the exercise of management powers by directors and members, (iii) the administration of LBEL was highly unusual meaning Parliament would never have contemplated the situation LBEL now found itself in when the rules on administration were introduced, (iv) the Proposal would not prejudice creditors, and (v) the creditors had been notified of the Proposal and had not raised any objections or concerns.

Whilst Hildyard J accepted these submissions, his concern centred on whether it was appropriate for a procedure as envisaged by the Proposal to be introduced judicially. Hildyard J resolved this dilemma by reference to the Supreme Court's judgment in Waterfall I, as well as Snowden J's judgment in *Re Nortel Networks UK Ltd* [2017] EWHC 1429 (Ch), noting that although the IA 1986 was 'fashioned as a complete code, it was not entirely exclusive and the Courts do have jurisdiction to supplement the legislation in appropriate circumstances, and particularly in areas where there is an apparent gap which might be covered or plugged by recourse to other legislation which is not expressly ousted or confined.' In this instance, the gap could be plugged by the CA 2006 such that it could not be said to be the intention of the CA 2006 to exclude the powers of directors or members to release and distribute a surplus, leaving liquidation as the only route available.

Secondly, whether it was necessary that the Proposal was consistent with and furthered the purpose of the administration. Hildyard J observed that the purpose of the administration was to achieve a better result for the creditors as a whole than would otherwise be likely if LBEL were wound up without first being in administration. As to this Hildyard J satisfied himself that the Proposal would achieve a better result for creditors so as to accord with the purpose of the administration.

Thirdly, whether the administrators were restricted by the administration proposals (dating from 2008) (the '2008 proposals'). As to this Hildyard J was content to find that the Proposal did accord with the 2008 proposals as, although there was no mention of shareholder distribution, they had been drafted in wide terms. It was determined that, even though the exit routes contemplated in the 2008 proposals did not contemplate the Proposed Settlement, these routes were at the discretion of the administrators and so did not preclude other means of fulfilling the 2008 proposals. This was particularly so because the adoption of the Proposal would enable both the settlement of Waterfall III and allow creditors to be paid their entitlements earlier than would otherwise be the case.

Fourthly, whether a statutory trust arises over assets in a distributing administration and, if so, what its impact is. Hildyard J acknowledged that it is well-established that the assets of a company in liquidation are held subject to a statutory trust, as per the early reported case of *Re Oriental Inland Steam Co.* (1873-74) LR 9 Ch App 557. However, there is no authority with regards to whether a statutory trust arises over the assets of a company in administration, or what the scope and implications of such a trust might be. The issue had arisen in *Harms Offshore AHT 'Taurus' GmbH & Co. KG* [2009] EWCA Civ 632. However, in the circumstances, the Court of Appeal had not found it necessary to determine the existence of a statutory trust in administration. Ultimately, Hildyard J was able to take a similar route, and was persuaded that he did not need to decide the point, as whether or not a trust existed, it did not prevent the directors and members from exercising managerial powers with the administrators' consent.

Overall therefore, Hildyard J was able to reach the conclusion that the directions sought provided 'a pragmatic solution to a practical problem [which was] consistent with the Administrators' duty to deal with the administration for the purpose for which it was sought, in the interests of the creditors and expeditiously.'

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Comment

Whilst the somewhat ingenious and novel mechanism proposed by the LBEL administrators is fascinating, in all probability, it is likely to have limited application. Nevertheless, the approach taken by Hildyard J to the issues may have wider relevance.

In particular, the judgment serves to highlight that the CA 2006, or any other legislation, may be used to plug a gap in the insolvency legislation where that other legislation is not expressly ousted or confined. This may be particularly helpful to insolvency practitioners as they continue to grapple with the insolvency legislation.

Further, it is apparent that not only must an administrator always perform his functions with the objective of achieving the statutory purpose behind the administration, an administrator must also be conscious of fulfilling the administration in line with the proposals for that administration. As to this, a helpful tip for insolvency practitioners is to always ensure that proposals are drafted in suitably wide terms, allowing for the exercise of future options as and when necessary.

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CASE REVIEW SECTION

Re Algeco Scotsman PIK S.A. [2017] EWHC 2236 (Ch)

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In this case, Mr Justice Hildyard sanctioned a cross-jurisdictional scheme of arrangement in relation Algeco Scotsman PIK SA (the 'Company') under Part 26 of the Companies Act 2006. At the beginning of his *ex tempore* judgment, echoing the words of Snowden J in *Re Van Gansewinkel Groep B.V* [2015] EWHC 2151 (Ch) at [6][1] with regard to the Court's function on a sanction hearing, Hildyard J noted that it was important in the context of a cross-jurisdictional scheme for the court to explain 'why it is proceeding so that any other court can both understand the approach of the English Court and also can see and be reassured that the function of the court in the context of schemes is not a ministerial or rubber-stamping one; it is to consider the scheme diligently, and to seek to identify and address any 'blots' on the scheme and any jurisdictional or enforcement problems, whether or not the scheme is the subject of opposition' (para. 1).

The Company served as a finance company in the Algeco Scotsman Group (the 'Group'). The Group is a leading global business service provider focussed on modular space, secure storage solutions and remote accommodations. The Company acted as the finance company within the group. Since 2013, the Group had been experiencing declining revenues primarily attributable to foreign currency movements and by a decrease in revenue in Asia Pacific and the Americas.

The Company was incorporated in the Grand Duchy of Luxembourg, where it also had its registered office. However, the court accepted that the Company's COMI was in England and not in the Grand Duchy, having regard to the evidence of the steps taken by the Company to displace the presumption that COMI was located in the latter. The court had regard to the following: (i) notification of creditors in advance of the scheme that an English address was to be used for correspondence with the Company; (ii) the Company was UK resident for tax purposes; (iii) the Company occupied its UK headquarters under a license to occupy office space in England; and (iv) prior to propounding the scheme, the Company had registered as an overseas company with a UK establishment with Companies House.

The scheme related to the restructuring of a lending agreement known as the 'PIK Loan Agreement', which was scheduled to mature in May 2018. The PIK Loan Agreement was governed by New York law and contained a jurisdiction clause in favour of New York. The scheme's purpose was to effect a compromise arrangement in respect of the lenders under the PIK Loan Agreement by cancelling the loan in exchange for a *pro rata* portion of: (i) an aggregate amount of cash consideration in the sum of US$95 million, subject to an early tender fee; and (ii) equity in a newly incorporated intermediate entity in the restructured Algeco Scotsman Group.

The Company's indebtedness under the PIK Loan Agreement was structurally subordinate to senior debt which ranked in priority to it (the 'Existing Senior Indebtedness'). The Existing Senior Indebtedness variously had the benefit of share and asset security granted by the Group's key operating subsidiaries, or had the benefit of guarantees from those subsidiaries. The Group considered that a restructuring of the PIK Loan Agreement would give it more flexibility to propose transactions to address the upcoming maturities of the Existing Senior Indebtedness.

A comparator analysis concluded that the estimated recoveries in either a distressed sale outside a formal insolvency process, or following the realisation of assets through an insolvency process would be less than the amount outstanding in respect of the Existing Senior Indebtedness. Therefore, the anticipated recovery for the lenders under the PIK Loan Agreement in either scenario would be nil. By comparison, the scheme consideration represented a 'real and valuable return to Scheme Creditors' (para. 18).

In order to open the gateway to the English court's jurisdiction, the Company had proposed that the

Notes

1 'It should be emphasised, however, that even where the scheme in question has the support of an overwhelming majority of the creditors who are to be subject to it, the court does not act as a rubber stamp. Whether or not the scheme is opposed, the court requires those presenting the scheme to bring to its attention all matters relevant to jurisdiction and the exercise of its discretion. The court will then consider carefully the terms and effect of what is proposed, whether it has jurisdiction, and whether it is appropriate to exercise such jurisdiction. That is particularly the case when the court is considering a scheme for an overseas company which does not have its COMI or an establishment in England, where jurisdictional issues necessarily arise, and where recognition of the scheme in other countries will be important.'

governing law of the PIK Loan Agreement be amended to English law, that the jurisdiction clause also be amended to submit the parties to the non-exclusive jurisdiction of the courts of England, and that certain restrictions under the agreement be waived to permit the Company to take steps to establish a sufficient connection with England, including shifting its COMI.

Mr Justice Hildyard referred to the convening hearing before Barling J, noting that at that hearing his Lordship had directed a single scheme meeting to be convened. Hildyard J also noted that jurisdictional matters were canvassed before Barling J, who had reserved judgment on that occasion, but that the sanction hearing had come on before the reserved judgment was delivered. Nothing his Lordship said in his judgment at sanction was intended to cut across Barling J's judgment.

Following the convening hearing, 98.7 per cent by value and 97.56 per cent by number of all scheme creditors entitled to vote had voted to approve the scheme. As to the matter of overall fairness, Hildyard J noted that, 'it is very rare for the court, if ever, to question the overwhelming majority views of persons who could be expected to be the best judges of their commercial situation, provided it is satisfied that they have been provided with proper information by reference to which to vote' (para. 38).

Turning to the questions of jurisdiction and discretion, his Lordship considered that there was no jurisdictional impediment nor any discretional reason to refuse to sanction the scheme by virtue of its cross-border element.

First, the judge accepted that the Company plainly fell within section 895 of the Companies Act 2006 as 'a company liable to be wound up under the Insolvency Act 1986' such that the strict jurisdictional test was fulfilled. As to the additional requirement of sufficiency of connection, the judge noted that either (i) the presence of COMI in the jurisdiction or (ii) the amendments to the governing law and jurisdiction clause under the PIK Loan Agreement provided a sufficient connection with the jurisdiction for him to sanction the scheme. As to (i), Hildyard J was satisfied with the steps taken to fortify the presumption of COMI being in England as described above. As to (ii), the principal question was whether the amendments were effective under the relevant New York law. Expert evidence by Judge Peck, a retired judge of the US Bankruptcy Court, concluded that the alterations were permissible under New York law.

Second, Hildyard J turned to the Brussels Regulation Recast and to the vexed question of whether it applies and, if it does, with what effect. The judge adopted the pragmatic course taken in other cases, namely, to consider whether jurisdiction would exist under chapter II on the assumption that the Brussels Regulation applied. His Lordship concluded that the court would have jurisdiction under Article 8 and/or Article 25, but left it to the reserved judgment of Barling J to elaborate on this point.

Third, Hildyard J addressed the likelihood of the recognition of the English Order made in relation to the scheme in a relevant foreign court, where the US court or the Luxembourg court were the relevant courts. Again, the opinion of Judge Peck confirmed that the US court would be likely to accept and give effect in the US to the English Order to sanction and implement the scheme. A further expert opinion confirmed the same with regard to the position in the Grand Duchy.

Looking at the particular steps taken by the Company with the intention of opening the jurisdictional gateway to the English court's scheme jurisdiction, Hildyard J said at [57]:

> 'As it seems to me, the resort to the English Court in these circumstances is appropriate as well as understandable, given what I have been given to understand are the lack of any viable or efficient alternatives. The aim and object of the scheme is not sectional, nor for personal advantage. A scheme has been propounded and the jurisdiction has been invoked because the general body of creditors requires the reconstruction for the protection of their interest and for the future business of the company and the group. The English scheme jurisdiction offers a salutary and fair solution. In those circumstances, I take the view that it is an example, if one has to use the phrase, of "good forum shopping".'

Finally, Hildyard J considered the provision of the early tender fee which could go to issues regarding class constitution and composition, or to the general question of fairness. The early tender fee constituted the sum of 2 per cent of the principal of the amount of the scheme creditors' PIK Loans. Hildyard J was satisfied that the fee was offered generally and not to a select few, that the fee was not beyond the norm, and that the fee did not raise the question as to whether it would purchase consent where otherwise it might be refused. Accordingly, his Lordship was content to sanction the scheme.

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Court of Justice of the European Union (CJEU) in *Vinyls Italia SpA v Mediterranea di Navigazione SpA* C-54/16

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The CJEU gave a preliminary ruling on Article 13 of Council Regulation (EC) No 1346/2000 of 29 May 2000 on insolvency proceedings (OJ 2000 L 160, p. 1) (IR).

The request for the preliminary ruling was made by the Tribunale Ordinario di Venezia, Italy, in the course of proceedings aimed at the setting aside of transactions between Mediterranea di Navigazione SpA ('Mediterranea') and Vinyls Italia SpA ('Vinyls'), following the latter company's insolvency, and the repayment of funds by Mediterranea paid to it by Vinyls in the six months prior to its declaration of insolvency.

Vinyls and Mediterranea were both Italian companies. The contested payments by Vinyls to Mediterranea were made pursuant to a ship charter contract (the 'Contract') concluded on 11 March 2008, the term of which was extended by an addendum of 9 December 2009. The Contract had an English governing law clause. Vinyls was in special administration in Italy.

The special administrator sought to have the payments to be set aside under Italian insolvency law. Mediterranea opposed this on the grounds that the payments were made in accordance with a contract governed by English law and, it said, under English insolvency law, the payments could not be challenged. It should be noted that the referring court pointed out that the sworn statement from an English lawyer on which Mediterranea relied for the latter proposition made clear that English law does not exclude in general or in the abstract, any possibility of challenging the contested payments, but requires the challenge to meet certain substantive requirements which differ from those laid down by the *lex fori concursus*.

Each party adduced an argument regarding the proper law under which the question of whether the transactions were to be set aside should be determined.

The administrator of Vinyls simply sought to have the transaction set aside under a provision of the Italian Law of Insolvency.

Mediterranea relied on Articles 4 and 13 of the IR to resist the application of the Italian Law of Insolvency to the set aside action.

Article 4 provides as follows:

> '1. Save as otherwise provided in this Regulation, the law applicable to insolvency proceedings and their effects shall be that of the Member State within the territory of which such proceedings are opened, hereafter referred to as the "State of the opening of proceedings".
>
> 2. The law of the State of the opening of proceedings shall determine the conditions for the opening of those proceedings, their conduct and their closure. It shall determine in particular:
>
> …
>
> (m) the rules relating to the voidness, nullity, voidability or unenforceability of legal acts detrimental to all the creditors.'

Article 13 provides as follows:

> 'Article 4(2)(m) shall not apply where the person who benefited from an act detrimental to all the creditors provides proof that:
>
> – the said act is subject to the law of a Member State other than that of the State of the opening of proceedings,
>
> – that law does not allow any means of challenging that act in the relevant case.'

Mediterranea stated that the effect of Art. 13 was to disapply the application of Art. 4(1)(m), so that the avoidance action was governed by English not Italian insolvency law.

The question for the Italian court was complicated by Regulation (EC) No 593/2008 of the European Parliament and of the Council of 17 June 2008 on the law applicable to contractual obligations (Rome I) (OJ 2008 L 177, p. 6; 'the Rome I Regulation'). Article 1(1) of the Rome I Regulation provides:

> 'This Regulation shall apply, in situations involving a conflict of laws, to contractual obligations in civil and commercial matters.'

Article 3 of the Rome I Regulation, entitled 'Freedom of choice', which provides in paragraphs (1) and (3):

> '1. A contract shall be governed by the law chosen by the parties. The choice shall be made expressly or clearly demonstrated by the terms of the contract or the circumstances of the case. By their choice the parties can select the law applicable to the whole or a part only of the contract.

...

> 3. Where all other elements relevant to the situation at the time of the choice are located in a country other than the country whose law has been chosen, the choice of the parties shall not prejudice the application of provisions of the law of that other country which cannot be derogated from by agreement.'

Article 3(3) of the Rome I Regulation appears to raise the possibility that despite the governing law clause, because 'all other elements relevant to the situation at the time of the choice' were in Italy, the choice of English law could not prejudice the application of Italian insolvency law.

Further, the administrator of Vinyls submitted that Art. 13 of IR makes provision for a procedural objection, and that this cannot be raised by the court of its own motion, but must be raised by the party concerned within the time-limit laid down by the procedural law of the Member State of the court hearing the action to set aside. In the present case, the objection was raised out of time.

The referring court asked five questions:

> '(1) Does the "proof" which Article 13 of Regulation No 1346/2000 requires of the person who benefited from an act detrimental to all the creditors, in order to prevent that act from being challenged in accordance with the rules of the lex fori concursus, include a requirement to raise a procedural objection in the strict sense of that term within the periods laid down by the procedural rules of the lex fori, when seeking to rely on the derogation provided in the regulation and to prove that the two conditions laid down by that provision have been met? Or does Article 13 of Regulation No 1346/2000 apply when the party concerned has requested its application during the proceedings, even when the time-limits laid down by the procedural rules of the lex fori for lodging procedural objections have expired, or even where that provision is applied by the court of its own motion, provided that the party concerned has provided proof that the detrimental act is subject to the lex causae of another Member State whose law does not permit the act to be challenged by any means in the specific circumstances of the case?

> (2) Must the reference to the rules of the lex causae in Article 13 of Regulation No 1346/2000, for establishing whether 'that law does not allow any means of challenging that act in the relevant case', be interpreted as meaning that the party bearing the burden of proof must show that, in the specific circumstances of the case, the lex causae does not provide, in general or in the abstract, any means to challenge an act such as that which, in the present case, was considered detrimental — namely the payment of a contractual debt — or as meaning that the party bearing the burden of proof must show that, where the lex causae allows an act of that type to be challenged, the conditions to be met in order for such a challenge to be upheld in the relevant case, which differ from those of the lex fori concursus, have not actually been fulfilled?

> (3) Is the derogation provided for in Article 13 of Regulation 1346/2000 — bearing in mind its objective of protecting the legitimate expectations of the parties concerning the stability of the act in accordance with the lex causae — applicable even when the parties to a contract have their head offices in a single Member State, whose law can therefore be expected to be intended to become the lex fori concursus in the event of insolvency on the part of one of those parties, and the parties, via a contractual clause designating the law of another Member State as the law applicable, exclude the setting aside of acts performed under the contract from the application of the mandatory rules of the lex fori concursus imposed in order to protect the principle that all creditors should be treated equally, to the detriment of all the creditors in the event of insolvency?

> (4) Must Article 1(1) of the Rome I Regulation be interpreted as meaning that 'situations involving a conflict of laws' for the purposes of the application of that regulation also include a situation involving a charter contract concluded in a Member State between companies with their head offices in the same Member State, with a clause designating the law of another Member State as the law applicable?

> (5) If the answer to Question 4 is in the affirmative, must Article 3(3) of the Rome I Regulation, read in conjunction with Article 13 of Regulation No 1346/2000, be interpreted as meaning that, where the parties choose to subject a contract to the law of a Member State other than that in which 'all the other elements relevant to the situation' are located, that does not affect the application of mandatory rules under the law of the latter Member State, which apply as the lex fori concursus, for the purpose of challenging acts performed before the insolvency to the detriment of all the creditors, thereby prevailing over the derogation provided for in Article 13 of Regulation No 1346/2000?'

Question 1

In the first question the referring court asked whether At. 13 of the IR requires a person benefitting from the act that is detrimental to all creditors in order to challenge an action to have that act set aside in accordance with the *lex fori concursus*, to raise a procedural objection in the form and within the time-limits laid down by the procedural law of the Member State on whose territory the dispute is pending

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The Court had previously ruled that Art. 13 expressly governs the allocation of the burden of proof. However, the court pointed out, it does not contain any provisions on more specific procedural aspects. Thus, it is silent on the questions of the form and time-limit for relying on that article in the context of proceedings: [25].

Accordingly, the form and time-limits for relying on Article 13 of Regulation 1346/2000 in the context of proceedings relating to the setting aside, in accordance with the rules laid down by the *lex fori concursus*, of an act that is detrimental to all the creditors, and the issue whether the court hearing those proceedings may apply that article of its own motion, come under the procedural law of the Member State on whose territory those proceedings are pending: [25].

This is so despite the fact that the exception in Art. 13 may be relied on where the act sought to be invalidated under Art. 4(1)(m) cannot be invalidated under the law of the other member state due to a limitation period or other time-bar in that other state, following judgment of 16 April 2015, *Lutz* (C 557/13, EU:C:2015:227, paragraph 49): [28].

The Court also noted that the objective pursued by Art. 13 is to protect the legitimate expectations of a person who has benefited from an act detrimental to all the creditors by providing that the act will continue to be governed, even after insolvency proceedings have been opened, by the law that was applicable at the date on which it was concluded. This objective does not require all time limits to be governed by the *lex causae*: Article 13 does not aim to protect a litigant from the usual risks of defending proceedings, under which the procedural rules of the court seized of a matter must be obeyed: [30].

Thus, the expiry of the Italian time-limit for the objection to transaction avoidance precluded a jurisdictional objection being raised under Art. 13 before the Italian court (notwithstanding that the substantive law of the objection does not impose such a time limit). This is subject to the general point that any time limit for the raising of an objection may not be stricter in the case of an objection raised under the law of another member state than it would be for an objection raised in similar domestic situations: this is the principle of equivalence. It is also subject to the principle of effectiveness: the time limit must not make it excessively difficult or impossible in practice to exercise the rights conferred by EU law. It was for the referring court to decide whether the principles of equivalence and effectiveness were upheld: [33].

The second question

By its second question the Venetian court asked whether what a party who wishes to rely on Art. 13 must show is that the in the specific circumstances of the case, the *lex causae* does not provide, in general or in the abstract, any means to challenge an act which was considered detrimental, or that where the *lex causae* allows an act of that type to be challenged, the conditions to be met in order for that challenge to be upheld, and which differ from those of the *lex fori concursus*, have not actually been fulfilled: [34].

The court ruled that following judgment of 15 October 2015, Nike European Operations Netherlands, C 310/14, EU:C:2015:690, paragraph 20, the objective of Art 13, that is to satisfy the legitimate expectations of creditors that an act will continue to be determined by the law which applied to it when it was committed, requires that all the circumstances of the case be taken into account: [35]. There cannot be legitimate expectations where, after insolvency proceedings have been opened, the validity of an act is to be assessed without regard being had to those circumstances whereas, where such proceedings are not opened, such circumstances would need to be taken into account.

The Court has an obligation to interpret Art. 13 strictly: [36]. A broad interpretation would allow a person who has benefited from an act detrimental to all the creditors to avoid the application of the *lex fori concursus* solely by relying on a provision of the *lex causae* as, in the abstract, rendering acts of a certain sort unchallengeable. Nike European Operations Netherlands, C 310/14, EU:C:2015:690, paragraph 31is authority for the proposition that where a defendant in an action relating to the voidness, voidability or unenforceability of an act relies on a provision of the *lex causae* limiting the circumstances in which the act can be challenged, it is for the defendant to plead that the circumstances necessary for reliance on that provision of the *lex causae* have in fact arisen.

The third to fifth questions

The Court treated the third to fifth questions, on the interaction of Art. 13 of the IR and its interaction with Art. 3(3) of the Rome I Regulation, together. It noted that in fact, in this case, Rome I Regulation does not apply to the main proceedings – the contract was concluded before the period to which Rome I Regulation applies: [41]. The third to fifth questions all hinge on whether Art. 13 of the IR applied in relation to a contract with a governing law clause designating a different Member State's law than that of the Member State in which all the other elements relevant to the situation are located.

Governing law clauses are often used in commerce and were common when the IR came into force: [45]-[46]. Article 13 of that Regulation does not contain any express limitation on its effect where there is a governing law clause, and nor does any other part of the IR: [46]. Accordingly, Art. 13 must be taken to apply even where a governing law clause makes a contract subject

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to the law of a Member State other than the Member State in which those parties are both established.

The Court further noted at [47] that recital 23 of the IR states that that the Regulation 'should set out, for the matters covered by it, uniform rules on conflict of laws which replace, within their scope of application, national rules of private international law.' This indicates that Art. 3(3) of the Rome I Regulation does not prevail as against Art. 13 of the IR, and that the latter article still applies when all the other elements of a situation, apart from the choice by the parties of the applicable law, are located in a Member State other than the one whose law is chosen.

The exception to this is where the governing law clause was introduced specifically to avoid the transaction avoidance provisions that would otherwise apply, for abusive or fraudulent ends. EU law cannot be relied on to further such ends. The Court noted that it will make a finding of abuse if it finds a combination of objective and subjective elements: [52]. Objectively, it must be found that despite formal observance of the conditions laid down by Community rules, the purpose of those rules has not been achieved. Subjectively, it must be found that the transactions made in formal observance of the rules were aimed at obtaining an undue advantage, and the economic activity carried out may not have some explanation other than the mere attainment of an advantage (judgment of 28 July 2016, Kratzer, C 423/15, EU:C:2016:604, paragraphs 38 to 40 and the case-law cited).

It concluded at [54]:

> 'Thus as regards the application of Article 13 of Regulation No 1346/2000 in a situation such as that at issue in the main proceedings, that application may be disregarded only in a situation where it would appear objectively that the objective pursued by that application, in this context, of ensuring the legitimate expectation of the parties in the applicability of specific legislation, has not been achieved, and that the contract was made subject to the law of a specific Member State artificially, that is to say, with the primary aim, not of actually making that contract subject to the legislation of the chosen Member State, but of relying on the law of that Member State in order to exempt the contract, or the acts which took place in the performance of the contract, from the application of the lex fori concursus.'

Simply introducing a governing law clause does not indicate abuse of this nature.

The Court concluded on questions three to five at [56] that Art. 13 of the IR may validly be relied on where there is a governing law clause even where the parties concerned have their head offices in single Member State on whose territory all the other elements relevant to the situation in question are located, and this Member State is not the Member State whose law has been designated in the governing law clause, provided that those parties did not choose that law for abusive or fraudulent ends, that being a matter for the referring court to determine.

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CASE REVIEW SECTION

Bakhshiyeva v Sberbank of Russia and others [2018] EWHC 59 (Ch) (18 January 2018)

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Introduction

On 18 January 2018, Hildyard J handed down judgment in *Bakhshiyeva v Sberbank of Russia and others* [2018] EWHC 59 (Ch). The application concerned the question of whether the Court has power to grant a permanent moratorium or stay to prevent a creditor exercising its rights under a contract governed by English law in order to prevent that creditor enforcing its rights contrary to the terms of the foreign insolvency proceedings by which all creditors were, under the relevant foreign law, intended to be bound. If the answer to this question was yes, the Court was then required to consider whether, in its discretion, it should exercise that power. However, after careful consideration, Hildyard J held the answer to be 'no'.

Factual background

The OJSC International Bank of Azerbaijan ('IBA') (represented by Gunel Bakhshiyeva in this case as IBA's foreign representative), Azerbaijan's largest commercial bank, had previously commenced restructuring proceedings in Azerbaijan, where it was registered and had its centre of main interests ('COMI'), in order to restructure its debts having fallen into commercial difficulties (the 'Restructuring Proceedings'). Following an application made to the English High Court, recognition of those proceedings as foreign main proceedings under the Cross-Border Insolvency Regulations 2006 (the 'CBIR') was granted (the 'Recognition Order').

The Recognition Order imposed a wide-ranging moratorium, similar to that which would arise under an English administration proceeding (the 'Moratorium'), preventing creditors from commencing or continuing action against the bank without the permission of the Court.

The restructuring plan proposed by IBA pursuant to the Restructuring Proceedings (the 'Plan') was approved by 97.3% of creditors and the Azerbaijan courts. As a matter of Azerbaijan law, the Plan was binding on all affected creditors, including those who did not vote or opposed the Plan.

The Plan however was due to expire at around the time of the application, prompting IBA to seek an extension to the Moratorium. However, the respondents objected to the application, relying on the rule in Gibbs (derived from *Antony Gibbs & Sons v La Société Industrielle et Commerciale des Métaux* (1890) LR 25 QBD 399) which states that a debt governed by an English law cannot be discharged by a foreign insolvency proceeding. Both respondents, Sperbank and Franklin Templeton, held debt governed by English law and had not submitted to Azerbaijan law. They therefore believed that they had retained the right to enforce their claims, subject only to the Moratorium.

The issues

Accordingly, there were two short but fundamental points of cross-border insolvency law that had to be addressed, namely:

Whether the Court had jurisdiction to extend the Moratorium imposed under the CBIR; and

Whether the Court should refuse to lift the continuing Moratorium in favour of a creditor whose debt is governed by English law, so as to prevent that creditor from achieving a better return than that enjoyed by all of the company's other creditors under the Plan.

The decision

Nature of the restructuring proceeding

In giving judgment, Hildyard J's starting point was to identify the nature of the Restructuring Proceeding and the Plan as, in his opinion, different consequences and attitudes were to follow according to whether the Restructuring Proceeding was akin to a liquidation or a termination procedure, or whether it was akin to a rescue or debt reconstruction intended to enable the bank to carry on business.

Relying on expert evidence as to Azerbaijan law, the undisputed assessment as to the nature of the Restructuring Proceeding was that it facilitated rehabilitation and the resumption of trading rather than the collection of assets and their distribution followed by dissolution.

The Rule in Gibbs

Commentary and evaluation was subsequently provided on the rule in Gibbs. In particular, Hildyard J pointed out that whilst the rule has a long pedigree, as cross-border insolvency issues have increasingly come to the fore, the rule has frequently been thought to be parochial and out of step in the context of foreign insolvency proceedings, especially by academic writers. Instead, commentators have tended towards the principle of universalism, regarding insolvency law as having an 'overriding effect'. There also exists an anomaly in Gibbs whereby, under English law, an English bankruptcy could discharge a foreign debt (see *Rubin v Eurofinance SA* [2013] UKSC 46, [2013] 1 AC 236). However, given the continued application of the rule, there was no real doubt as to the continued application of it here.

The real question, it was stated, was therefore not whether the rule in Gibbs applies. Instead, it was whether principles of 'modified universalism' as expressed in the common law and in the Model Law on Cross-Border Insolvency (the 'Model Law') adopted by UNCITRAL on which the CBIR was based, enabled the Court to grant relief without upsetting the rule in Gibbs. In particular, it had to be queried whether at one and the same time, the rule in Gibbs could formally be observed by accepting the continuation of the rights conferred by English law, but giving effect to modified universalism by preventing the exercise of those rights by a stay or moratorium.

The solution suggested

It was suggested by counsel for IBA that the rule in Gibbs should be confined in its application to prevent the abrogation or modification of the English law governed contractual right as a matter of law and should not be applied or extended so as to prevent the Court taking procedural steps to assist a foreign insolvency proceeding which it had chosen to recognise. It was nevertheless accepted that a permanent moratorium continuation would in practical terms materially undermine the rule in Gibbs. However, it was submitted that as a matter of strict legal definition of legal rights, the contractual position would not itself be affected, and so the rule in Gibbs should not affect the granting of a continuation of the Moratorium. In other words, the question of enforcement, it was argued, was different from the question of discharge, the latter being where the rule in Gibbs should be confined to.

Further, it was also submitted that the practice of remitting assets found in this jurisdiction to the control of the rule in the context of a recognised foreign liquidation provides a parallel precedent for confirming and restricting Gibbs. Additionally, it was averred that that such a restrictive approach to the rule would give proper effect to the Model Law and the CBIR, in line with the concept of modified universalism.

Effect of the CBIR and the Model Law

On counsel for IBA's submission, Hildyard J also analysed what was said to be the 'critical question' as to the effect of the CBIR and the Model Law.

The objective of the Model Law was to assist in the development of universalism, with the ultimate aim of that being to provide a single forum applying a single regime to all aspects of a debtor's affairs on a worldwide basis. In turn, the Guide to Enactment of the Model Law was to be used as an aid to the construction of the CBIR. To that end, the Model Law seeks to advance the notion that the law of the debtor's COMI should determine issues arising in the context of insolvency proceedings.

Nevertheless, it was also averred that it must also be appreciated that the Model Law is not dependent or premised upon reciprocal recognition, and it does not address substantive domestic insolvency provisions. Further, it does not seek to achieve a substantive uniformity or reconciliation between different jurisdictions and their substantive laws. This, it was explained, means that the notion of universalism was subject to modification according to the jurisdiction in which it has been adopted. Those modifications accordingly follow the substantive law in that jurisdiction. By way of example, the law on COMI cannot be enforced in the UK, unless and to the extent that by treaty or statute it is absorbed into and becomes part of British law.

On this basis, Hildyard J stated that the Model Law and the CBIR should be viewed as providing a framework of procedural mechanisms to facilitate the more efficient and constructive disposition of cases where an insolvent debtor has assets or debts in more than one state.

Outcome

Although counsel for IBA sought to displace the notion that the purpose of recognising foreign proceedings is only to enable a 'breathing space', with any relief under the CBIR being confined to that and not to permanence, asserting this didn't apply to any additional relief sought after the automatic moratorium, Hildyard J was not persuaded. Instead, Hildyard J preferred the more restrictive interpretation provided by the respondents in reliance on the decision in *Pan Ocean Co Ltd, Re* (2014] EWHC 2124 (Ch), [2014] Bus LR 1041.

In particular, Hildyard J agreed with the approach taken in *Pan Ocean* which in turn relied upon *Rubin* in that the Model Law and the CBIR were 'concerned with procedural matters' and not matters affecting the existence, exercise or enforcement of substantive rights, nor the recognition of foreign judgments against third

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parties. Hildyard J was also convinced, in reliance on *Pan Ocean Co Ltd* and *Rubin* that 'the question whether relief sought is of a procedural or substantive nature is to be answered according to whether in all the circumstances it would affect otherwise than in a purely temporal way, the substantive rights and obligations of both parties.'

Further, it was held that *Pan Ocean Co Ltd* affirmed that the Model Law and the CBIR did not empower the English court to vary or discharge substantive rights conferred under English law by the expedient of procedural relief, which had been fashioned with the intention of confirming the rights of English creditors with the rights which they would have under the relevant foreign law. Accordingly, as per Hildyard J 'any such power could never appropriately be exercised so as to achieve the application of foreign law to the discharge or variation of an English law right. In the strict sense, this was a jurisdictional bar, and could not be used as a means to circumvent the rule in Gibbs'.

Comment

This judgment is important for two reasons.

Firstly, it re-affirms the rule in Gibbs and despite the criticism the rule has received, it is clear that the courts remain unwilling to circumvent it, even in the name of the universalism advanced by the Model Law and the CBIR. Whether, and for how long, this will continue to be the case remains to be seen.

Secondly, and perhaps more significantly, this judgment will be welcomed by creditors, especially those who do not submit in a foreign insolvency restructuring, as this judgment seems to suggest they are able to merely wait and bide their time whilst a restructuring occurs and until the moratorium reaches an end, and then issue claims and seek whatever remedy they assert they are entitled to. A restructuring process will clearly, and sadly for companies, not shake off the claims by such predatory creditors.

Nevertheless and interestingly, following the court giving its oral decision on the case (but before issuing the written judgment), Hildyard J was provided with a witness statement on behalf of the foreign representative of IBA, which stated that the Azerbaijan parliament had approved an amendment to Azerbaijani law which would now enable the courts of Azerbaijan to order further extensions of IBA's restructuring proceedings. This decision appears to have effectively compromised the English law obligations. Permission has therefore been granted to appeal the judgment in this case to the Court of Appeal, and we wait to see how this case develops.

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CASE REVIEW SECTION

Re Agrokor [2017] EWHC 2791 (Ch) (9 November 2017)

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Introduction

On 9 November 2017, judgment was handed down by the Companies Court in *Re Agrokor* [2017] EWHC 2971 (Ch). The application was for recognition in Great Britain (i.e. England, Wales and Scotland) under the Cross-Border Insolvency Regulations 2006 (the 'CBIR') of 'extraordinary administration proceedings' ongoing in Croatia as 'foreign proceeding' within article 2(i) of Schedule 1 of the CBIR. The application was vigorously contested by Sperbank of Russia ('Sperbank'), Agrokor's largest creditor, and was the first time in an English court that a recognition application had been opposed. However, despite this opposition, recognition was granted.

Factual background

The Agrokor group carries on business in agriculture, food production and related activities in Croatia. It is said to be the largest privately-owned company in that country, with annual revenue equalling approximately 15% of Croatia's gross domestic product, increasing to 30% if supply chains are included. Following financial difficulties encountered by the group, the Croatian government enacted new legislation on 6 April 2017, the Law on Extraordinary Administration in Companies of Systematic Importance for the Republic of Croatia (the 'EAL'), intended to facilitate the restructuring of Agrokor, including its subsidiaries and affiliates, and to preserve their businesses as going concerns.

On 7 April 2017, Agrokor made an application to the Croatian court for the commencement of extraordinary administration, with such an order being granted on 10 April 2017. The effect of this was to prohibit the bringing or conducting of civil or enforcement proceedings against Agrokor and its controlled and affiliated companies pending the restructuring. Nevertheless, given this was an order of the Croatian court, it did not automatically mean that the order would be recognised or enforced outside of Croatia.

Agrokor were therefore required to seek recognition of the extraordinary administration in England, so as to allow it to be recognised and enforceable here. This was because certain of the company's debt obligations, for example, were governed by English law and subject to the jurisdiction of the English courts. Further, Sperbank whist submitting claims in the extraordinary administration had also taken other steps in other countries in relation to its claims, which included commencing two arbitrations in London against Agrokor.

The court, in turn, had to decide whether the Croatian proceeding fulfilled the criteria for recognition under the CBIR.

Arguments raised

Sperbank opposed the recognition application on two principal grounds:

(1) The extraordinary administration proceeding was not a 'foreign proceeding' within the meaning of article 2(i) of Schedule 1 to the CBIR, which defined a 'foreign proceeding' as 'a collective judicial or administrative proceeding in a foreign State, including an interim proceeding, pursuant to a law relating to insolvency in which proceeding the assets and affairs of the debtor are subject to control or supervision by a foreign court, for the purpose of reorganisation or liquidation'; and

(2) That even if it were such a 'foreign proceeding', recognition of that proceeding would be manifestly contrary to English legal public policy.

As to the argument that the extraordinary administration was not a 'foreign proceeding', Sperbank relied on five submissions:

(1) The EAL was not a 'law relating to insolvency'. This, it was argued, was on the basis that the EAL provided for Agrokor's affiliates to be included in the administration proceeding even if they were not insolvent;

(2) The purpose of EAL was not one of reorganisation or liquidation, instead it was to protect systematically important companies, the law indicating that it would protect the debtor over the creditors;

(3) The proceeding was not a 'collective proceeding' as per the meaning given in the Guide to Enactment which specifies that 'a key consideration is whether substantially all of the assets and liabilities of the debtor are dealt with in the proceeding'. Sperbank

therefore objected on this basis because the proceeding affected the assets and liabilities of all the affiliated and connected companies in the Agrokor group, and submitted that 'collective' must mean relating to the debtor and its own creditors and not the debtor and creditors of others;

(4) The extraordinary administration was not 'subject to the control or supervision by a foreign court' as per the requirement under the CBIR. In particular, Sperbank objected to the level of control asserted by the Croatian government over the proceeding, arguing that there was no substantive control that could be asserted by the Croatian courts; and

(5) The proceeding was a single group proceeding in respect of the applicant and all its controlled companies and affiliates, which was outside the scope of article 2(1) of Schedule 1 to the CBIR. More specifically, in answer to the question posed by the court, as to whether the CBIR made it possible to recognise a foreign proceeding in England which was expressly brought in a foreign court in respect of a group of companies, even though recognition was only sought in relation to one specific company, Sperbank argued 'no'.

In relation to it being contrary to English public policy should the extraordinary administration proceeding be recognised as a 'foreign proceeding', Sperbank argued that this would be contrary to fundamental principles designed to ensure a fair insolvency proceedings, including the right to practical and effective access to a legal remedy and the right to private property.

The decision

The court rejected all five of Sperbank's objections to the extraordinary administration being a 'foreign proceeding'.

On the first objection, in relying on a variety of common law cases such as *Re Stanford International Bank Limited* [2011] CH 33, *In Re Betcorp Ltd* 400 BR (2009), and *Re Chow Cho Poon (Private) Limited* [2011] 300, 80 NSWLR 507, the court held 'that the requirement that the law under which the proceeding is brought be "an insolvency law" is satisfied if insolvency is one of the grounds on which the proceeding can be commenced, even if (as in *Re Betcorp*) insolvency could not actually be demonstrated'.

Further, the court noted that pursuant to Article 4 of the EAL, an extraordinary administration proceeding could be initiated on the basis of either insolvency or impending insolvency, whether proved or deemed. It was also agreed by the experts in the case that whatever the position for Agrokor itself, there was no requirement in the EAL that any of its affiliated or controlled companies should be insolvent or facing insolvency before they could be brought into the proceeding.

Accordingly, the court held that the mere fact that an affiliated or controlled company was not insolvent and might be joined to the proceeding, did not mean that overall the proceeding was not brought under a 'law relating to insolvency'. As explained in the judgment '[i]t is the fact the insolvency, actual or threatened, of one company which triggers the proceedings, and the law under which the proceeding is brought is accordingly in principle a law relating to insolvency for this purpose.'

On the second objection, the court held that the purpose of the EAL was clearly to protect the stability of the economic system against systematic shocks by enabling the restructuring of companies of systematic importance that get into financial difficulty, and rejected Sperbank's objection that creditors would not be afforded the minimum protection. Overall therefore, it was clear that the EAL could be described as a law for the purposes of the reorganisation or liquidation within the meaning of the CBIR.

On the third objection, the court asserted that Sperbank's objections were not that the proceeding was not 'collective', but that the proceeding was 'too collective', the objection primary being that a proceeding to deal with the whole group at once means that persons who are creditors of another entity are entitled to claim in the assets of the debtor. Accordingly, the court merely dismissed this objection by simply holding that it could not be said that the proceeding was not a 'collective proceeding'.

On the fourth objection, the court held that it was in fact clear that the proceeding would be under the control and supervision of the court through the medium of the extraordinary administrator. The fact that the EAL gave significant power to the government of Croatia was deemed unsurprising and irrelevant; unsurprising because the EAL was concerned with companies of strategic importance to the economy of Croatia, and irrelevant because the relevant test for the court was not whether the government had a particular power in relation to the proceeding, but whether the proceeding was subject to the control or supervision of the court.

As to the fifth objection, the court held that there was nothing in the CBIR to prevent a foreign proceeding being recognised, which in the foreign court involved a group of companies, but where the recognition sought was in relation to only a particular individual debtor. In reaching this conclusion, reliance was placed on two American cases, *Re Rede Energia SA* 515 BR 69 (SDNY 2014) and *Re OAS SA* 533 BR 83 (SDNY 2015).

Turning to Sperbank's opposition on the ground of public policy, this too was dismissed, the court finding that there was 'no violation of English public policy, let alone a manifest violation, in merely recognising the extraordinary administration proceeding in Croatia as

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a main proceeding within the CBIR.' The court noted that the fact that priorities of Croatian law in reorganising or liquidating a company are different to those which would apply under English law was simply not enough to make a finding that there was a violation.

Comment

The judgment provides valuable guidance on the key tests for recognition of a foreign insolvency proceeding, and in particular gives helpful clarification on the meaning of 'foreign proceeding' within the CBIR. In particular, the judgment confirms that a wide range of foreign proceedings will be granted recognition by English courts and highlights the viability for recognition of procedures commenced under the laws of non-Member States.

Further, the case serves as a reminder that creditors may not always view recognition as desirable, and will, in certain circumstance, oppose that recognition vehemently.

Given this was the first case before an English court where recognition was opposed, it will be interesting to see how any future opposition cases may be dealt with, and indeed whether this judgment will be upheld.

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