

# South Square Articles 2013

- 1 European Insolvency Regulation: Where Does It Go Next?  
*David Marks QC*
- 5 Enforcement of Foreign Insolvency Judgments: A Missed Opportunity?  
*William Trower QC and Charlotte Cooke*
- 8 *ERSTE Bank Hungary (Judicial Cooperation in Civil Matters)* [2012] EUECJ C-527/10 (5 July 2012)  
*Alexander Riddiford*
- 11 Recognition of Foreign Insolvency Proceedings: The Continuing Saga: A Recent Isle of Man Development  
*David Marks QC*
- 15 *Sparkasse Hilden Ratingen Velbert v Benk* [2012] EWHC 2432 (Ch)  
*Charlotte Cooke*
- 17 *Re Lehman Brothers International (Europe) (in administration) and others*, [2012] EWHC 2997 (Ch)  
*Sunay Radia and Charlotte Cooke*
- 20 *Tambrook Jersey: There but for the Grace ...*  
*Glen Davis QC*
- 25 Provable Debts and Administration Expenses: *Lehman* and *Nortel* in the Supreme Court  
*Stephen Robins*
- 30 The Supreme Court Decision in *Eurosail*  
*David Allison*
- 33 *Bank Handlowy w Warszawie SA v Christianapol Sp. z.o.o.* (C-116/11)  
*Charlotte Cooke*
- 35 *Olympic Airlines SA Pension and Life Assurance Scheme v Olympic Airlines SA* [2013] EWCA Civ 643  
*Charlotte Cooke*

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## European Insolvency Regulation: Where Does It Go Next?

David Marks QC, Barrister, South Square, London, UK

This article contains largely the personal views of the author. Although the author was a member of the drafting Committee formed by INSOL Europe with regard to considering a revision of the EC Insolvency Regulation, it is only fair to say that there are obvious grounds for stating that many of the recommendations made in the published proposal, published in booklet form earlier this year, are clearly contentious and justify the taking of many views which are not necessarily those of the drafting Committee itself.

The EC Regulation on its face is to be reviewed every five years. The INSOL Europe recommendations are numerous. Only the principal ones need be mentioned here. With regard to Article 1, it is suggested that the liquidity test be included in order to promote further harmonisation of the substantive insolvency laws in the Member States. This does no more than echo a prior report issued by INSOL Europe with regard to possible harmonisation of major insolvency laws across the European Union.

The definition of COMI in Article 2 is addressed. COMI is expanded so as to mean the place of the registered office except where the operational head office functions of the relevant company or of any legal person are carried out in another Member State. Moreover that other Member State must be ascertainable to prospective creditors as the place where such operational head office functions are carried out. In such a case, it shall mean and refer to the Member State where such head office functions are carried out. The mere fact that economic choices and decisions of a company are, or might be controlled by a parent company in a Member State other than the Member State of the original office, will not cause a centre of main interests to be located in this other Member State.

Of much more importance however is the suggested insertion in the EC Regulation of a chapter on the insolvency of groups of companies. There are suggested definitions of the following expressions, namely, 'group of companies', 'parent company', 'subsidiary', and 'group main proceedings', those definitions being included in a draft amended Article 2. Furthermore, there is an inclusion of the definition of, amongst other things, 'non-EU proceedings', 'non-EU main proceedings' and similar associated definitions in view of a new suggested Chapter VII regarding provisions on insolvency proceedings opened outside the European Union.

Although the insolvency of groups of companies has been for many years a contentious, or at least a much debated, area, the Report also addresses an equally contentious area, namely a look-back period with regard to COMI itself. A new suggested Article 3(1) provides that if a company has moved its COMI less than one year prior to the request for the opening of the insolvency proceedings, only the courts of the Member State where the COMI was located in that one year prior to the request will have jurisdiction to open insolvency proceedings. That will be the case if the debtor has left unpaid liabilities caused at the time when its centre of main interests was located in this Member State unless all creditors agree in writing to the transfer of the COMI out of that Member State.

There are also far reaching suggested reforms to Article 5(1). The Report took the view that the discrepancy of the treatment of security rights depending on whether insolvency proceedings had been actually opened in the Member State where the assets were located had also been the cause of much debate. It was felt that in general terms such a distinction was no longer justified even though it had historical justification. The suggested amended Article 5(1) in effect means that the effects of insolvency proceedings on the rights in rem of creditors or third parties in respect of tangible or intangible assets belonging to a debtor and which are situated within the territory of another Member State at the time of the opening of proceedings shall be governed solely by the law of the Member State within which those assets are situated.

With regard to Article 13, INSOL Europe took the view that it appeared to be undesirable that a legal act could be made 'avoidance proof' by selecting the law applicable to the contract. However, it was also to be observed according to the Report that a relocation of the COMI might be detrimental to the other party to an agreement if under the law of the new COMI, an avoidance action might be easier to institute. The amended suggested wording was to the effect that Article 4(2) (m) should not apply if the law of the Member State where the COMI of the debtor was situated at the time of the legal act did not allow any means of challenging that legal act in the relevant case. Similar analogous amendments were suggested with regard to Article 14 and Article 4(2)(f). Other principal suggested changes address Articles 20, 21, 27 and 33. With regard to

Article 20, it was suggested if administrative expenses had been incurred during the course of insolvency proceedings and had been caused by the liquidator or by a court, such costs should be borne in proportion to the proceeds which had been realised in each of the insolvency proceedings and which have to contribute to the payment of administrative expenses from those proceedings.

In the proposed Article 21(3), the Report suggested that there should be an additional provision to the effect that a liquidator should take all necessary steps to ensure publication of the judgment opening insolvency proceedings in all other Member States in the event that that liquidator considered such publication to be necessary. With regard to Article 27 and mindful of what clearly has been an extensive debate on the question whether the possibility of secondary proceedings is desirable, the Report proposes that the court which has jurisdiction under Article 3(2) should have discretionary powers to appraise and assess the need for secondary proceedings in view of the interests of one or more creditors and an adequate administration of the estate.

With regard to Article 37, the Report takes the view that there is simply no compelling reason why secondary proceedings cannot be reorganisation proceedings. That meant that there could be no reason why the last sentence of Article 3(3) reading: *'These latter proceedings must be winding up proceedings'* could be deleted. In turn, that meant that the liquidator of the main proceedings should have the same conversion rights with respect to the secondary proceedings as the liquidator of the secondary proceedings themselves.

Reverting to what has been said above, Chapters V and VI introduce substantive suggested changes with regard first to the insolvency of groups, and secondly with regard to what is called in the Report, a European Rescue Plan.

As indicated above, there is no doubt that the occurrence of substantial group company liquidations and insolvencies has become a frequent phenomenon in effect crying out for rules on coordination. It may well be that in practice the European Commission will, in the event, take some steps in terms of addressing this particular issue, i.e. that of coordination and cooperation, without turning to any more substantive changes within the EC Regulation itself. In such a case the Report's suggestions may have a positive and tangible outcome. It is suggested in the Report that if a subsidiary and its ultimate parent company both enter into insolvency proceedings, the liquidator of the parent be given powers similar to those which a liquidator in main proceedings has as regards secondary proceedings. This still however may be a step too far for the European Commission.

However, the centrepiece of the Report which may again be a few more steps too far for the European Commission, is the possibility of proposing a plan covering

one or more group companies. In essence, this Rescue Plan is designed to provide for a restructuring mechanism which on the one hand ensures that each creditor should at least receive value which equals the distribution in the case of a winding up of its debtor, and on the other, procures that conglomerates are saved and do not fall victim to a lack of coordination in an international setting.

It is important to note that the suggested European Rescue Plan is in no way meant to replace any legislation of or within the Member States themselves with regard to compositions and rescue plans. It said that it is simply an additional instrument for the adoption of cross border rescue plans involving groups.

Finally, again, as hinted at above, the Report took the view that as to the recognition of insolvency proceedings opened outside the European Union, the UNCITRAL Model Law provides a workable system supported by the global community which created it. Contrary to the Regulation, as is well known, it is not based on a similar principle to that of community trust. The effect of foreign proceedings within a receiving State is therefore much less pronounced. There are in addition more elaborate reviews than under the EC Regulation. The best example of the latter is the absence of any automatic recognition of the powers of a foreign liquidator. Instead, the Model Law provides for a two tier review system.

The Report took the view that it was desirable that these provisions be incorporated within the EC Regulation.

Pausing here, there has been much debate about the overall merit of these proposals. Only the main ones need be noted for the purposes of this review. It may be appropriate to deal with the question of groups first since, on any basis, this is an important issue of principle. In effect, the opponents to any form of regime addressing cross border insolvency and groups of companies point to the fact the present system cannot be said to work badly, let alone in any deficient manner. It could be said with some force that addressing group companies insolvency across the European Union has in fact worked by and large reasonably satisfactorily. Some aspects have been clarified by case law. Where there has been ambiguity, it might make sense to legislate, but only perhaps to some degree at most to make the respective intentions clear. This school of thought justifies the argument that there is simply no need to go quite to the lengths proposed by the Report. The Regulation as a whole is a compromise. What is important to recognise is the fact that the EC Regulation, as it has been implemented, if anything could be said to be biased somewhat in favour of debtors and creditors, rather in favour of counterparties. The real impact of the Report's proposals could be said to upset that balance.

Turning next to the look-back period with regard to a one year period in which the question of COMI can be

readdressed as proposed in the amended Article 3(1), the counter-arguments could be seen to be relatively weighty. The first criticism is that the one year period is totally arbitrary. Second, and by way of a more serious criticism, is that it fails perhaps to deal with the real issue, namely whether a particular case involves so-called good forum shopping or bad forum shopping. Recital 4 as it stands specifies that it is necessary for the proper function of the internal market to avoid incentives for parties who transfer assets in judicial proceedings from one Member State to another in order to obtain a more favourable legal position, i.e. the well-known and well recognised phenomenon of forum shopping. Recent European Court of Justice pronouncements, particularly in the forms of opinions by the Advocates General in the well-known *Staubitz-Schrieber* and *Seagon* cases could be said to confirm that view. Reference was made in those cases, it could be said, to the Recital, but only in the sense of referring to what could be called fraudulent shifts of COMI designed to disadvantage or prejudice creditors. Moreover, the suggested reforms by the Report might be said to ignore well publicised and recent successful shifts of COMI in corporate cases. These shifts are, on any basis it could be said, designed largely to benefit creditors by enabling a more beneficial reorganisation. So, the argument runs, one can recognise good as distinct from bad forum shopping when one sees it. There is no need in those circumstances to tamper with the regime as it presently stands, let alone by inserting what can be said to be an arbitrary time limit. Moreover, issue is taken with the fact that reliance can be placed on creditors agreeing to a case where there might be an exception for a shift of COMI. This is a practical issue. The question is raised as to whether or not it would ever be possible to get all creditors to agree in the way contemplated by the suggested reform.

In other words, the courts, it could be said, are very used to spotting problem areas in this respect. Each case should ideally be treated on a case by case basis. An analogy could be drawn by looking at the present drafting of Article 4(2)(m) which refers to 'the rules relating to the voidness, voidability or unenforceability of legal acts detrimental to all the creditors'. It has been argued in a number of serious commentaries on the EC Regulation that in this context, the phrase 'all the creditors' means the creditors as a whole or as it is generally put 'general body of creditors'. With regard to Article 13 and the proposed change that Article 4(2)(m) should not apply, if the law of the Member State where the COMI of the debtor was situated at the time of the legal act did not allow any means of challenging that legal act in the relevant case, it could be said that the proposed change suggested by the Report, again, tends to favour the creditors and upset the balance on which the Regulation itself is based, i.e. striking a fair balance between creditors and counterparties.

Criticisms have also been levelled against the proposed changes to Article 27. Here, the Report, as hinted

at above, proposes that there should be a limit to the ability to open secondary proceedings in situations where it is 'justified by the interests of one or more creditors or an adequate administration of the estate'. Against that proposal, it is claimed that Article 27, particularly taken along with Article 3(2), represents a compromise between the ideal of universalism and the principle of territoriality. Allowing secondary proceedings by way of exception to the general universal rule protects the creditors. Rather than the proposal put forward by the Report, it might be better, it is said, that the interests of creditors means in effect the interests of the general body of creditors as already referred to above. The concept of creditors did not mean in essence 'one or more creditors' as appears to be the necessary inference drawn from the Report's proposals.

The question of groups and possible reform is equally contentious. Opponents to any form of real change, either along the lines suggested by the Report or otherwise, point to the absence of any formal or comprehensive regime dealing with groups outside insolvency. In the Virgos-Schmit Report, particularly at paragraph 76, there was a clear indication that insolvency law should in principle follow the general corporate law structure. Thus, however desirable it might be to have a code of rules designed to address group insolvencies, it would be difficult to see how that would operate in the absence of any cogent set of principles or well established practice regarding solvent groups. In the light of that dichotomy, it is questionable whether the liquidator of a parent company should be given any sort of power, let alone that suggested by the proposals, similar to the powers enjoyed by a liquidator in main proceedings, vis-à-vis secondary proceedings. If there was to be an insolvency of a subsidiary, particularly if the latter was a substantial trading company, the parent company of the liquidator could really have no stake or interest in the insolvency of the trading subsidiary. Quite the contrary, it would in such a case, it is claimed, make more sense for the liquidator of the subsidiary to have powers similar to the liquidator in main proceedings in relation to a pure holding company parent.

Much the same approach and analysis is brought to bear upon criticisms levelled against the suggested European Rescue Plan. Even on the basis of the present EC Regulation, and indeed domestic law in general, insolvency pleadings are based on an entity principle and not on a group basis. It is claimed therefore that if anything, the suggested proposals with regard to a Rescue Plan, smack off a Chapter 11 type of proceeding. This in turn it is claimed would also shift the balance of power underlying the present EC Regulation from one tending to favour creditors to one favouring the debtor and again, might be said therefore to upset the balance which the EC Regulation was designed to exhibit and has in fact demonstrated since its inception.

These are difficult issues. It may well be that none of the major reforms proposed come anywhere near to

seeing the light of day, at least in the foreseeable future. However, there is cause for thinking that at least three areas need to be addressed. One of them may well find some echo in the near future, either in terms of a formal amendment to the EC Regulation, or in some other way, thereby attracting some degree of adherence to principle with regard to cross border insolvency within the European Union.

This first case where there may well be said to be justification for action of some sort concerns the coordination of insolvency cases, or if not, communication between courts and judges across the Union. Many practitioners already believe that the EC Regulation should be modified to augment the obligations between the courts, as well as between officeholders and courts, in order to take into account the better coordination of cases in different countries. Article 31 is particularly important. It imposes a series of obligations on the liquidator in the main proceeding and upon a liquidator in a secondary proceeding to communicate information to each other. It could be said with some force that much more is needed with regard to this type of communication and coordination. There is some echo of the need to impose coordination and cooperation in the context of the Model Law. The EC Regulation does not impose a duty on liquidators to inform the relevant courts of relevant developments in corresponding cases in other countries. However, it is clear that there is some importance attached to the need for a judge to whom a main proceeding has been assigned to be informed of developments that might be said to be relevant in a secondary proceeding. This is but one example of how coordination and cooperation should be addressed with rather more vigour than it has been so far.

Next, there is no corresponding duty, or even mandate, within the EC Regulation for judges administering

main and secondary proceedings to communicate with each other. There is clearly a reluctance to do this across many parts of the European Union, not least in England and Wales. However, other major jurisdictions, especially involving United States and Canadian courts, have shown that court to court communication is a valuable contribution to the proper progress of closely related insolvency cases. It is a difficult question as to whether, and if so to what extent, that degree of cooperation and communication can in any way be transplanted, not simply into England and Wales, but also across the Union as a whole.

The use of protocols however has become rather more widespread. A protocol generally speaking is a document prepared on a case by case basis to provide for the coordination of specific international cases. Invariably, there will be some form of schedule for the progress of the related international cases, together with some form of allocation and responsibility between the parties, the various groups of officeholders and the respective courts. Again, there seems no reason why something should not emerge from these discussions, both within the Commission or outside, along these lines with a view to improving coordination generally. At most, although the same is unlikely, the EC Regulation itself could be revised to include a provision specifically approving the use of protocols, but something with lesser force than this may well emerge in the coming years.

These are no more than isolated thoughts in a very complex area. Just as the EC Regulation itself took many years to emerge after a series of frustrated and frustrating prior international regimes which never saw the light of day, so too it may well be that even the most modest accretions to the Regulation will not see the light of day for quite a while. This is not to say however that the debate should not go on.

## Enforcement of Foreign Insolvency Judgments: A Missed Opportunity?

William Trower QC, Member, and Charlotte Cooke, Member, South Square, London, UK

In two conjoined appeals, *Rubin v. Eurofinance S.A.* ('*Rubin*') and *New Cap Reinsurance Corporation v. A E Grant* ('*New Cap*'),<sup>1</sup> the Supreme Court of the United Kingdom was required to consider the circumstances in which a judgment of a foreign court in insolvency avoidance proceedings will be recognised and enforced in England. In the leading judgment, Lord Collins (with whom Lords Walker and Sumption agreed) identified the issue as being whether, as a matter of policy and in the interests of the universality of insolvency proceedings, the court should devise a rule for the recognition and enforcement of judgments in insolvency proceedings which is more expansive, and more favourable to liquidators, trustees in bankruptcy and other insolvency officeholders, than the traditional common law rule. The traditional rule he was referring to is now encapsulated in Rule 43 of *Dicey, Morris and Collins on the Conflict of Laws* (15th edn) and is to the effect that a judgment *in personam* will not be capable of enforcement or recognition unless the judgment debtor was present in the foreign jurisdiction at the time the proceedings were instituted, or has otherwise submitted to the jurisdiction of the foreign court (either by agreement or appearance).

The cases of *Rubin* and *New Cap* presented the Supreme Court with a timely opportunity to address the approach of English law to the interplay between the principles of cross border insolvency and the traditional conflict of laws rules governing the recognition and enforcement of foreign judgments. The answer it gave was somewhat disappointing.

The salient facts can be briefly stated as follows. In *Rubin* the insolvency officeholders, having been recognised in England as foreign representatives of a trust ('TCT') which was subject to Chapter 11 proceedings in New York, sought to enforce in England an insolvency judgment of the US Bankruptcy Court for the Southern District of New York. The judgment was given in adversary proceedings in the Chapter 11, and included causes of action in respect of transactions at an under-value and preferences arising under the US Bankruptcy

Code. In the Court of Appeal and the Supreme Court (but not at first instance), the officeholders only sought enforcement of those parts of the judgment which were based on state and federal avoidance laws. None of the defendants was present in the US at the time the adversary proceedings were commenced and the judgments were given in default of their appearance. However, two of the defendants had had a role in initiating the Chapter 11 proceedings, because they had been involved in an application to the English court for the original appointment of the officeholders as English receivers of TCT for the purposes of causing it to obtain protection under Chapter 11.

In *New Cap*, the insolvency officeholders sought to enforce in England a judgment of the Supreme Court of New South Wales concerning a preference given to a Lloyd's syndicate during the period of 6 months prior to the date on which administrators were first appointed in Australia. The syndicate was not present in Australia at the time the preference proceedings were instituted, nor did it enter an appearance in those proceedings, in any event to the extent that would warrant a conclusion that it had submitted to the jurisdiction of the Australian court in the preference proceedings looked at in isolation. The syndicate did, however, participate in the *New Cap* insolvency proceedings more generally by submitting proofs of debt and by attending and voting at creditors' meetings.

By a majority of 4:1 (Lord Clarke dissenting), the Supreme Court disagreed with the Court of Appeal in *Rubin* and held that the traditional common law rule is applicable to the enforcement of foreign insolvency avoidance judgments. It also rejected an argument that enforcement was available under the Cross Border Insolvency Regulations 2006.<sup>2</sup> The consequence of these conclusions was that the appeal in *Rubin* was allowed. The syndicate's appeal in *New Cap* was, however, dismissed, on the grounds that it had submitted to the jurisdiction of the foreign court, with the consequence that the relevant judgment was entitled to recognition and enforcement by application of the traditional

### Notes

1 [2012] UKSC 46.

2 Implementing the UNCITRAL Model Law.

common law rule. Although strictly *obiter*, because of its conclusion on the submission point, the Supreme Court in *New Cap* also expressed the view that section 426 of Insolvency Act 1986 had no application to the enforcement of judgments given by courts outside the United Kingdom.

In reaching its conclusion, the Supreme Court eschewed the opportunity to take a logical step forward in developing the principle of modified universalism; a principle which was described by Lord Hoffmann in the case of *McGrath v. Riddell, Re HIH Casualty and General Insurance Limited* ('HIH')<sup>3</sup> as being the golden thread running through English cross-border insolvency law since the 18th century. Indeed, and this will have come as a surprise to many not least because the point was not fully argued, the Supreme Court decided (on this point by a bare majority) not just that the decision of the Privy Council in *Cambridge Gas Transport Corp v. Official Committee of Unsecured Creditors of Navigator Holdings Plc* ('Cambridge Gas')<sup>4</sup> did not indicate the direction which the law should take, but that the case was wrongly decided. Lord Mance reserved his opinion on the correctness of *Cambridge Gas* and Lord Clarke's dissent was based, anyway in part, on the propositions that it remained good law and that it pointed the way towards a principled basis for recognition and enforcement of a foreign insolvency avoidance judgment.

Ultimately, the Supreme Court's decision comes down to the fact that the majority did not agree that, in the interests of the universality of insolvency proceedings, there should be a more liberal rule for the recognition and enforcement of judgments given in foreign insolvency proceedings for the avoidance of prior transactions than the traditional common law rule. In the view of Lord Collins, such a conclusion would be a radical departure from substantially settled law, and was more suitable for the legislature than for judicial innovation.

In a number of respects, the decision of the Supreme Court in *Rubin* is a missed opportunity. To understand why, it is necessary to appreciate the interaction between two basic principles; the first is the nature and purpose of collective insolvency proceedings and the second is the way in which the law of cross-border insolvency deals with the administration of insolvent estates with a connection to, or a presence in, more than one jurisdiction.

So far as the first principle is concerned, the main purpose of collective insolvency proceedings is not to establish individual rights by or against individual litigants, with the commensurate grant of an entitlement to the successful party to enforce those established

rights; rather it is to replace the race to enforce, whereby individuals pursue their own claims, with an orderly statutory regime, pursuant to which the debtor's assets are collected and distributed amongst creditors *pari passu* or otherwise in accordance with a statutory code. Rights may have to be established as part of that process, but the process as a whole is one of collective execution.

It is well established that one of the essential aspects of implementing such an orderly process for the collection and distribution of a debtor's assets to its creditors is the ability of the court charged with the administration of the insolvency proceedings to avoid prior transactions in such a manner that the statutory scheme is given the effect intended by the relevant insolvency legislation. The ability of an insolvency court to avoid prior transactions (and make the consequential orders necessary to give effect to that avoidance) is a core aspect of most, if not all, insolvency law and the proceeding in which such relief is granted is itself an integral part of the collective insolvency proceedings taken as a whole. An avoidance proceeding is brought to restore the estate to the condition that it should have been in at the commencement of the insolvency. As Lord Hoffmann said in *HIH*<sup>5</sup> 'the process of collection of assets will include, for example, the use of powers to set aside voidable dispositions ...'. As such, the most principled approach is to give proper recognition (for enforcement as well as other purposes) to the fact that the judgments of foreign courts in the course of insolvency proceedings, including in particular judgments giving effect to the relevant avoidance law, are part and parcel of those insolvency proceedings.

The second principle is that described by Lord Hoffmann in *HIH* as the principle of modified universalism, i.e. that to the extent possible, there should be a single insolvency proceeding in relation to a single debtor, which takes place in one jurisdiction and which has universal effect. As recognised by Lord Hoffman in *Cambridge Gas*:<sup>6</sup> 'The English common law has traditionally taken the view that fairness between creditors requires that, ideally, bankruptcy proceedings should have universal application. There should be a single bankruptcy in which all creditors are entitled to and required to prove. No one should have an advantage because he happens to live in a jurisdiction where more of the assets or fewer of the creditors are situated ...'

Pure universalism is out of reach, but it is well established that recognition of the insolvency proceeding in the place of the debtor's domicile (for which it may now be necessary to read the place of its centre of main interests), carries with it the active assistance

## Notes

3 [2008] 1 WLR 852 (at paragraph 30).

4 [2007] 1 AC 508.

5 [2008] 1 WLR 852 (at paragraph 19).

6 [2007] 1 AC 508 (at paragraph 16).



of the court in so far as it is able properly to give that assistance.<sup>7</sup> Given the encouragement that the law has hitherto given to developing the principle of modified universalism, it is a little difficult to see why assistance should not extend to the enforcement of orders made by a foreign insolvency court in the debtor's COMI, particularly where the defendants are well aware of those proceedings and have made a simple but deliberate decision not to participate in them.

There are, therefore, broad policy considerations, relating to the collective nature of the insolvency process and to fairness to creditors as a whole, which are engaged when it comes to questions relating to the enforcement of judgments which are an integral part of the insolvency process. These are considerations which go beyond the considerations which apply in the case of ordinary civil litigation, where a litigant will normally be seeking to enforce his own judgment in his own individual self-interest. They are sufficient on their own to justify a reworking of the traditional common law. Even if the common law was unable to get there on its own, there was plenty of room for an appropriately expansive construction of the CBIR and section 426 to achieve that result.

Lord Collins recognised these principles, and in some respects their significance. It is a pity that the Supreme Court was not prepared to draw the conclusion from them that it was no more than an incremental development of the common law to hold that an insolvency judgment given by a foreign court with international jurisdiction in relation to the insolvency as a whole should be enforced in England in so far as it is consistent with justice and public policy to do so. This is the result that was favoured by the Court of Appeal in *Rubin* and by Lord Clarke in the Supreme Court and is, it is suggested, a more principled basis on which the law should develop.

It might be said that there are difficulties in identifying a principled distinction between those individual proceedings which are in substance part of the insolvency process taken as a whole (and to which the solution favoured by Lord Clarke should therefore apply), and those individual proceedings which merely happen to be brought by a debtor when subject to a formal informal process. That distinction is, however, one which has been examined in the jurisprudence surrounding the EC Insolvency Regulation<sup>8</sup> and the Brussels I Regulation<sup>9</sup> and simply requires the court to decide whether the relevant claim is one which derives directly from the insolvency proceedings themselves and which is closely connected to them. Lord Collins

summarised the cases in his judgment and accepted that this is a workable test capable of adaption to other contexts (including presumably the enforcement of insolvency judgments emanating from courts outside the EU) should it be useful or necessary to do so.<sup>10</sup> It is suggested that the Supreme Court should have recognised the utility of taking such an approach.

This is more especially the case, as the Supreme Court gave at least some recognition to the fact that there are different enforcement considerations in the context of insolvency proceedings. The appeal in *New Cap* was dismissed on the ground that the syndicate had in fact submitted to the jurisdiction of the Australian court by submitting proofs of debt in the liquidation and participating in creditors' meetings. Plainly, these were acts of submission to the process as a whole, even if they were not acts of submission in relation to the avoidance proceedings looked at in isolation. The explanation for the Supreme Court's conclusion on this point is said to be that it should not be possible for the syndicate to take any benefit from the insolvency proceedings, without also accepting the burden of complying with all of the orders made in those proceedings. This amounts to a recognition that, for some enforcement purposes (i.e. submission), the collective insolvency process ought to be treated as a whole. It is not immediately obvious why that principle should not be applicable to concepts of enforcement in their entirety, nor indeed is it entirely obvious why the *de facto* initiation of the foreign insolvency process (which the defendants in *Rubin* were responsible for) does not amount to a submission for these purposes, while the participation in it (as occurred in *New Cap*) apparently does.

As to where this leaves matters, the consequence of the Supreme Court's decision is that the common law on cross border insolvency may have reverted to its 'state of arrested development'.<sup>11</sup> Whilst the process of development was reignited by the Privy Council's decision in *Cambridge Gas*, followed by the House of Lords in *HIH*, it appears that any further development of the universalist approach to insolvency proceedings must now await legislative developments. This is unfortunate because there is little sign that there is any political will to take that course. Courts properly responsible for the administration of insolvent estates with cross-border interests will find that their task (and that of any officeholder appointed in that insolvency) has been made more difficult. Given the ability of the court to fashion appropriate protections for defendants against whom enforcement is sought, there is no very obvious reason why this should be so.

## Notes

7 See e.g. Millett LJ in *Credit Suisse Fides Trust v. Cuoghi* [1998] QB 818, 827.

8 EC No 1346/2000.

9 EC No 44/2001.

10 See paragraphs 100 and 101 of Lord Collins' judgment in the *Rubin / New Cap* appeal.

11 As noted by Lord Hoffmann in *Cambridge Gas* (at paragraph 18).

## *ERSTE Bank Hungary (Judicial Cooperation in Civil Matters)* [2012] EUECJ C-527/10 (5 July 2012)

Alexander Riddiford, Barrister, South Square, London, UK

### Background

Article 4(1) of Council Regulation (EC) No 1346/2000 (the 'Insolvency Regulation')<sup>1</sup> provides as a general rule that insolvency proceedings and their effects are governed by the law of the Member State in which they are opened (i.e. the *lex concursus*). Article 5(1) of the Insolvency Regulation<sup>2</sup> provides one of the exceptions to this general rule, namely that rights in rem<sup>3</sup> shall not be subject to the effects of the main proceedings arising under the *lex concursus*. Article 5 has been described as a 'negative conflict' rule,<sup>4</sup> in that its effect is to prevent rights in rem from being governed by the law of a state other than that in which the res is situated (i.e. a law other than the *lex rei sitae*).

### The decision in *ERSTE Bank*

The European Court of Justice (First Chamber), in its recent TFEU Article 267 preliminary ruling in *ERSTE Bank Hungary (Judicial cooperation in civil matters)* [2012] EUECJ C-527/10, decided that Article 5(1) of the Insolvency Regulation is applicable even in circumstances where insolvency proceedings had been opened in a Member State (Austria) prior to the accession to the European Union of another Member State (Hungary) in which the debtor's assets, on which the relevant right in rem was based, were situated. The ECJ's decision was

in contrast to the Opinion of Advocate General Mazák who expressed the view that Article 5(1) was inapplicable in such circumstances since it was a condition of its applicability that an asset of the debtor should be located within the territory of another Member State, i.e. not the territory of a prospective Member State, as at the time of the opening of the insolvency proceedings.<sup>5</sup>

The dispute before the referring national court, the Hungarian court of cassation Legfelsobb Bíróság,<sup>6</sup> was between ERSTE Bank Hungary Nyrt ('ERSTE Bank') and the Hungarian State.

A letter of credit had been issued in 1998 by Postabank és Takarékpénztár Rt ('Postabank'), a Hungarian bank, in favour of BCL Trading GmbH ('BCL Trading'), an Austrian company. BCL Trading subsequently took shares in Postabank which it held as a security deposit so that, in the event that the letter of credit was drawn upon, Postabank would be required to make payment. Insolvency proceedings were opened in Austria in respect of BCL Trading on 5 December 2003, i.e. prior to the accession of Hungary as a Member State of the European Union on 1 May 2004. Subsequently the Hungarian court ordered the Hungarian state, pursuant to an obligation to which it was subject as a matter of Hungarian law, to purchase the shares held by BCL Trading by way of a security deposit. The Hungarian state duly purchased the shares and paid an amount into the Hungarian court representing the value of those shares.

### Notes

- 1 Article 4(1) provides: '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 Article 5(1) provides: 'The opening of insolvency proceedings shall not affect the rights in rem of creditors or third parties in respect of tangible or intangible, moveable or immovable assets – both specific assets and collections of indefinite assets as a whole which change from time to time – belonging to the debtor which are situated within the territory of another Member State at the time of the opening of proceedings.'
- 3 Article 5(2) provides a list of rights which are to be regarded 'in particular' as being 'rights in rem' for the purposes of Article 5(1), e.g. the right to dispose of assets (Article 5(2)(a)), the exclusive right to have a claim met (Article 5(2)(b)), etc. The decision as to whether a given right is a right in rem for the purposes of Article 5(1) is to be made according to the rules of the national law which governs that right prior to the insolvency (typically the *lex rei sitae*): see the Virgós-Schmit Report (1996) para. 100.
- 4 Virgós-Schmit Report (1996) para. 163.
- 5 Opinion of Advocate General Mazák, dated 26 January 2012, paragraph 47.
- 6 Note that Advocate General Mazák, in his Opinion dated 26 January 2012, expressed the view that the ECJ lacked jurisdiction to answer the question referred on the basis that it was a 'hypothetical' question (paragraph 46). The ECJ decided that it did have jurisdiction to answer the question referred, presumably, though its reasons do not appear on the face of the judgment, on the basis of the well-established principle that it is not for the ECJ but for the national court seised of a given dispute to determine the need for a preliminary ruling.

Once the sum had been paid by the Hungarian state into court, representing the value of the security deposit, a dispute arose between ERSTE Bank and the Hungarian state as to their rights with respect to the security deposit (the *res* for the purposes of Article 5(1)).

ERSTE Bank, a Hungarian bank which had become the legal successor of Postabank, brought an action before the Hungarian court seeking a declaration that it had a right in rem in respect of the security deposit and requesting the opening in Hungary of secondary insolvency proceedings against BCL Trading. The Hungarian Fovárosi Ítélotábla (Court of Appeal), upholding the decision of the first instance court, held on the basis of Article 4(1) of the Insolvency Regulation that no claim could be brought against BCL Trading since Austrian law, the *lex concursus* with respect to BCL Trading's insolvency, provided that no action could be brought against a company such as BCL Trading once it was in liquidation. ERSTE Bank appealed the Court of Appeal's decision and argued, consistently with the Opinion of Advocate General Mazák, that the Insolvency Regulation was not applicable in the present case on the basis that the judgment opening insolvency proceedings against BCL Trading in Austria had been handed down prior to Hungary's accession to the European Union.

The question referred by the Hungarian court of cassation to the ECJ was specifically whether Article 5(1) was applicable in the context of civil proceedings concerning the existence of a right in rem in circumstances where the property to which that right referred was situated in a prospective rather than actual Member State. In contrast to Advocate General Mazák's Opinion, which was sparsely reasoned in its view as to the referred question itself (focusing instead on the question of jurisdiction), the ECJ's decision was reasoned with some subtlety. The ECJ's starting point was to interrogate and modify the terms of the question referred by focusing not on the relative timing of (i) the opening of insolvency proceedings and (ii) the accession of the state in which the relevant *res* was situated, but rather on the principle established by Case C-444/07 *MG Probud Gdynia* [2010] ECR I-417 (at paragraph 26), namely that Articles 16(1)<sup>7</sup> and 17(1)<sup>8</sup> of the Insolvency Regulation entail that 'the judgment

opening insolvency proceedings in a Member State is to be recognised in all the other Member States from the time that it becomes effective in the State of the opening of proceedings and that it is, with no further formalities, to produce the same effect in any other Member State as under the law of the State of the opening of proceedings' (*ERSTE Bank*, paragraph 33).

According to the ECJ's analysis the relevance of the date of a Member State's accession, when viewed from this perspective, goes only to the question as to when that Member State accrues the obligation<sup>9</sup> to recognise a judgment opening insolvency proceedings handed down by a court of another Member State which has jurisdiction under Article 3 of the Insolvency Regulation (*ERSTE Bank*, paragraph 36). Hungary accrued this obligation on 1 May 2004 and it was from that date onwards that it was obliged to recognise the decision to open insolvency proceedings handed down by the Austrian court, regardless of the date on which that decision might have been handed down by the Austrian court (*ERSTE*, paragraph 44). Further, the court suggested that the only temporal limit to the applicability of the Insolvency Regulation was Article 43,<sup>10</sup> the effect of which is that 'the Regulation applies only to insolvency proceedings opened after its entry into force which, as stated in Article 47 thereof, is fixed for 31 May 2002' (*ERSTE*, paragraph 30). Given that insolvency proceedings were opened in Austria on 5 December 2003, there was 'no doubt that those proceedings were opened in a Member State after 31 May 2002 and that, therefore, they fall within the scope of the Regulation' (*ERSTE*, paragraph 32).

Moreover, since Article 5 is inseparable from the Article 4 general rule to which it is an exception, it follows that the rights and obligations arising under Article 5 are also accrued by the acceding Member State on the date of its accession, and again apply regardless of the date on which the judgment opening insolvency proceedings was handed down. In this way the ECJ's reasoning leads neatly to the conclusion that Article 5(1) must be interpreted 'as meaning that that provision is applicable even to insolvency proceedings opened before the accession of the Republic of Hungary to the European Union in a case ... when, on

## Notes

- 7 Article 16(1) of the Insolvency Regulation provides: 'Any judgment opening insolvency proceedings handed down by a court of a Member State which has jurisdiction pursuant to Article 3 shall be recognised in all the other Member States from the time that it becomes effective in the State of the opening of proceedings'.
- 8 Article 17(1) of the Insolvency Regulation provides: 'The judgment opening the proceedings referred to in Article 3(1) shall, with no further formalities, produce the same effects in any other Member State as under this law of the State of the opening of proceedings, unless this Regulation provides otherwise and as long as no proceedings referred to in Article 3(2) are opened in that other Member State'.
- 9 The obligation to recognise judgments opening insolvency proceedings in other Member States is reinforced by the principle of 'mutual trust' encapsulated in Article 16(1) and recital 22 in the preamble of the Insolvency Regulation: *ERSTE*, paragraph 34. See further Case C-341/04 *Eurofood IFSC* [2006] ECR I-3813, (paragraphs 39 and 40) and Case C-444/07 *MG Probud Gdynia* [2010] ECR I-417 (paragraphs 27 and 28).
- 10 Article 43 of the Insolvency Regulation provides: 'The provisions of this Regulation shall apply only to insolvency proceedings opened after its entry into force. Acts done by a debtor before the entry into force of this Regulation shall continue to be governed by the law which was applicable to them at the time they were done.'

1 May 2004, the debtor's assets on which the right in rem concerned was based were situated in that State' (*ERSTE*, paragraph 45).

### **Assessment and impact of the decision in *ERSTE Bank***

The ECJ's decision in *ERSTE Bank* is plainly correct and its impact is to clarify an issue which was by no means obvious. The decision is consistent with the purposive interpretation of Articles 16(1) and 17(1) advanced in Case C-341/04 *Eurofood IFSC* [2006] ECR I-3813 and Case C-444/07 *MG Probud Gdynia* [2010] ECR

I-417 (see fn. 9 above). Once it is established that the Insolvency Regulation applies at all, there could be no principled basis for holding that Article 4 applied but that Article 5 did not. In this way, whilst the Opinion of Advocate General Mazák may seem intuitively correct in that the asset (the res) in question was plainly not located in another Member State (but only a prospective Member State) as at the time of the handing down of the judgment of the Austrian court opening the insolvency proceedings, nonetheless the decision of the ECJ is the only possible answer to the question referred which would accord both with the principles established in the ECJ case law and with a purposive interpretation of the Insolvency Regulation.

# Recognition of Foreign Insolvency Proceedings: The Continuing Saga: A Recent Isle of Man Development

David Marks QC, Barrister, South Square, London, UK

In the recent decision by the Isle of Man Deemster in *Interdevelco v Waste2Energy* (10 October 2012, High Court of Justice of the Isle of Man: Case Ref. CHP/2012/56) it was shown that the issues concerning assistance with regard to foreign insolvency proceedings are very much alive and kicking despite the claims that the recent Supreme Court decision in *Rubin v EuroFinance* [2012] UKSC 46 has in some thwarted what was being seen as a welcome common law embracing of judicial assistance in this area.

It is perhaps best to remind oneself what *Rubin* did and did not do. There is no doubt that the judgment of the Supreme Court has not met with universal approval amongst insolvency lawyers and practitioners. The Court of Appeal's decision in that case, and indeed in the related case with which it was concerned, namely *New Cap Reinsurance Corporation v A E Grant* had suggested ever greater judicial cooperation in multi-jurisdiction insolvency cases. The fact remains however that despite certain views of the majority, in particular those of Lord Collins in the Supreme Court, *Rubin* and *New Cap* both remain effectively the principal binding authorities on the recognition of judgments in this area. To that extent at least it could perhaps be conceded that the perceived harmful effects of *Rubin* are perhaps not as extreme as might otherwise be feared.

Both cases in the *Rubin* litigation concern the recognition in England of foreign judgments, in particular, those obtained in default of appearance by officeholders seeking to attack and impeach antecedent transactions. The central question before the Supreme Court was to what extent there could be any relaxation of more traditional approaches to default judgments in the context of insolvency proceeding related judgments.

This article is not concerned with *Rubin* but nonetheless, certain basic principles need to be kept in mind. Classic conflict of law rules in English law postulate four cases in which a foreign court can be taken have assumed jurisdiction to recognise a judgment *in personam* capable of enforcement in England. Primarily, they are where there is active participation on the part of the person against whom judgment is rendered, or some form of submission by that person. The position is, again in the context of classic conflict of law rules, quite different in relation to judgments *in rem*. In those

cases, the critical issue is whether or not, and if so to what extent, the property was within the jurisdiction of the foreign court.

The *Rubin* litigation concerned the extent to which these well entrenched principles should be departed from, and if so, to what extent. At the heart of the claim in *Rubin* and indeed at the heart of all similar cases, including the recent Isle of Man decision, is the contention made by progressive insolvency law scholars that since insolvency proceedings constitute or reflect collective proceedings out of which there can be said to be a benefit which can enure to creditors generally, the classic division of judgments *in personam* and judgments *in rem* should be dispensed with in this particular context. Pausing there, one can see why the Supreme Court at least speaking through the authoritative voice of Lord Collins, had difficulties with the ramifications of that approach. The difficulties stem from the fact that it is in turn not easy to find some binding and universal principle of law which can be said to apply to the wide variety of claims that can arise in and out of an insolvency. A very simple and self evident illustration is enough to show the vast conceptual difference between on the one hand a claim brought by a liquidator against a debtor to enforce a pre-existing right, and on the other, the power of the liquidator to unwind antecedent transactions under the more classic claw-back provisions contained in, for example, section 238 and following of the English Insolvency Act 1986.

As is well known, English law now provides a variety of mechanisms whereby recognition and assistance can be afforded to a foreign insolvency proceeding. There is first the EC Regulation on insolvency proceedings, i.e. the Insolvency Regulation as it is commonly called. There is in addition the UNCITRAL Model Law and Cross-Border Insolvency now embodied within the UK Cross-Border Insolvency Regulations 2006 (the 2006 Regulations) and there is by way of a third statutory or formal procedure, section 426 of the Insolvency Act itself. On top of the three co-existent regimes, there is the common law.

The common law was revisited with great relish and authority by the Privy Council in *Cambridge Gas Transport Corporation v Official Committee of Unsecured Creditors of Navigator Holdings Plc and others* [2007]

UKPC 26. The only opinion in that decision as is customary in the Privy Council was given by the judge who many regard as being a pre-eminent judicial voice on such matters, namely, Lord Hoffmann. By the time the *Rubin* case was decided, Lord Hoffmann had retired, much to the chagrin of his admirers.

It is important even in the context of the Isle of Man case which dealt with perhaps a far simpler issue, to revisit the *Cambridge Gas* decision.

In that case, in the Privy Council, there had been a loan made to European investors of some US\$300m on the New York bond market. The loan was made to facilitate the purchase of gas transport vessels. The vessels were held by means of a reasonably complex structure in which they were directly owned by Isle of Man subsidiaries of a management company. This last management company was itself a wholly owned subsidiary of a holding company based in the Isle of Man, namely Navigator. Navigator was in turn as to 70% of its shares owned by Cambridge Gas which was a Cayman Islands company. Navigator became insolvent and petitioned for relief under Chapter 11 of the US Bankruptcy Code.

By way of a general prelude to the facts which were in issue in the recent Isle of Man decision, the US court in the *Navigator* litigation made an order purporting to vest the shares in Navigator in its creditors.

Those creditors applied to the Isle of Man court. They applied for assistance in giving effect to the vesting of the shares in Navigator in those representatives on behalf of the creditors generally. Cambridge Gas countered by saying that the US court had lacked jurisdiction since its order was one which could be viewed as being one *in rem*. The *in rem* quality was with regard to the shares in the Isle of Man. Since those shares were based within and/or subject to the jurisdiction to the Isle of Man court, it followed that they were not within the jurisdiction of the US court. In addition, it was claimed that the judgment vesting those shares could not be viewed as an *in personam* judgment against Cambridge Gas as the shareholder. Cambridge Gas had simply not submitted to the jurisdiction of the US court. The end result of this rather extended argument was that the Manx court had no jurisdiction to recognise the US order.

Lord Hoffmann adopted what he called the principle of modified universalism. He took the view that the insolvency proceedings were neither judgments *in rem* nor judgments *in personam*. They were, as a mild echo of what is set out above, in effect a one-off, namely that insolvency proceedings are in effect *sui generis*: this approach was based on the fact that, again as indicated above, a bankruptcy whether personal or corporate is a collective proceeding.

As a separate issue or theme, Lord Hoffmann then went on to say that the underlying principle in universality (which could be said to reflect the collective nature of insolvency proceedings referred to above)

therefore applied and should, at least in the *Navigator* case be given effect to by virtue of recognising the foreign officeholder who, on that basis, would be properly empowered to act on behalf of the insolvent company within the particular jurisdiction in question, namely the Isle of Man court. Moreover, he said that the court should provide active assistance, as it was put, to foreign officeholders subject only to such conditions as might be imposed for the protection of local creditors. In other words, only the domestic law of the forum should apply when such active assistance took place. This last point, it could be said, in the eyes of many people, reflects the thrust, purpose and intent behind the Cross-Border Regulations.

As is equally well known, Lord Hoffmann revisited this concept of modified universalism in *Re HIH Casualty & General Insurance Co Ltd* [2008] UKHL 31, although his thinking was perhaps not reflected throughout the tribunal constituted the panel in the House of Lords in that decision, there being in effect it could be said at most, a view shared by him with only one other law Lord, with one of the five law Lords in question remaining at best, neutral. However, the *HIH* case was welcomed warmly by insolvency practitioners and experts. Although not all their Lordships agreed that the assistance in that case could be discovered or justified outside the scope of section 426 which applied to the key company in that case, since it was one which was liquidated in Australia, Lord Hoffmann took the view that the English court had jurisdiction at common law.

Reverting to the *Rubin* case, the 4-1 majority decided that there was no difference in principle between the judgment in the type of avoidance action referred to above, e.g. under section 238 and following of the English 1986 Act and any other *in personam* judgment. It followed that there could be no warrant for a more liberal rule in the interests of the universality of bankruptcy. That meant returning to basic common law principles, namely that an English court would not recognise a judgment of a foreign court, at least in common law, and probably in addition under the relevant statutory regimes dealing with foreign judgments, unless the defendant was present in or had submitted to the foreign jurisdiction.

Echoing a point made above, Lord Collins pointed out in particular that the Model Law was not designed to provide full reciprocal enforcement of judgments and again in relation to section 426, he stressed the fact that the relevant provisions were simply not concerned with enforcement.

Lord Collins therefore applied the provisional rules in respect of which he was supported by at least two law Lords, namely Lords Walker and Sumption. The practical import of *Rubin* is perhaps not as serious as might be expected. It may lead to the issuance of more avoidance proceedings in the UK courts by foreign liquidators, but at the moment, this outcome seems debatable. It also shows that every effort should be made not to submit in

any way whatsoever, e.g. by lodging a proof in a foreign proceeding, to avoid the *in personam* classic rule applying. However as can be seen from this short coverage of the *Rubin* case, its ambit is perhaps reasonably narrow. At least one question remains unanswered. It is not clear to what extent, if at all, submission to a foreign insolvency jurisdiction will allow enforcement in respect of foreign judgments that are not classic avoidance judgments, although the chances must be that such enforcement will be allowed in the light of the general tenor of the *Rubin* majority views. More significantly, *Cambridge Gas* was said, at least by Lord Collins, to be wrongly decided. There is a strong view for contending that the view of Lord Collins and indeed of his immediate supporters in the Supreme Court was obiter. Lord Mance had held that the *Cambridge Gas* case was distinguishable on its facts and Lord Clark had said that it was rightly decided. In any event, and hopefully as is made clear from what has been said up to this point, there is a strong case for saying that the principle of modified universalism articulated so elegantly by Lord Hoffmann in *Cambridge Gas* remains unaffected, if not in whole, then certainly in large part. In the recent case of *Re Phoenix* [2012] 3 WLR 681, that view was endorsed, at least at first instance, by Proudman J, there being no appeal from that judgment. Indeed, there is nothing on the face of the *Rubin* case which suggests that the *Phoenix* case should be dissented from, discarded or otherwise disapproved of.

The view that the concept of modified universalism remains fit and well, at least in large part, is endorsed by the Isle of Man decision mentioned at the head of this article. The judgment concerned the Isle of Man domestic rules regarding forum non conveniens and indeed the principle of universalism itself. As described by the Deemster, the principle of universalism is, as one knows, one in which there should be ideally a unitary insolvency proceeding in the appropriate lead jurisdiction receiving worldwide recognition which in turn should apply and be applied universally to all of the insolvent's assets. There should in an ideal world be a single universally applicable system of distribution. Put shortly, the doctrine of forum non conveniens was used in the *Interdelvelco* case to ensure that the primacy of a US bankruptcy which encompassed the target company should be acceded to and given as much weight as possible so that what could be said to be the appropriate lead jurisdiction received worldwide recognition and applied universally to all the insolvent's assets.

In the *Interdelvelco* case, the defendant company was a company incorporated in the Isle of Man. The only creditor was also an Isle of Man entity but there were other disputed creditors, the majority, if not the entirety of whom, were outside the Isle of Man. The claimant was a Guernsey company and claimed monies under a contract governed by Guernsey law. The parent company of the defendant was a Delaware company, the defendant being a wholly owned subsidiary

of that company. The Chapter 11 Trustee of the parent company claimed that he had been appointed Chapter 11 Trustee of both companies, i.e. the parent as well as the defendant company by the US Bankruptcy Court in October 2011 and 15 February 2012. He therefore claimed that as court appointed Trustee, he was authorised and directed to manage the assets and investigate the financial affairs and operate the business of the defendant under the supervision of the US court. In short, the Trustee claimed that the defendant, along with its own wholly owned subsidiary, its sole parent, and that parent's sole parent, were all subject to the administration in and by the US Bankruptcy Court and the proceedings in that court which he said were 'well under way' before the claimant allegedly purchased, by way of assignment, its claim from another company which had claimed against the defendant.

The Deemster eventually allowed a claim by the defendant that it was not appropriate to allow a winding up to be prosecuted or pursued in any way in the Isle of Man. Of some import appears to have been the fact that to the best of the US Trustee's knowledge, the defendant had no employees, operations or assets other than its share ownership in a subsidiary company, itself an Isle of Man company.

The claimant had strongly urged that the Isle of Man assume jurisdiction, or at least maintain it, with regard to the winding-up proceeding of the defendant in the Isle of Man. One aspect of that argument was that the activities of what were called 'the stakeholders' relevant to the claimant's claim were said to be all carried on in the Isle of Man, UK and China. Overall the claimant alleged, particularly in the light of the last factor, that the US had substantially less connection to the parties than the Isle of Man. It applied well known non-insolvency related principles of the conflict of laws in English law, particularly as embodied in the leading case of *Spiliada Maritime Corporation v Cansulex Ltd* [1987] AC 460, but the burden was on the defendant to show not simply that the Isle of Man was not the natural and appropriate forum, but that the US was clearly and distinctly a more appropriate forum than the Isle of Man for winding-up proceedings.

Pausing here, it is perhaps unusual to see the *Spiliada* doctrine applied so overtly to a winding-up context but in the end it may not matter that recourse was had to non-insolvency conflict of law principles, given the acceptance by the Deemster that the US Bankruptcy Court should maintain exclusive jurisdiction over the winding up and that the principle of universality effected and expressed in the *Cambridge Gas* decision should apply.

However, what is significant is the fact that there appear to have been no recognition proceedings as such emanating from the US proceedings. There had been what were called 'numerous orders' within the US, including an order for sale, but recognition proceedings *per se* had not yet, as it was put, 'proven necessary'. The

Deemster noted however that the defendants speaking no doubt for the US Trustee asserted that it was ‘likely that in the future recognition and assistance of the court may be sought in implementing the order if necessary’. It could be thought with some justification that this factor weighed heavily in the final outcome of this decision. The fact that the US was, as it was put, ‘the most convenient forum for administering insolvency proceedings in respect of the defendant’, prevailed.

It can be seen therefore that that case really turned upon the counting of those factors which militated in favour of the finding that there was here a more real and substantial connection with the US than there was with the Isle of Man. The importance of the case is the explicit embracing by the Manx court of the fact that it openly and expressly allowed the US court to exercise what it called ‘exclusive jurisdiction over the winding-up proceeding’ which would, it said, ‘allow all creditors to participate in the collective winding up of the group structure rather than dealing with the matter piecemeal’. It should also be pointed out that one of the factors which seemed to have weighed in the balance in favour of the eventual outcome was that the claim which formed the basis of the winding up petition in the Isle of Man was based on a claim originally owned by the assignor of the claim described in terms of being an entity controlled by a previous officer of the defendant itself, as well as being the Chief Executive Officer of the ultimate parent company. The assignor had it seems prior notice of the US proceedings and had, as it was put by the Deemster ‘ample opportunity to participate in the US bankruptcy proceedings’. Instead of so doing, it was claimed by the defendant, and it seems accepted by the Manx court, that the assignor at least had ‘embarked upon a deliberate attempt to circumvent the collective fair and US bankruptcy procedure by embarking on a course of action in to taking the ultimate assets’ of the group ‘outside’ the collective bankruptcy proceedings.

The Deemster’s decision pre-dated the finding in the Supreme Court in *Rubin*. It is an important decision given the fact that it is not a decision as such based on any request that sought, either directly or indirectly, any form of recognition or assistance. However, standing back from the case, it is clear that that is in effect what the court in the Isle of Man was doing. Of particular interest is the fact that the Deemster at paragraph 93 said that he was not entirely convinced that the existence of prejudice of local creditors would ‘on its own amount to a good reason to withhold assistance to foreign courts or foreign insolvency officers if the substantive insolvency proceedings should otherwise take place in that “foreign” jurisdiction’. Again, he went on to say that in the present case, there was no evidence that any local creditors would be unduly prejudiced. That too it seems must have weighed to some extent in the balance in determining the final outcome of this case.

Finally, it can be said with regard to the Isle of Man decision that it is a fairly explicit demonstration of an embracing by a foreign court if not of modified universalism, then perhaps of some form of almost fully qualified universalism. Indeed, at paragraph 101 of his judgment, the Deemster said that there should in the circumstances of the case before him ‘be one unitary and universal insolvency based in the US, the jurisdiction with which the group of companies including the Defendant have close connections or to put it in other words “the centre of their main interests” or their “nerve centre”.’

Whether the case would be applied four square in England at High Court level is debatable, but it is a healthy reiteration of the principle which seems to have emerged unscathed as expressed in the *Cambridge Gas* case from the legacy of the *Rubin* litigation and the outcome in the Supreme Court. There is perhaps a useful footnote to be added to this Isle of Man decision. In the recent decision in the Grand Court of the Cayman Islands (Financial Services Division) (14 January 2013: Cause No. FSD275/2010-AJJ), namely *Irving Picard v Bernard L Madoff Investment Securities LLC v Primeo Fund (in official liquidation)* there was some degree of support for the learned Deemster’s decision, although the *Primeo* decision dealt with a number of disparate issues, some of which may find expression in future articles in this learned publication. One of the questions raised in the *Primeo* decision was whether there was a common law right to bring claw back proceedings under the relevant Cayman Insolvency law. The answer was clearly yes, although with some reservations. The Cayman court applied the *Phoenix* decision in finding that there was a power, at least in the Cayman Islands, to use the common law to recognise and assist a foreign officeholder with the precepts adopted in *Cambridge Gas*, namely that assistance should be limited to doing whatever the English or, in that case, Cayman court could have done in the case of a domestic insolvency. More importantly perhaps is the fact that the *Primeo* decision which is being appealed, also endorsed the fact that bankruptcy proceedings are collective proceedings for the enforcement of, and not for the establishment of rights, for the overall benefit of creditors as a whole with claw back proceedings of the type addressed in the *Primeo* case being central to the purposes of an insolvency. Equally important is the fact that the decision in the *Primeo* case addressed a point already touched on in this article, namely the fact that even though the *Cambridge Gas* can in some way be treated as having been wrongly decided, it did not change the view as to the effect of modified or near total universalism, nor the related principle that recognition at common law at least engaged the active assistance of the court.

It is clear that this particular show will run for some time to come.



## *Sparkasse Hilden Ratingen Velbert v Benk* [2012] EWHC 2432 (Ch)

Charlotte Cooke, Barrister, South Square, London, UK

### Introduction

With automatic discharge after 12 months, bankruptcy in England is perceived, at least from the debtor's point of view, as having certain advantages as compared with procedures in certain other jurisdictions. It is therefore not surprising that so-called 'bankruptcy tourists' come to England from other jurisdictions, with a view to obtaining a bankruptcy order from the England Court.

Of course, in order for a debtor to obtain a bankruptcy order in England, it is necessary for the debtor to demonstrate that his centre of main interest ('COMI') is in the jurisdiction, Article 3 of the EC Regulation on Insolvency Proceedings ('the EC Regulation') providing that 'the courts of the Member State within the territory of which the centre of a debtor's main interest is situated shall have jurisdiction to open insolvency proceedings'.

Whilst it is clear that the motive for shifting one's COMI to England being to take advantage of the English bankruptcy procedure does invalidate subsequent bankruptcy proceedings in this jurisdiction, the COMI shift must be a genuine one. That being the case, the Court, in light of the potential for abuse, will scrutinise evidence on this point with particular care, as indeed it did in *Sparkasse Hilden Ratingen Velbert v Benk*.

### The decision

One jurisdiction where the bankruptcy procedure might, from the point of view of the debtor, be said to be less advantageous than the procedure in England is Germany and Mr Benk, the debtor with whom this case was concerned, claimed that he had moved his COMI from Germany to England. He claimed to have shifted his COMI, such that at the relevant date (being the date of presentation of the bankruptcy petition) his COMI was in England and he obtained a bankruptcy order on that basis. An application was, however, subsequently made by Sparkasse Hilden Ratingen Velbert ('the Bank') to annul that bankruptcy order, on the grounds that Mr Benk's COMI in fact remained in Germany at the material time, such that the English Court had no jurisdiction to make the bankruptcy order.

Whilst the EC Regulation does not define COMI, recital 13 thereto provides that a debtor's COMI should

correspond to the place where the debtor conducts the administration of his interests on a regular basis and is therefore ascertainable by third parties. There is also an extensive body of case law on the COMI concept, such that the relevant legal principles were not in dispute before the Court hearing the Bank's application. In summary, the Court derived from the authorities and applied the following legal principles: (i) a debtor can only have one COMI; (ii) a debtor's COMI is, in the case of professionals, the place of their professional domicile and for natural persons in general the place of their habitual residence; (iii) '*regular administration*' of a debtor's interests means that the court must look for the place from which the debtor exercises the management, organisation and control of his interests; (iv) '*on a regular basis*' suggests a quality of presence and a degree of continuity or permanence; (v) particular regard must be had for the COMI to be ascertainable by third parties; and (vi) as noted above, if a debtor relocates in the face of potential insolvency, the court must scrutinise the facts in order to determine whether the purported change is based on substance or is an illusion.

In support of his contention that his COMI had shifted to England, Mr Benk produced tenancy agreements for flats in Birmingham, bank statements showing purchases made in England, as well as receipts from English shops, details of the purchase and insurance of cars in England and evidence of utility and council tax payments and national insurance contributions. Mr Benk also pointed to his photography business in England, including receipts from business trips. On the other hand, the Bank argued that the supposed shift in Mr Benk's COMI was a mere illusion and that his move to England was temporary and contrived in order to enable him to take advantage of the English bankruptcy procedure.

The Court agreed with the Bank, holding that at the material time (when the bankruptcy petition was presented) Mr Benk's COMI did indeed remain in Germany. Whilst the evidence produced by Mr Benk was consistent with his having moved his COMI to England, it was, the Court concluded, also consistent with Mr Benk creating an illusion of a permanent presence in the jurisdiction, with his intention being to return to Germany. In this regard the Court placed particular emphasis on the fact that his activities as a sports

photographer, offering no long term prospects of economic survival, were 'window-dressing calculated to create the illusion of permanence here, but that was not the reality'. In reaching its decision the Court also drew attention to the facts that Mr Benk had taken no formal steps to notify his creditors (most of whom were located in Germany) of his purported COMI shift and that his partner, also a German national, retained her German residential address, despite purporting to live in England with Mr Benk at the material time, with the indications being that her habitual residence and COMI have been in Germany throughout. In all the circumstances, the Court considered that Mr Benk's COMI, at the date of presentation of the bankruptcy petition, was in Germany and accordingly annulled the bankruptcy order.

## Comment

The case thus demonstrates the fact that the Court will, if a debtor relocates in the face of potential insolvency, carefully scrutinise the evidence before it as to the debtor's COMI; a debtor seeking to take advantage of the English bankruptcy system must be able to show that the purported shift is genuine. Of course, what evidence will suffice to convince the Court in this regard is something that can only be addressed on a case by case basis and, for that reason and given the differences between the bankruptcy procedures in different EU member states, cases like *Sparkasse Hilden Ratingen Velbert v Benk*, are likely to continue to come before the courts.

## ***Re Lehman Brothers International (Europe) (in administration) and others, [2012] EWHC 2997 (Ch)***

Sunay Radia, Associate, Proskauer Rose LLP, and Charlotte Cooke, Barrister, South Square, London, UK

### **Summary**

The High Court of England and Wales has held in the 'Extended Liens' application that a 'general lien' granted in favour of LBIE (as defined below) over financial collateral was a floating charge and could not be interpreted as being a species of lien under English Law. Whilst the extension of the security to cover obligations owed by LBF (as defined below) to LBIE's affiliates did not invalidate the charge, the fact that LBIE did not exert sufficient possession or control over the financial collateral as it related to the LBIE affiliates, rendered the charge incapable of constituting financial collateral for the purposes of the FCAR (as defined below).

### **Facts and background**

Lehman Brothers International (Europe) ('LBIE') entered into a master custody agreement ('MCA') with Lehman Brothers Finance SA ('LBF') in August 2003, which governed the terms upon which LBIE provided custodial services to LBF. The MCA was based on a form of agreement which was originally used to govern the terms upon which LBIE would hold as custodian certain property belonging to its 'street customers'. The bulk of the Property (as defined in the MCA) of LBF held by LBIE consisted of intangibles, mainly dematerialised securities and money. The MCA contained certain provisions which purported to grant security interests over the Property in favour of LBIE.

The Administrators of LBIE sought directions in relation to these security provisions which would determine whether LBIE could validly claim a proprietary interest in any of the Property.

#### ***Did the MCA create a general lien and if not did it create any other type of security interest?***

Clause 13 of the MCA purported to create a 'general lien' over the intangible Property until all liabilities owed to LBIE by LBF were discharged. In addition, the provisions purported to create security over the Property for other debts owed by LBF to various other LBIE affiliates.

It was common ground between the parties that under English law any right classified as a 'general lien' could only apply to tangible property and older style certificated securities. As the Property in question consisted of mainly intangibles, the court held that it was highly improbable that the parties to the MCA had intended to create a general lien over the Property in question. It was held that although the MCA did not create a valid 'lien' over the Property, it did create a charge, specifically a floating charge as between LBIE and LBF.

Briggs J. went on to consider whether the rights as between LBF and LBIE's affiliates were incapable of creating a charge. His comments on this point were that, it is not essential to the nature of a charge, that the chargee (i.e. LBIE) must be a trustee or fiduciary for the creditor (i.e. the LBIE affiliates). Indeed, in this case, no trustee or fiduciary relationship existed between LBIE and its affiliates in respect of any security interest which may or may not have been created over the Property. He held that all that was necessary to create a charge is that the chargee has a specifically enforceable right to have the Property appropriated in payment of a debt owed to it, and the absence of a trustee relationship between the charge and the creditor did not bear upon this question.

#### ***Did the charge constitute a 'financial collateral arrangement' for the purposes of the Financial Collateral Arrangements (No. 2) Regulations 2003?***

Having determined that the security interest created by the MCA was a floating charge, Briggs J. had to go on to consider whether it constituted a financial collateral arrangement for the purposes of the Financial Collateral Arrangements (No.2) Regulations 2003 ('the FCAR'). The reason this mattered is that the FCAR disapply section 53(1) of the Law of Property Act 1925, section 365 of the Companies Act 1985 and section 245 of the Insolvency Act 1986 in respect of financial collateral arrangements; in the event that the security interest created by the MCA did not constitute a financial collateral arrangement for the purposes of the FCAR those provisions would have rendered it invalid.

The FCAR implement Directive 2002/47/EC on financial collateral arrangements ('the Directive'), the recitals to which (whilst noting that a balance must be struck between market efficiency and the safety of the parties to the arrangement and third parties, thereby avoiding, *inter alia* the risk of fraud) provide that the creation, validity, perfection, enforceability of admissibility in evidence of a financial collateral arrangement, or the provision of financial collateral under a financial collateral arrangement, should not be made dependant on the performance of any formal act such as the execution of any document in a specific form or in a particular manner. The balance, recital 10 to the Directive records, should be achieved through the scope of the Directive covering only those financial collateral arrangements which provide for some form of dispossession (i.e. the provision of the financial collateral).

The relevant definitions for the purposes of resolving this issue are set out in Article 2 of the Directive, which provides that 'financial collateral arrangement' means a title transfer financial collateral arrangement or a security financial collateral arrangement whether or not these are covered by a master agreement or general terms and conditions. For the purposes of the FCAR, 'title transfer financial collateral arrangement' means an arrangement, including repurchase agreements, under which a collateral provider transfers full ownership of financial collateral to a collateral taker for the purpose of securing or otherwise covering the performance of relevant financial obligations. 'Security financial collateral arrangement' means an arrangement under which a collateral provider provides financial collateral by way of security in favour of, or to, a collateral taker, and where the full ownership of the financial collateral remains with the collateral provider when the security right is established.

In order to determine whether the charges created by the MCA constituted a security financial collateral arrangement for the purposes of the FCAR, Briggs J. was required to address a number of sub-issues: (i) does the arrangement fall outside the scope of the FCAR because of the 'multilateral' rather than 'bilateral' nature of the arrangement?; (ii) is the purpose of the arrangement to secure relevant financial obligations owed by the collateral taker?; and (iii) did LBIE (or a person acting on its behalf) have the requisite possession of, or control over, the relevant assets?

As to the first sub-issue, whether the arrangement falls outside the scope of the FCAR because of the multilateral rather than bilateral nature of the arrangement, Briggs J. held that neither the Directive nor the FCAR impose a bilaterality test, accepting that the reference in recital 3 to the Directive was made simply to draw a distinction from the subject matter of the earlier Directive 98/26/EC on settlement finality in payment and securities settlement systems. In any event though, Briggs J. considered that any bilaterality test would have been satisfied by the arrangements

before him, conferring no proprietary interest upon, or rights directly enforceable by, anyone other than its two parties.

On the second sub-issue, whether the purpose of the arrangement was to secure relevant financial obligations owed by the collateral taker, Briggs J. considered that the MCA did create security over LBF's relevant property for the purpose of security debts owed by LBF to LBIE and, to that extent, it qualified as a security financial collateral arrangement for the purposes of the FCAR.

Finally, much of Briggs J.'s judgment addresses the third issue: did LBIE (or a person acting on its behalf) have the requisite possession of, or control over, the relevant assets? In this regard Briggs J. reviewed the earlier decision of Vos J. in *Re F2G Realisations Ltd: Gray v GTP Group Limited* [2011] BCLC 313. In that case, Vos J. had decided that 'possession' had no relevance to intangibles and that the collateral-taker was required to show not only 'administrative' control of the assets (e.g. where the collateral is credited to the name of the collateral-taker in the account of the depository), but also 'legal control' (i.e. the right to prevent the withdrawal of the collateral), a view which many commentators regarded as making it difficult, if not impossible, for any floating charge to be caught by the Regulations.

Unlike Vos J., Briggs J. thought that possession was a relevant concept for intangible assets; and he thought that both 'possession' and 'control' meant something more than custody. Although he agreed with the judgment in *Re F2G Realisations Ltd: Gray v GTP Group Limited* that 'legal' control was likely to be required rather than 'administrative' control, he did consider it possible for floating charges to be within the scope of the Regulations.

Insofar as the MCA was concerned, Briggs J. took the view that, as between LBIE and LBF, there was a financial collateral arrangement within the meaning of the FCAR because LBIE had 'a sufficient right to retain the security pending crystallisation to render LBF's right as provider not significantly greater than rights of substitution or the withdrawal of the excess'. However, he considered that the security should be treated as creating a single security and therefore, as the MCA did not provide LBIE with similar rights of retainer in relation to LBIE's affiliates, held that it failed to satisfy the requirements of possession and control for the FCAR.

## Comment

As well as serving as a reminder that determining the nature of a security created by a specific document is a matter of substance, rather than form, the case helpfully provides further detailed analysis of the concepts of possession and control in the context of the FCAR. In this regard, perhaps the key point to take away from

the judgment is Briggs J.'s conclusion that, in order to bring a particular collateral arrangement within scope of the protection afforded by the FCAR, what needs to be shown is that the terms upon which it is 'provided' or 'delivered, transferred, held, registered or otherwise designated' are such that there is shown to be sufficient possession or control in the hands of the collateral taker for it to be proper to describe the collateral provider as having been 'dispossessed'. As Briggs J. notes, there will be cases in which the collateral is sufficiently clearly in the possession of the collateral taker that no further

investigation of its rights of control is necessary, but in other cases, it will be necessary to analyse the degree of control thereby conferred on the collateral taker. Indeed, there may be cases, particularly where there is no delivery, transfer or holding to or by the collateral taker, only some designation, where the collateral remains wholly in the possession of the collateral provider, but on terms which give a legal right to the taker to ensure that it is dealt with in accordance with its directions. The difficulty, of course, will lie in deciding on which side of the line a particular arrangement falls.

## Tambrook Jersey: There but for the Grace ...

Glen Davis QC, Barrister, South Square, London, UK

The Bailiwick of Jersey – a British Crown Dependency consisting of the island of Jersey, together with two groups of smaller islands – nestles off the coast of Normandy in the English Channel. Jersey is a picturesque island with a benign climate, an even more benign tax regime, and an airport which (in my experience) tends to be prone to fog. Interest in the tax advantages outweighing potential travel inconvenience, Jersey is frequently the domicile of choice for single purpose vehicles for property developments and other investments in the UK.

Jersey is constitutionally separate from the UK, with its own legal system, ruled today, as it has been ruled for a thousand years, by the Duke of Normandy (nowadays, the English Queen wearing one of her other crowns). As Lord Maugham explained in the Privy Council in 1936:<sup>1</sup>

‘... the Island of Jersey is not a colony, or, to use the old phrase, “a plantation.” It is part or parcel of the ancient Duchy of Normandy, which came into the possession of William, Duke of Normandy, in A.D. 933, and remained attached to the English Crown when Philip II of France conquered the rest of Normandy from King John. It has its own constitution, and is governed by its own laws.’

It is well-known that Jersey has relatively undeveloped insolvency laws. A form of compulsory liquidation (and a personal insolvency equivalent) is available under the graphically-named *Bankruptcy (Désastre) (Jersey) Law 1990*, and a procedure broadly similar to an English creditors’ voluntary liquidation may be commenced by resolution of the shareholders under the *Companies (Jersey) Law 1991*. When a company is *en désastre*, its assets are in effect sequestered and vest in the Viscount, an official of the court, to be sold subject to any security interests.

There is no direct equivalent in Jersey to administration under the English Insolvency Act 1986 or the US Chapter 11 regime; Jersey has yet to embrace the

‘rescue culture’ in that sense. There is a process which the Jersey Court has said is in some senses similar,<sup>2</sup> under the *Loi (1839) sur les Remises de Biens*, which establishes a process by which a debtor can surrender his assets into the control of the court whereby he hopes to achieve a more orderly administration of his estate for the benefit of ordinary creditors, and possibly for his own benefit as well.

For some years, over a number of cases, a well-trodden path to address this lacuna has become established where the significant assets are in the UK. The creditor asks the Jersey Court to seek the assistance of the English Court under section 426 of the Insolvency Act 1986 (‘the 1986 Act’) and the making of an English administration order. For a fateful fortnight in April of this year, it seemed an inconvenient decision of Mr Justice Mann<sup>3</sup> in the Companies Court in London might throw a spanner in the works, but fortunately our Court of Appeal moved swiftly to confirm the correct analysis, and normal service has been resumed. As a by-product, we have a further useful appellate authority on the proper construction of, and approach to, section 426 of the 1986 Act.

Section 426 is a very helpful statutory provision, where it applies, but in some respects it is a discriminatory and therefore rather odd one to find in a modern insolvency statute. It has its roots in section 122 of the Bankruptcy Act 1914,<sup>4</sup> which required and therefore enabled, ‘The High Court, the county courts, the courts having jurisdiction in bankruptcy in Scotland and Ireland, and every British court elsewhere ...’ to ‘severally act in aid of and be auxiliary to each other in all matters of bankruptcy ...’.

This was an imperial measure, passed on the eve of the first world war and at the zenith of Britain’s powers, just as the imperial sun was beginning to set. The expression ‘British court’ was as much a political as a legal term: as Lord Denning MR put it in 1976: ‘... the word “British” in that Act was there used in the same sense as it was often used at that time in the phrase “British Empire,” see Roberts-Wray, op. cit., pp. 19-22.

### Notes

1 *Renouf v Attorney-General for Jersey* [1936] AC 445 at 460.

2 [2011] JRC 232A at [15].

3 *Re Tambrook Jersey Ltd* [2013] EWHC 866 (Ch), [2013] 2 WLR 1249.

4 In England, ‘bankruptcy’ refers only to personal as opposed to corporate insolvency.

It meant any part of Her Majesty's dominions outside Great Britain and Ireland. It included colonies and protectorates.<sup>5</sup>

In 1980, in the first case of a request from Jersey under section 122 of the 1914 Act to come to the English Court,<sup>6</sup> Goulding J rejected an argument that the Royal Court of Jersey was not a 'British court' for these purposes.

The position nowadays is beyond doubt. Section 426(4) of the 1986 Act provides:

'The courts having jurisdiction in relation to insolvency law in any part of the United Kingdom shall assist the courts having the corresponding jurisdiction in any other part of the United Kingdom or any relevant country or territory.'

And Jersey, being one of the Channel Islands, is in a privileged position as one of the relevant countries or territories: section 426(11) provides:

'In this section "relevant country or territory" means –

- (a) any of the Channel Islands or the Isle of Man, or
- (b) any country or territory designated for the purposes of this section by the Secretary of State by order made by statutory instrument.<sup>7</sup>

From the point of view of the Jersey Court, there is no statutory jurisdiction to make a request to the English court, but the Jersey Court does so in its inherent jurisdiction. This was asserted in the *OT Computers* case,<sup>8</sup> and considered in more detail in 2011 in the *REO (Powerstation)* case, in which the Deputy Bailiff said:<sup>9</sup>

'As to the inherent jurisdiction of the Court it is perhaps apt to refer to two decisions of the Court of Appeal. The first is the *Finance and Economics Committee-v-Bastion Offshore Trust Company Limited* [1994] JLR 370, at page 382 where Sir Patrick Neill J A said this:

"Practitioners in these courts and in the courts of Guernsey are familiar with the maxim '*la cour et toute puissante*' and 'the court is master of its own procedure'."

The better known a proposition is, the harder it is to find authority for it and so it turns out if one seeks judicial statements of these two maxims (though in Guernsey the Court of Appeal relied on the second maxim in *Cherub Invs. Limited-v-Channel Islands Aero-club (Guernsey) Limited*).

Both maxims are expressions of the inherent jurisdiction of the court.'

The Deputy Bailiff then went on to say:

'16. All these considerations, however, go to support these two propositions:

- (i) The Court does lend its assistance in an appropriate case to a process by which formal proceedings against a debtor can be suspended in order to achieve an orderly realisation of the debtor's assets;
- (ii) In insolvency matters generally, the Court has in the past exercised an inherent jurisdiction in a number of different respects.

17. We have gone into some detail in relation to the matter because although in the First Orion Amber case this was described as a well trodden path, it appears to us that this was perhaps something of an overstatement and that in the event that objection might be taken in the High Court to the application for an administration order, it was right that we should deal in some detail with the question of our own jurisdiction to make a request. Furthermore, the fact that the companies have not appeared to object to the exercise of any jurisdiction, notwithstanding that they were put on notice, also suggests that perhaps there is no dispute that the jurisdiction exists.'

The procedure which has now been established over a series of cases is that an application is made either by the Jersey company itself<sup>10</sup> or by substantial creditors<sup>11</sup> on notice to the company. The application is accompanied by an affidavit setting out the evidential background, and supported by an Opinion of English leading counsel confirming that the English court is likely to accede to the request.

## Notes

- 5 *In re James (an Insolvent) (Attorney-General intervening)* [1977] Ch 41; however, the majority of the Court of Appeal in that case disagreed with Lord Denning that the courts of Rhodesia, which had unilaterally declared independence, continued nonetheless to qualify as 'British' courts for this purpose.
- 6 *In re a Debtor (Order in Aid No 1 of 1979), ex parte Vicount of the Royal Court of Jersey* [1981] Ch 384.
- 7 The original list of relevant countries or territories was set out in 1986 in the *Co-operation of Insolvency Courts (Designation of Relevant Countries and Territories) Order 1986* (SI 1986/2123). These were: Anguilla, Australia, the Bahamas, Bermuda, Botswana, Canada, Cayman Islands, Falkland Islands, Gibraltar, Hong Kong, the Republic of Ireland, Montserrat, New Zealand, St Helena, Turks and Caicos Islands, Tuvalu and the Virgin Islands. Malaysia and South Africa were added in 1996 (SI 1996/253) and the list was extended to Brunei in 1998 (SI 1998/2766).
- 8 *In re OT Computers* [2002] UR 29 at [4].
- 9 [2011] UR 232A, at [12].
- 10 As in the *OT Computers* case.
- 11 Examples are *Re First Orion Amber Limited and First Orion Amber Nominees Limited* [2009] UR 126 and *Re REO (Powerstation) Ltd* [2011] UR 232 A.

The Jersey court confirms for itself that the company is insolvent and could apply to have its property declared *en désastre* pursuant to the Bankruptcy (Désastre) (Jersey) Law, 1990 or for a winding up pursuant to the Companies (Jersey) Law, 1991, and then considers whether, against that background, it is in the interests of the creditors to issue a Letter of Request to the English Court, notwithstanding the absence of any insolvency proceedings in Jersey. If it does, it issues the Letter, which is then brought before the English Court.<sup>12</sup>

In the *REO (Powerstation)* case, the Deputy Bailiff said:<sup>13</sup>

‘It seems to us that the Court should be prepared to contemplate issuing a letter of request if it is in the interests of the creditors, or if it is in the interests of the debtor or if it is in the public interest. In relation to the latter of these three considerations, the public interest obviously includes, indeed we think as a matter of priority, a satisfactory methodology for dealing with the interests of the creditors and the debtor. Subordinate to these considerations in relation to the public interest is also the interests of the Island in terms of its reputation outside these shores. Public policy considerations do not overtake the requirement to do justice as between those who are directly affected, and in our view is therefore subordinate to those interests when it comes to exercising a discretion in a matter of this kind, but we can have regard, at the edges of our discretion, to the fact that a major insolvency of a Jersey company, causing extensive damage to creditors and debtor alike is not in the best interests of the Island, and this can operate as an additional reason to exercise the discretion to issue a letter of request.’

Examples of cases in which this procedure has been followed<sup>14</sup> include: *OT Computers Limited* in 2002, where the company manufactured computer hardware (‘Tiny’ brand computers) and sold them through some 160 High Street stores, and was expected to lose its banking facilities within a couple of days – a purchaser of material parts of the business had been identified, but was said only to be prepared to complete a sale from an independent insolvency practitioner; the *First Orion* cases in 2009, where the principal asset of the insolvent companies was a substantial charged leasehold property in London; the *St John Street Limited* case

in 2010, involving a property development again in London where the company had defaulted on a £30.5 million loan and the secured creditor had appointed receivers, but it was nonetheless considered desirable to appoint administrators under the 1986 Act with their wider powers; the *REO (Powerstation) Limited* case in 2011, in which the main assets were again said to be real estate in London.

So when the application by HSBC for administrators to be appointed in the *Tambrook Jersey* case was brought by junior counsel before the Companies Court in London on 12 April 2013 on a Letter of Request granted by the Royal Court of Jersey on 28 February, there was every expectation that the application would be granted, and it was something of a shock when it was not.<sup>15</sup>

Mann J was satisfied that, apart from one point, the case before him would be an appropriate one for the appointment of administrators. The point he considered insuperable was jurisdiction. He was aware that similar orders had been made in some five previous cases,<sup>16</sup> but was concerned that:

‘In none of the English cases is a reasoned decision recorded. The only thing that is known about the hearing at which the order was made is its date and (in most but not all cases) the judge making it.

The mistaken view the Judge took of the English court’s jurisdiction under section 426 was that he thought the English could only assist if there were some insolvency proceedings on foot in the foreign court. As he put it:<sup>17</sup>

‘The problem in the present case lies in the fact that it is not possible to see how the Royal Court is “assisted” for these purposes. The English court is not empowered to act merely because a foreign court invites it to do so. The foreign court has to be an insolvency court (which I accept the Jersey court is) and the English court has to be invited to “assist” that court. In my view that requires that the foreign court be assisted in its functions as an insolvency court. That in turn presupposes that the foreign court is doing something, or perhaps planning to do something, which the English court can, and is invited to, assist. That is what the plain words seem to me to mean.’

Even the best Judges sometimes make mistakes. The Applications List in the Companies Court at the Rolls

## Notes

12 on an urgent application, this can be done almost immediately.

13 at [18].

14 The present author was involved as English counsel in a number of them.

15 Mann J’s decision is [2013] EWHC 866 (Ch) available on BAILII and reported at [2013] 2 WLR 1249.

16 the Judge refers to an online article by Paul Omar, *Section 426 of the Insolvency Act 1986: Extending Rescue to Foreign Debtors on a ‘Passporting Basis’* (<[www.iiiglobal.org/component/jdownloads/viewcategory/647.html](http://www.iiiglobal.org/component/jdownloads/viewcategory/647.html)>) in which the cases were ‘gathered and considered’.

17 at [10].



Building in London, which is where the application came to be heard, is a busy one, and in the course of a sitting day the Judge hearing that list deals with a range of different applications of varying complexity. It is interesting to note that in the same list there was apparently an application for recognition under the Cross-Border Insolvency Regulations 2006, which implement in England the *UNCITRAL Model Law on Cross-Border Insolvency*, and it is an important distinguishing feature that for such an application to be brought, there must be insolvency proceedings on foot in the foreign jurisdiction. Perhaps it was this which led Mann J astray.

The vagaries of litigation can sometimes mean that an inconvenient decision on a point of principle nonetheless stands uncorrected, but fortunately in this case an appeal was urgently brought before the Court of Appeal, which heard and granted it on 1 May 2013 and gave considered reasons on 22 May.<sup>18</sup> Davis LJ, with whom Longmore and McFarlane LJ agreed, makes clear that the English court can assist a foreign court under section 426 of the 1986 Act, whether or not there are insolvency proceedings on foot in the foreign jurisdiction.

Davis LJ traces section 426 back to its origins in section 122 of the 1914 Act, and the view expressed in the Cork Report, the precursor to the 1986 Act, that it should be the paramount objective of each of the insolvency systems of the United Kingdom, the Channel Islands and the Isle of Man that 'so far as practicable, there should be only one insolvency administration of any insolvent person subject to the jurisdiction of any of them'. He says that the provisions of s.426 as enacted are designed to accord with what Lord Hoffmann had described in the course of his judgment in *HIH Casualty and General Insurance Limited*<sup>19</sup> as the 'principle of modified universalism'.

Davis LJ also considers two well-known background cases which were cited to the Court of Appeal. The first was *re Dallhold Estates*,<sup>20</sup> in which Chadwick J granted an English administration order to preserve the value of a lease in England on a Letter of Request from the Australian court. Davis LJ observes that *Dallhold* shows the English court applying a purposive approach to the interpretation of sections 426(4) and (5), and also highlights that administration was being sought in

*Dallhold* as an alternative to an Australian winding-up order; under the terms of the lease, there could have been a forfeiture on a winding-up, in which event the value would have been lost. He notes that *Dallhold* had been approved by the Court of Appeal in *Hughes v Hannover*,<sup>21</sup> and that in *Rubin v Eurofinance*,<sup>22</sup> Lord Collins had referred to *Hughes v Hannover* among other authorities indicating that section 426 'has been given a broad interpretation'.

The second case considered by Davis LJ was *Television Trade Rentals*,<sup>23</sup> an unreported decision of Lawrence Collins J in which there had been no insolvency proceedings on foot in the Isle of Man but the Manx Court had recognised an appointment of English provisional liquidators and then issued a Letter of Request asking the English Court to apply the provisions of Part 1 of the 1986 Act (relating to company voluntary arrangements), which the English Court had done although, as Davis LJ noted, if the reasoning and approach of Mann J in *Tambrook* had been correct, *Television Trade Rentals* would also seem to be a case where the court had no jurisdiction.

Davis LJ was in no doubt that Mann J had erred in his construction of section 426(4) and in his approach to its application. Although the Judge's reasoning 'could not have been more clearly and lucidly put',<sup>24</sup> his interpretation and approach were 'unduly and unnecessarily restrictive'.<sup>25</sup> Davis LJ gives four reasons for his conclusions.

First, section 426(4) is not applicable to courts *exercising* jurisdiction in relation to insolvency law: it is by its wording applicable to courts *having* jurisdiction, or the corresponding jurisdiction, in insolvency law.<sup>26</sup> 'Having' is not the same as 'exercising': there is no need for insolvency proceedings to be on foot in the requesting jurisdiction.

Second, sections 426(4) and (5) are to be given a broad interpretation: there is neither linguistic necessity nor purposive compulsion to adopt a narrow and restrictive approach.<sup>27</sup> This is in line with previous authority, and will be helpful in any future cases where the scope of section 426 is in issue.

Third, freedom to request or make orders under section 426 where insolvency proceedings are not on foot in the requesting jurisdiction is in accordance with 'modified universalism' (and the desirability of there

## Notes

18 [2013] EWCA Civ 576.

19 [2008] UKHL 21, [2008] 1 WLR 852.

20 *Re Dallhold Estates (UK) Pty Limited* [1992] BCLC 621.

21 *Hughes v Hannover Rückversicherung Aktiengesellschaft* [1997] 1 BCLC 497.

22 *Rubin v Eurofinance SA* [2012] UKSC 46, [2013] 1 AC 236.

23 *Re Television Trade Rentals Ltd* [2002] EWHC 211 (Ch).

24 At [21].

25 At [35].

26 At [37].

27 At [38].

being only one insolvency administration where that is practicable).<sup>28</sup>

Fourth, Davis LJ did not accept the Judge's propositions that the English court was not being asked to assist the Jersey court 'in any endeavor', or that the Jersey court was not 'exercising the corresponding jurisdiction in relation to insolvency law'.<sup>29</sup> He considered that the Jersey court *was* engaged in an endeavour:

'The endeavour was to further the interests of this insolvent company and its creditors and to facilitate the most efficient collection and administration of the Company's assets. In that regard, the Company had itself resolved that it should seek to be placed in administration in England: and the Royal Court had (before making its order that a Letter of Request be issued) itself duly considered the interests of the creditors. Indeed, the whole insolvency flavour of what was being done here is yet further illustrated by the request contained in the Letter of Request to give priority to Jersey creditors in accordance with Jersey insolvency law. All of this is the very stuff of insolvency; and there is no good reason, in my opinion, to refuse to acknowledge it as an exercise of insolvency jurisdiction simply because formal proceedings for

an (unwanted) *désastre* order had not been issued or contemplated.'

In short, it was clear to Davis LJ reviewing the Jersey authorities cited to him that making a request in such a context is considered to be part of, and the exercise of, Jersey insolvency law, and it had been appropriate for the Jersey court to have made the statement in the first paragraph of its Letter of Request that 'This court is a court exercising jurisdiction relating to insolvency law in Jersey'.

As the Judge himself had accepted that it would have been appropriate to accede to the request if there was jurisdiction to do so, and as the Court of Appeal was satisfied that the English Court had jurisdiction, the Court of Appeal therefore made the administration order when the appeal was allowed (and confirmed that the previous five orders were orders which the court had had jurisdiction to make).<sup>30</sup>

So inconvenience has been avoided, normal service can be resumed, and for all those jurisdictions which enjoy a gateway to the English Court under section 426, there is further Court of Appeal authority as to the liberal breadth of the provisions.

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## Notes

28 At [39], and LJ Davis also prayed in aid in this context the well-known comments of Lord Hoffmann in *Cambridge Gas Transportation v Official Committee of Unsecured Creditors* [2006] UKPC 508, [2007] 1 AC 508 at paragraph 22 by reference to s 426(5): 'But the domestic court must at least be able to provide assistance by doing whatever it could have done in the case of a domestic insolvency. The purpose of recognition is to enable the foreign office holder or the creditors to avoid having to start parallel insolvency proceedings and to give them the remedies to which they would have been entitled if the equivalent proceedings had taken place in the domestic forum.'

29 At [41].

30 At [46].

# Provable Debts and Administration Expenses: *Lehman* and *Nortel* in the Supreme Court

Stephen Robins,<sup>1</sup> Barrister, South Square, London, UK

## Introduction

The Supreme Court has recently handed down judgment in the *Lehman* and *Nortel* pensions appeals,<sup>2</sup> reversing the decisions of Briggs J and the Court of Appeal and, in the process, sweeping aside numerous other well-known and long-established decisions.

The Supreme Court unanimously allowed the appeals (Lords Neuberger (President), Mance, Clarke, Sumption and Toulson) and held that:

1. The liability imposed on a company by the Pensions Regulator by way of a financial support direction ('FSD') and a contribution notice ('CN') under the Pensions Act 2004 ('the 2004 Act') after the commencement of the company's administration will fall within Rule 13.12(1)(b) of the Insolvency Rules 1986 so as to be provable in the company's administration, even if the FSD was not issued until after the commencement of the administration.
2. The liability will not be payable as an expense of the administration. Where: (i) a statutory liability is one which could have been imposed before or after an insolvency event, (ii) the liability does not give rise to a provable debt, and (iii) the statute is completely silent as to how the liability should be treated if it is imposed after an insolvency event, the liability can only be an expense if the nature of the liability is such that it must reasonably have been intended by the legislature that it should rank ahead of provable debts.

The decision is one which is bound to be welcomed by insolvency practitioners and others working in the insolvency industry.

Its legal relevance lies principally in the explanation of how to identify: (i) whether a contingent liability is provable in an administration or liquidation; and (ii) whether a statutory liability will be payable as an expense in an administration or liquidation. As to the

former, the Supreme Court has sought to define the concept of 'obligation' for the purposes of rule 13.12(1)(b) of the Insolvency Rules 1986 ('the 1986 Rules'). As to the latter, the Supreme Court has sought to clarify the concept of 'necessary disbursements' within rule 2.67(1)(f) of the 1986 Rules.

Commercially, the decision is bound to be seen as promoting the rescue culture. Substantial expense claims hinder the ability of an administrator or liquidator to achieve an advantageous result for creditors.

The decision also avoids the risk of liquidity drying up more generally. Prior to the decision of the Supreme Court, the liability under the 2004 Act was payable as an expense and, therefore in priority to the floating chargeholder. Those lending to companies against the security of a floating charge were therefore at risk of making no recovery at all where the borrower was the target of liabilities under the 2004 Act after the commencement of insolvency proceedings.

However, the decision of the Supreme Court could potentially generate as much uncertainty as it has resolved. In particular it means that the position in respect of statutory liabilities (particularly in the regulatory context) must be judged on a case-by-case basis, and accordingly the decision leaves significant scope for future argument as to when and whether, for the purposes of rule 13.12(1)(b), an obligation has been 'incurred' under particular statutory provisions.

There will also be room for debate as to whether the legislature must reasonably have intended that a particular statutory liability should rank ahead of provable debts.

## The facts

The Lehman group included a company which entered into service contracts with, and ran a pension scheme for the benefit of, employees who worked for other group members.

## Notes

<sup>1</sup> Junior counsel for the appellant administrators of Lehman Brothers International (Europe) and two other companies in the Lehman group.

<sup>2</sup> *Re Nortel GmbH, Re Lehman Brothers International (Europe); Bloom v Pensions Regulator* [2013] UKSC 52 (Supreme Court; Lords Sumption, Mance, Neuberger, Clarke and Toulson).

The Nortel group included a company which had a pension scheme and which was insufficiently resourced to fund that scheme. The pension scheme in each case was a final salary scheme which is in substantial deficit.

After the appointment of administrators in respect of numerous members of the Lehman Brothers group of companies and the Nortel group of companies, the Pensions Regulator initiated machinery under the 2004 Act to require certain group members to provide financial support for the relevant scheme. As stated above, the 2004 Act provides for a two-stage process involving FSDs and contribution notices CNs.

The FSD/CN regime was introduced to address the risks of moral hazard, namely (i) to prevent groups of companies from taking steps to avoid their pension obligations by using company structures and business transactions, leaving such obligations to be borne by the Pension Protection Fund and (ii) to act as a deterrent against such behaviour.

Although the FSD/CN regime under the Pensions Act 2004 is of central importance, section 75 of the Pensions Act 1995 Act is also relevant, as it provides that, upon the happening of an 'insolvency event' (which term includes administration and liquidation), an amount equivalent to any shortfall in the assets of an occupational pension scheme as against its liabilities, which exists immediately prior to the relevant event, is to be a debt (known as a 'section 75 debt') due from the employer to the trustees of the scheme. The FSD/CN regime under the 2004 Act permits the Pensions Regulator to seek financial support from associates of the employer to seek to recover the section 75 debt.

The administrators of the Lehman companies and the Nortel companies applied to Court for directions as to whether the liabilities imposed by the Regulator under the 2004 Act after the date of appointment of administrators would be: (i) payable as expenses; (ii) provable *pari passu* with other unsecured liabilities; or (iii) neither.

Briggs J held that the liabilities would be payable as expenses.<sup>3</sup> His decision was upheld by the Court of Appeal.<sup>4</sup>

The administrators of the Lehman companies and the Nortel companies appealed to the Supreme Court. As noted above, the Supreme Court upheld the appeals, concluding that the liabilities imposed by the Regulator under the 2004 Act after the appointment of administrators will be provable debts.

## The statutory waterfall

In corporate insolvencies, there is a waterfall of distributive priority which consists of descending interlinked pools. The order of priority is (in simplified form):

1. fixed charge creditors;
2. the 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.

There can be no guarantee that any money will be available to pay the liabilities at any particular level of priority. The money might not even be sufficient to cover all the expenses: it is for this reason that Rules 2.67(1) and 4.218(1) of the Insolvency Rules 1986 contain an order of priority for expenses *inter se* and the Court has a power in Rules 2.67(3) of the Insolvency Rules 1986 and section 156 of the Insolvency Act 1986 to re-order the priority of expenses in the event of a deficiency.

The question for the Supreme Court was whether liabilities imposed by the Regulator under the 2004 Act after the commencement of insolvency proceedings would fall within level (2), level (5) or level (7) in the priority waterfall set out above.

## Provable debts

The current statutory provision in respect of provable debts is contained in Rule 13.12(1) of the Insolvency Rules 1986. Paragraph (a) of Rule 13.12(1) is concerned with liabilities to which the company 'is subject' at the date of the commencement of insolvency proceedings. Paragraph (b) is directed to those liabilities to which it 'may become subject' subsequent to that date 'by reason of an obligation incurred' before that date.

The statutory test has changed over time. Originally, pursuant to section 7 of the Bankrupts Act 1705, it was necessary for the liability to be due and payable in a liquidated sum at the commencement of the insolvency proceedings. In other words, the category of provable debts was confined to what is now paragraph (a) of Rule 13.12(1) and there was nothing equivalent to paragraph (b). Over the course of three centuries,

## Notes

- 3 *In re Nortel GmbH; In re Lehman Brothers International (Europe); Bloom v Pensions Regulator* [2010] EWHC 3010 (Ch), [2011] Bus LR 766 (Briggs J).
- 4 *In re Nortel GmbH; In re Lehman Brothers International (Europe); Bloom v Pensions Regulator* [2011] EWCA Civ 1124, [2012] Bus LR 818 (Court of Appeal).

however, Parliament re-drafted the statutory test repeatedly to widen the category of provable debts in a gradual attempt to bring prospective and contingent liabilities into the category of provable debts.<sup>5</sup> With each reform, the class of provable debts expanded, and the category of non-provable liabilities contracted. The most significant development in the history of provable debts occurred with the enactment of the Bankruptcy Act 1869, which introduced the ‘obligation incurred’ wording that survives to this day in paragraph (b) of Rule 13.12(1) of the Insolvency Rules 1986.

The courts were quick to recognise the fact that this new wording was wide and that it represented something of a new departure. In *Ex parte Llynvi Coal & Iron Co, In re Hide* (1871) LR 7 Ch App 28, for example, Mellish LJ said at p.33:

‘The Legislature, in Bankrupt Act after Bankrupt Act, has been trying to relieve the bankrupts from both their present and future liabilities upon contracts; but up to the passing of this last Act, that had been very incompletely provided for, and by the construction which has been put on previous sections, it was found that, notwithstanding the language used by the Legislature, a bankrupt did still remain liable on a variety of contracts which he had previously entered into. It is quite plain that the object of these sections is that the bankrupt shall be absolutely relieved from any liability under any contract he has ever entered into’.<sup>6</sup>

However, despite the width of the ‘obligation incurred’ wording, liabilities imposed by a decision-maker under a statutory jurisdiction after the commencement of insolvency proceedings were repeatedly held to be non-provable. In particular, costs orders imposed by the court after the commencement of the bankruptcy, but in respect of litigation which had taken place before the commencement of the bankruptcy, were repeatedly held to be non-provable in the bankruptcy, on the basis that the bankrupt had incurred no obligation in respect of the costs before the commencement of his bankruptcy. See, for example, *Re Bluck, Ex parte Bluck* (1887) 57 LT 419, in which Cave J said at p. 420:

‘The contention was, that this was a contingent liability to which he might become subject by reason of an obligation incurred before his discharge; but it is impossible to see what the obligation is. There had been litigation, and that too commenced by the plaintiff, but where is the obligation? If a man brings an action he does not place on himself an obligation to pay costs; that obligation arises when judgment is given against him ... I cannot think that before judgment there was an obligation in respect of which a debt or liability arose’.<sup>7</sup>

This reasoning was followed by the Court of Appeal in *Glenister v Rowe* [2000] Ch 76 and applied the same reasoning to a statutory liability to repay overpaid benefits, which was held to be non-provable in *R (Steele) v Birmingham City Council* [2007] 1 All ER 73.

The Supreme Court has rejected this narrow interpretation of the word ‘obligation’ in paragraph (b) of Rule 13.12(1), holding that it is not confined to contractual liabilities. Rather, according to the Supreme Court’s conclusion, a company will have incurred an ‘obligation’ if it has taken or been subjected to some step or combination of steps which (a) had some legal effect (such as putting it under some legal duty or into some legal relationship) and (b) resulted in it being vulnerable to the specific liability in question, such that there would be a real prospect of that liability being incurred.<sup>8</sup> If these two requirements are satisfied, it is also relevant to consider (c) whether it would be consistent with the regime under which the liability is imposed to conclude that the step or combination of steps gave rise to an obligation under rule 13.12(1)(b).<sup>9</sup>

This conclusion was based heavily<sup>10</sup> on *Winter v Inland Revenue Commissioners, Re Sutherland* [1963] AC 235, a case about tax liabilities, which the Court of Appeal had held to be irrelevant in both *Glenister* and *Steele*. The Supreme Court overruled *Bluck, Glenister* and *Steele*.<sup>11</sup>

As regards the liabilities under the Pensions Act 2004, the Supreme Court held that:

- (a) Prior to the date they went into administration, each of these companies had become a member of

## Notes

- 5 See section 1 of the Bankrupts Act 1720, section 2 of the Bankrupts Act 1745, section 8 of the Bankrupts Act 1809, sections 52 to 54 of the Bankrupts Act 1824, section 178 of the Bankrupt Law Consolidation Act 1849, sections 153 and 154 of the Bankruptcy Act 1861, and section 31 of the Bankruptcy Act 1869
- 6 See also *Ex parte Neal, In re Batey* (1880) 14 Ch D 549, Bramwell LJ said at p. 584.
- 7 See also *Re A Debtor (No 68 of 1911)* [1911] 2 KB 652, in which Buckley LJ approved Cave J’s analysis in *Re Bluck, Ex parte Bluck* (1887) 57 LT 419 and said at p. 657: ‘I am unable to find here that the debtor was under any obligation at the date of the prior bankruptcy ... An obligation may arise in any one of various ways. It may arise by contract. It will arise if a judge makes an order against him. But in the latter case until judgment there is no obligation’. See also *Re Pitchford* [1924] 2 Ch D 260, in which Astbury J said at pp. 264-265: ‘In my judgment this is not a debt certain or contingent and it was never incurred by reason of any obligation within the meaning of this section’.
- 8 Para. 77 per Lord Neuberger.
- 9 *Ibid.*
- 10 Paras 78 to 82 per Lord Neuberger.
- 11 Paras 89 to 91 per Lord Neuberger.

a group of companies. Membership of a group of companies is undoubtedly a significant relationship in terms of law: it carries with it many legal rights and obligations in revenue, company and common law.<sup>12</sup>

- (b) Prior to the commencement of the administration, the group concerned included either a service company with a pension scheme or an insufficiently resourced company with a pension scheme. Accordingly, the target companies were precisely the type of entities who were intended to be rendered liable under the 2004 Act.<sup>13</sup>
- (c) The sensible and fair answer would appear to be that the potential liability of a target company under the 2004 Act after the commencement of insolvency proceedings should be treated as a provable debt, even where the FSD is not issued until after the commencement of the insolvency proceedings.<sup>14</sup>

The Supreme Court also dealt expressly with the status and ranking of costs liabilities, holding that, where an order for costs is made after the company has gone into administration or liquidation in respect of litigation which took place before the commencement of the administration or liquidation, the costs order will be provable in the administration or liquidation. In summary, by becoming a party to legal proceedings in this jurisdiction, a person is brought within a system governed by rules of court, which carry with them the potential for being rendered legally liable for costs, subject of course to the discretion of the court.<sup>15</sup> An order for costs made against a company in administration or liquidation, made in proceedings begun before it went into that process, is therefore provable as a contingent liability under rule 13.12(1)(b), as the liability for those costs will have arisen by reason of the obligation which the company incurred when it became party to the proceedings.

The decision of the Supreme Court therefore brings clarity to the law regarding the status and ranking of pensions liabilities under the 2004 Act and costs orders made after the commencement of insolvency proceedings in respect of litigation initiated prior to that date.

However, the decision of the Supreme Court will serve to generate uncertainty in respect of other statutory liabilities, particularly in the regulatory context,

which must now be judged on a case-by-case basis by reference to the Supreme Court's threefold test.<sup>16</sup> Accordingly the decision leaves significant scope for future argument as to when and whether, for the purposes of rule 13.12(1)(b), an obligation has been 'incurred' under particular statutory provisions.

## Expenses

It had been held by Briggs J and the Court of Appeal that the liability imposed by the Regulator under the 2004 Act would be payable as an expense falling within rule 2.67(1)(f) of the 1986 Rules as a 'necessary disbursement ... in the course of the administration'.

The Supreme Court rejected this conclusion, holding that a liability may arise during an administration without being 'in the course of' the administration. In construing this phrase, the Supreme Court found assistance<sup>17</sup> in *Davidson v Robb* [1918] AC 304, in which Lord Dunedin explained at 321 that 'in the course of his employment' had a more limited meaning than 'during the period of his employment' and connoted 'something which is part of his service' namely 'work or the natural incidents connected with the class of work'.<sup>18</sup>

The Supreme Court held that a disbursement falls within rule 2.67(1)(f) only if it arises out of something done in the administration (normally by the administrator or on the administrator's behalf) or if it is imposed by a statute whose terms render it clear that the liability to make the disbursement falls on an administrator as part of the administration – either because of the nature of the liability or because of the terms of the statute.<sup>19</sup>

The Supreme Court therefore rejected Briggs J's conclusion (which had been adopted by the Court of Appeal) that where by statute Parliament imposes a financial liability which is not a provable debt on a company in an insolvency process then, unless it constitutes an expense under any other sub-paragraph in the twin expenses regimes for liquidation and administration, it will constitute a necessary disbursement of the liquidator or administrator.<sup>20</sup> The Supreme Court held that Briggs J and the Court of Appeal had misunderstood and misapplied the guidance of the House of Lords in *Re Toshoku Finance UK plc* [2002] 1 WLR

## Notes

12 Para. 84 per Lord Neuberger.

13 Para. 85 per Lord Neuberger.

14 Para. 86 per Lord Neuberger.

15 Para. 91 per Lord Neuberger.

16 Para. 77 per Lord Neuberger.

17 Para. 99 per Lord Neuberger.

18 See also Lord Russell in *Alderman v Great Western Railway Co* [1937] AC 454, 459.

19 Para. 100 per Lord Neuberger.

20 Para. 111 per Lord Neuberger.

671.<sup>21</sup> Unless the statute states, expressly or impliedly, how the liability is to rank, the liability can only be an expense if the nature of the liability is such that it must reasonably have been intended by the legislature that it should rank ahead of provable debts.

Applying this approach, the Supreme Court held that a potential liability under the 2004 Act does not fall within rule 2.67(1)(f). First, there is no question of such a liability resulting from any act or decision taken by or on behalf of the administrator or any act or decision taken during the administration.<sup>22</sup> The liability self-evidently arises out of events which occurred before the insolvent event. Secondly, the terms of the 2004 Act contain no suggestion that the liability would be an expense of the administration.<sup>23</sup> The fact that the CN gives rise to a debt payable by the target company is not sufficient to render the payment of the debt a 'necessary disbursement ... in the course of the administration'. The mere fact that an event occurs during the administration of a company which a statute provides give rise to a debt on the part of the company is not enough to render payment of the debt an expense of the administration. The liabilities imposed under the 2004 Act would be payable 'during the period of' the administration, but they would not be 'part of' the administration and would not form one of the 'natural incidents connected with' the administration, to use the language of Lord Dunedin in *Davidson*.

## Conclusion

The decision of the Supreme Court is to be welcomed.

First, the claims in respect of pension liabilities under the 2004 Act are placed into level (5) of the statutory

waterfall set out above, alongside the target company's other unsecured creditors, whether the FSD is served before or after the commencement of the insolvency proceedings.

Secondly, Briggs J's misinterpretation of *Toshoku* has been laid to rest. There is nothing special about statutory liabilities. They will only be payable as expenses if they are genuinely one of the costs of doing the administration or liquidation.

Thirdly, the anomalies thrown up by the decisions of the lower courts have been avoided.

For example, the section 75 debt is merely provable and non-preferential in respect of the employer. There is no obvious reason why the secondary liability of a target under the 2004 Act should rank as an expense. Another oddity arises from that fact that section 43(6)(a) of the 2004 Act makes it clear that FSDs and CNs may be issued to insolvent employers. According to the reasoning of the lower courts, the Regulator was able to use section 43(6)(a) of the 2004 Act to elevate the merely provable and non-preferential section 75 debt against the employer into an expense of the employer's administration of liquidation payable in priority to the provable debts.

A further peculiarity of the lower courts' reasoning was that, if an FSD and CN gave rise to the super-priority inherent in expense liabilities but only where no FSD had been issued prior to the commencement of the insolvency event, is that it would produce an entirely different result depending on the timing of the issue of the FSD.

Insolvency practitioners can now continue to focus their energies on achieving the statutory purpose for which they are appointed, free from the risk of having insufficient assets available to them even to discharge the expenses of the process.

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## Notes

21 *Ibid.*

22 Para. 105 per Lord Neuberger.

23 Para. 106 per Lord Neuberger.

# The Supreme Court Decision in *Eurosail*

David Allison, Barrister, South Square, London, UK

## Introduction

This article analyses the recent decision of the Supreme Court in *BNY Corporate Trustee Services Ltd v Eurosail-UK 2007-3BL PLC* [2013] 1 WLR 1408 on the interpretation of section 123(2) of the Insolvency Act 1986 ('the Act') and its possible future implications. The decision represents the first time that the UK's highest court has considered the meaning of section 123(2) since its introduction onto the statute book a quarter of a century ago.

Section 123(2) sets out one of the circumstances in which a company is to be deemed to be unable to pay its debts. The provision plays a key role as a jurisdictional gateway relevant to a large number of remedies made available under the Act.<sup>1</sup> In addition, it plays an important role in finance documentation where it is commonly included by the draftsman as an event of default which operates as a gateway to the acceleration of the sums owed by a debtor and the enforcement of the security held by or on behalf of the lenders. Accordingly, it is easy to see why the decision is likely to have important ramifications for finance lawyers.

## Section 123 of the Act

Section 123 is headed 'Definition of inability to pay debts'. The key provisions of section 123 are sections 123(1)(e) and 123(2):<sup>2</sup>

(1) A company is deemed unable to pay its debts –

...

(e) if it is proved to the satisfaction of the court that the company is unable to pay its debts as they fall due.

(2) A company is also deemed unable to pay its debts if it is proved to the satisfaction of the court that the value of the company's assets is less than the amount of its liabilities, taking into account its contingent and prospective liabilities.

The test found in section 123(1)(e) is commonly known as the 'cashflow test'. This provision was the subject of detailed consideration in *Re Cheyne Finance plc (No. 2)* [2008] Bus LR 1562, where Briggs J concluded that the test contains an element of futurity such that it is concerned not only with whether the company is able to pay debts that are immediately payable, but also with those that would be payable in the future.

The test found in section 123(2) is commonly known as the 'balance sheet test': see, for example, *R v Commissioners of HM Treasury* [2009] BCC 251, at [16]. There must, however, be a serious question as to whether this remains an appropriate label following the decision of the Supreme Court. The wording of section 123(2) requires the Court to strike a balance between the assets and the liabilities of a company, taking into account not only debts which are immediately due and payable, but also its contingent and prospective liabilities.<sup>3</sup>

## Factual background to the *Eurosail* case

The Issuer is a special purpose company that issued Notes in order to fund the acquisition of a portfolio

## Notes

- 1 To give three examples: (i) it is a jurisdictional pre-condition to the existence of the discretion to make a winding-up order under section 122 of the Act; (ii) the applicant for an administration order must, save where the application is made by a holder of a qualifying floating charge, satisfy the Court the company is or is likely to become unable to pay its debts: see paragraph 11 of Schedule B1 of the Act; (iii) an inability to pay debts within the meaning of section 123 is a necessary pre-condition to a successful claim by an officeholder to avoid an antecedent transaction as a preference under section 239 of the Act or an undervalue under section 238 of the Act: see section 240(2) of the Act.
- 2 The legislative history leading to the enactment of section 123 and the case law decided in relation to its statutory predecessors is beyond the scope of this article. A detailed treatment of these matters can be found in the judgment of Lord Walker (with whom each of the other members of the Supreme Court agreed) and an article by Dr Peter Walton, 'Inability to pay debts: beyond the point of no return' (2013) *Journal of Business Law* 212.
- 3 See *Stonegate Securities v Gregory* [1980] 1 Ch 576, where Buckley LJ described a contingent creditor as a 'creditor in respect of a debt which will only become due in an event which may or may not occur' and a prospective creditor as a 'creditor in respect of a debt which will certainly become due in the future, either on some date which has been already determined or on some date determinable by reference to future events'.



of mortgage-backed loans. The Notes were issued in a number of separate classes with different priority and interest entitlements. The Notes had long stop dates for payment as late as 2045, but the Offering Memorandum explained that it was expected that the Notes would be discharged at a much earlier date as and when the underlying mortgages were redeemed.

The mortgage-backed loans were all Sterling denominated, whereas the Notes were denominated in GBP, EUR and USD. Accordingly, the Issuer entered into various foreign exchange hedging transactions to hedge its obligations under the Notes. These agreements were terminated following the collapse of the Lehman group. The Issuer was unable to purchase replacement hedging arrangements and the strengthening of the US\$ caused heavy losses to the transaction as the non-sterling notes were being paid down at a much slower rate than originally anticipated.

Prior to the service of an Enforcement Notice by the Trustee, the principal sums due in respect of the Notes would be paid sequentially to the Noteholders, having regard to the different rankings of the sub-classes of Notes. This meant that the Issuer would be obliged to repay the A1 Notes in full first, then the A2 Notes, then the A3 Notes. The service of an Enforcement Notice would lead to all of the A Notes ranking *pari passu*.

The A3 Noteholders were concerned that there would not be sufficient collateral to meet the principal due on their notes as and when they fell due for payment and wished the Trustee to serve an Enforcement Notice. They sought to rely on the trigger set out Condition 9(a)(iii) of the Notes which incorporated the section 123(2) test:

‘The Issuer ... being unable to pay its debts as and when they fall due or, within the meaning of Section 123(1) or (2) (as if the words “it is proved to the satisfaction of the court” did not appear in Section 123(2)) of the Insolvency Act 1986 (as that Section may be amended from time to time), being deemed unable to pay its debts.’

The A3 Noteholders relied on the fact the latest financial statements revealed that the Issuer had net liabilities of around GBP 75 million. They contended that the balance sheet was the beginning and the end of the enquiry and that in view of the large deficiency in net assets it could not sensibly be contended that the section 123(2) trigger had not occurred.

A breach of Condition 9(a)(iii) would not automatically give rise to the service of an enforcement notice by the Trustee. The clause additionally required a direction

by the Noteholders or the exercise of the Trustee’s discretion and the requirement that the Trustee certify to the Issuer that the event was, in the Trustee’s sole opinion, materially prejudicial to the interests of the Noteholders.

The Chancellor [2011] 1 WLR 1200 and the Court of Appeal [2011] 1 WLR 2524 found that the Issuer was not unable to pay its debts within the meaning of section 123(2).

## Decision of the Supreme Court

The Supreme Court held that the Issuer was not unable to pay its debts within the meaning of section 123(2).

Lord Walker found that section 123(2) requires a petitioner to satisfy the court, on the balance of probabilities, that a company has insufficient assets to be able to meet all its liabilities, including prospective and contingent liabilities: see [48].

Lord Walker noted that the starting point in a case where the liabilities of the Issuer were not repayable for a further 30 years and it was meeting its debts as they fall due, was that the Court should proceed with the greatest caution: see [42]. Lord Walker then considered the impact of the fact that the movements of foreign exchange and interest rates over this period were incapable of prediction with any confidence: see [49]. He concluded that this meant that the Court could not be satisfied that there would eventually be a deficiency of assets to meet the Issuer’s future liabilities under the Notes as and when the Notes matured: see [49].

This meant that there was no need for the Supreme Court to rule on the alternative argument of the Issuer that the section 123(2) trigger in Condition 9(a)(iii) should be seen as having a special meaning different to the ordinary meaning of the statute when viewed in the overall context of the transaction. Lord Walker did note, however, that this would have been a difficult argument in view of the fact that Condition 9(a)(iii) expressly cross-referred to the statutory provision, thereby *prima facie* incorporating its ordinary meaning into the contract: see *Enviroco Ltd v Farstad Supply A/S* [2011] 1 WLR 921.

There was also no need for the Supreme Court to consider in any detail whether, on the assumption that section 123(2) had otherwise been triggered, the post-enforcement call option (‘PECO’) included in the structure of the transaction would preclude Condition 9(a)(iii)<sup>4</sup> from being breached. Lord Hope did, however, take time to answer this question, finding that the

## Notes

<sup>4</sup> The Eurosail structure included a PECO which, in certain circumstances, entitled OptionCo (a company associated with the Issuer) to acquire the entirety of the notes for a nominal consideration. The option could only be exercised following the enforcement of the security in circumstances that led to a deficiency of assets to meet the claims of the Noteholders. The commercial effect of the PECO would be to protect the Issuer from the risk of being wound-up as the notes would find their way into the hands of a friendly entity.

Chancellor and the Court of Appeal were correct to find that the PECO would not have assisted the Issuer: see [61]-[64].

Lord Walker's judgment contains a number of helpful clarifications in relation to the interpretation of section 123(2).

Lord Walker confirmed that the assessment of whether a company is unable to pay its debts within the meaning of s123(2) may differ from a company's statutory balance sheet prepared in accordance with the requirements of the Companies Act 2006 as the test may require the Court to take in to account contingent assets or contingent liabilities that are not reflected on the statutory balance sheet: see [1].

Lord Walker found that Lord Neuberger MR was wrong to interpret section 123(2) as requiring an answer to the question of whether the company had 'reached the point of no return' or whether it was a company which should 'put up the shutters': see [42] and [48]. This is to be welcomed as the labels do not find any support in the statutory language and they could have given rise to serious practical issues<sup>5</sup>.

Lord Walker expressly approved the finding of Briggs J in *Cheyne Finance (No. 2)* that the cashflow test in s123(1)(e) contains an element of futurity: see [34]. Lord Walker did note, however, that once the Court has to move beyond the reasonably near future any attempt to apply a cashflow test will become completely speculative, and that s123(2) then becomes the only sensible test for determining whether a company is unable to pay its debts: see [37].

## Future issues

The Supreme Court did not take the opportunity to provide any detailed guidance on how contingent and prospective liabilities should be taken into account when conducting the balancing exercise called for by section 123(2). It may be that the Court felt it unnecessary to do so in light of its view that the facts of the Eurosail case were not close to the line. Lord Walker does helpfully inform us that there is a need to discount for 'contingencies and deferment' (at [37]) and agrees with the view of Toulson LJ in the Court of Appeal that

there is a need to make 'proper allowance' for contingent and prospective liabilities (at [42]), but he does not comment further on the methodology to be adopted when undertaking the discounting exercise. The simple answer may be that this is a fact sensitive question that depends on the nature of the liability in question, but it is a point which is likely to generate litigation in the future. It is perhaps unfortunate that the Supreme Court did not clarify whether the Court should adopt the methodology set out in the Insolvency Rules 1986 for the valuation of contingent debts (rule 4.86) and prospective debts (rules 4.94 and 11.13) or whether there is some other basis for 'taking into account' contingent and prospective liabilities under section 123(2). Indeed, the issue of the valuation of contingent liabilities may give rise to additional difficulties in the future following the Supreme Court's recent decision in *Lehman/Nortel* [2013] UKSC 52 that expands the matters that are capable of giving rise to contingent liabilities under rule 13.12.

Lord Walker places reliance on the fact that the Court 'cannot be satisfied that there will eventually be a deficiency', thereby suggesting that section 123(2) involves an enquiry as to whether a company could reasonably be expected to meet contingent and prospective liabilities as and when they fall due: see [49]. It is arguable that such an enquiry is irrelevant to the balancing exercise required by section 123(2), but relevant only to the cashflow test found in section 123(1)(e). Indeed, it is difficult to discern the need for such an enquiry from the wording of section 123(2) and the practical application of such a test must be uncertain in view of Lord Walker's recognition that a cashflow test is difficult to apply beyond a point in the reasonably near future.

Finally, it is helpful to finish by considering the way in which the decision may influence the draftsman of finance documents in the future. We now know that section 123(2) is a highly fact sensitive test that may require much more than a cursory glance at the balance sheet of the company. There must be a serious question as to whether section 123(2) is an appropriate trigger in circumstances where certainty is required when determining whether an event of default has occurred under a finance document.

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## Notes

- 5 For example, a test which required the Court to be satisfied that a company had reached the 'point of not return' would have imposed an unnecessarily high hurdle for a contingent or prospective creditor seeking to petition for the winding-up of a company. Moreover, it appeared to align the test under section 123(2) with the test for wrongful trading under section 214 of the Act which requires the Court to be satisfied 'that there was no reasonable prospect that the company would avoid going into insolvent liquidation'.

# ***Bank Handlowy w Warszawie SA v Christianapol Sp. z o.o.*** **(C-116/11)**

Charlotte Cooke, Barrister, South Square, London, UK

## **Introduction**

The European Court of Justice has handed down judgment in *Bank Handlowy w Warszawie SA v Christianapol sp. z o.o.* (Case C-116/11), a reference having been made by the Polish Court as to the interpretation of Articles 4(1), 4(2)(j) and 27 of the EC Regulation on Insolvency Proceedings (No. 1346 of 2000) ('the Regulation'). As explained below the European Court of Justice's decision in this case is one clearly aimed at ensuring the efficiency and effectiveness of cross-border insolvency proceedings.

## **Background**

On 1 October 2008 the French Court opened insolvency proceedings in respect of Christianapol sp. z o.o., a Polish company (wholly owned subsidiary of a German company in turn 90% owned by a French company), finding its centre of main interests to be situated in France. The proceedings were protective, being opened on the ground that the debtor was not in situation calling for the cessation of payments, but that it would be in that situation if a financial restructuring was not undertaken quickly.

On 21 April and 26 June 2009 Bank Handlowy, a creditor of Christianapol, asked the Polish Court to open second insolvency proceedings in respect of Christianapol pursuant to Article 27 of the Regulation. In the event that the judgment of the French Court was held to be in breach of public policy in accordance with Article 26 of the Regulation, an alternative application was made by Bank Handlowy for the opening of winding up proceedings under Polish law.

Thereafter, on 20 July 2009, the French Court approved a rescue plan for Christianapol, pursuant to which debts would be paid off in installments over a 10 year period. Having originally maintained that Bank Handlowy's application for the opening of secondary proceedings in Poland should be dismissed on the basis that such proceedings would be contrary to the objectives of the French insolvency proceedings, once the French Court approved the rescue plan, Christianapol argued that the secondary proceedings should be discontinued as the main proceedings had closed. That

argument having been raised, the Polish Court asked the French Court whether the insolvency proceedings in France had indeed been closed. However, the answer given by the French Court failed to provide the necessary clarification.

## **Reference for a preliminary ruling**

In the circumstances, the Polish Court referred the following questions to the European Court of Justice for a preliminary ruling:

1. Is Article 4(1) and (2)(j) of [the Regulation] to be construed as meaning that the term 'closure of insolvency proceedings' used in that provision should be interpreted autonomously, independently of the rules applicable in the legal systems of the individual Member States, or is it solely for the national law of the State of the opening of proceedings to decide when closure of insolvency proceedings occurs?
2. Is Article 27 of [the Regulation] to be interpreted as meaning that the national Court dealing with an application for the opening of secondary insolvency proceedings may never examine the insolvency of a debtor in respect of whom main insolvency proceedings have been opened in another State, or rather that the national court may in certain situations examine the existence of the debtor's insolvency – particularly where the main proceedings are protective proceedings in which the court has established that the debtor is not insolvent?
3. Does interpretation of Article 27 of [the Regulation] permit secondary insolvency proceedings, the nature of which is specified in the second sentence of Article 3(3) of [that] regulation, to be opened in the Member State in which the whole of the assets of the insolvent person are situated, when the main proceedings, which are subject to automatic recognition, are of a protective nature, a scheme of payment has been accepted and confirmed in those proceedings, that scheme is being implemented by the debtor and the court has forbidden the disposal of the debtor's assets?

## The first question – Closure of insolvency proceedings

On the first question, the European Court of Justice ruled insofar as the concept of the closure of insolvency proceedings in Article 4(2)(j) of the Regulation is concerned that it is for the national law of the Member State in which the insolvency proceedings had been opened to determine when those proceedings are closed.

The Court noted that the principle that provisions of EU law are to be interpreted autonomously only applies where the provision in issue makes no reference to the law of Member States for the purpose of determining its meaning (see *Interdil* [2011] ECR I-0000 (Case C-396/09)). As such, insofar as questions as to the conditions for and the effects of the closure of insolvency proceedings are concerned, as Article 4(2)(j) makes express reference to national law, that term does not need to be interpreted autonomously; rather it is for the national law of the Member State of the opening of proceedings to determine when insolvency proceedings are closed.

## The second question – Examination of insolvency

On the second question, it was held by the European Court of Justice that a Court to which an application to open secondary insolvency proceedings is made cannot look behind the main proceedings, even where it is the case that the main proceedings have a protective purpose. This is because it is a prerequisite for the opening of main insolvency proceedings that the Court is satisfied that the debtor is insolvent under its national law and its ruling in this regard is binding on other Courts to which an application to open secondary proceedings may be made.

The European Court of Justice noted that the first sentence of Article 27(1) of the Regulation states that the opening of main proceedings 'shall permit the opening' of secondary proceedings in another Member State within the territory of which the debtor has an establishment 'without the debtor's insolvency being examined in that other State' and that, the wording is not entirely clear as to whether, when secondary proceedings are opened, the examination of the debtor's insolvency is not necessary but remains possible, or is not authorised at all.

That being the case, the Court had to construe the wording in light of the overall purpose of the Regulation. As such, the Court considered that the examination of the debtor's insolvency by the Court opening the main proceedings is binding on other Courts before which an application for the opening of secondary proceedings may be made; otherwise difficulties would arise by virtue of, for example, diverging national definitions of the

concept of insolvency, which would by contrary to the object of efficient and effective cross-border insolvency proceedings with the Regulation seeks to achieve.

## The third question – Protective main proceedings and secondary proceedings

Finally, the European Court of Justice held that Article 27 of the Regulation permits the opening of secondary insolvency proceedings in the Member State in which all of the debtor's assets are situated, where the main proceedings have a protective purpose. It is for the Court having jurisdiction to open secondary proceedings to have regard to the objectives of the main proceedings and take account of the scheme of the Insolvency Regulation.

The European Court of Justice reached this conclusion on the basis that neither Article 27 of the Regulation makes any distinction according to the purpose of the main proceedings; nor does Article 3(3) of the Regulation, which provides that, where main proceedings have been opened, any insolvency proceedings opened subsequently by a court basing its jurisdiction on the presence of an establishment of the debtor are to be secondary proceedings. Therefore, secondary proceedings may always be opened.

Moreover, although (at present) they are to be liquidation proceedings, the Regulation affords various tools allowing the insolvency official appointed in the main proceedings to influence the evolution of the secondary proceedings. Indeed, the liquidator in main proceedings is able to influence the secondary proceedings in order that the protective purpose of main proceedings (where they are protective) is not jeopardised. For example, pursuant to Article 33(1) of the Regulation, the liquidator in main proceedings may request a stay of the process of liquidation for up to three months, which may be continued or renewed for similar periods. Further under Article 34(1) the liquidator in the main proceedings may propose closing the secondary proceedings with a rescue plan, a composition or a comparable measure and Article 34(3) provides that during the stay of the process of liquidation under Article 33(1) of the Regulation, only the liquidator in the main proceedings or the debtor, with the liquidator's consent, may propose such measures. What is more though, Article 4(3) of the Regulation requires the Court having jurisdiction to open secondary insolvency proceedings to have regard to the objectives of the main proceedings and to take account of the scheme of the Regulation, which, as noted above, has the objective of ensuring the efficiency and effectiveness of cross-border insolvency proceedings, an objective which very clearly underpins each aspect of the European Court of Justice's decision in this case.

# *Olympic Airlines SA Pension and Life Assurance Scheme v Olympic Airlines SA* [2013] EWCA Civ 643

Charlotte Cooke, Barrister, South Square, London, UK

## Introduction

The Court of Appeal's recent decision in *Olympic Airlines SA Pension and Life Assurance Scheme v Olympic Airlines SA* [2013] EWCA Civ 643 concerns the jurisdiction under EU law to commence secondary insolvency proceedings. Under the EU Regulation on Insolvency Proceedings (1346/2000) ('the Regulation'), secondary proceedings can only be opened in a Member State where the debtor has an 'establishment' and the case provides guidance as to what constitutes an 'establishment' for the purposes of the Regulation. The case is, however, also notable for exposing a hole in the protection afforded by English pensions legislation where main proceedings are opened in another Member State in respect of a company with UK employees and pension scheme members.

## The Regulation

Under the Regulation, 'main proceedings' can be opened in the Member State where the insolvent company has its centre of main interests ('COMI'). 'Secondary proceedings' (the effects of which are restricted to the assets of the insolvent company in the secondary Member State) can be opened in another Member State, if the insolvent company has an 'establishment' there (see article 3(2) of the EC Regulation).

As to what constitutes an 'establishment', article 2(h) of the EC Regulation provides that an 'establishment' is 'any place of operations where the debtor carries out a non-transitory economic activity with human means and goods'. Guidance as to what this means has been given by the Court of Appeal in the Olympic Airlines case.

As to the rationale for allowing the opening of secondary proceedings, it is worth noting that recital 19 to the EC Regulation provides that:

'Secondary insolvency proceedings may serve different purposes, besides the protection of local interests. Cases may arise where the estate of the debtor is too complex to administer as a unit or where differences in the legal systems concerned are so great that difficulties may arise from the extension of effects

deriving from the law of the State of the opening to other States where the assets are located. For this reason the liquidator in the main proceedings may request the opening of secondary proceedings when the efficient administration of the estate so requires.'

## Background

Olympic Airlines SA ('Olympic') was a Greek airline. Olympic's COMI was Greece, but it also carried on business in England, with a head office in London, as well as offices in Heathrow and Manchester, and around 27 employees in the jurisdiction.

Following a decision of the European Commission in September 2008 to the effect that the company had received illegal state aid, Olympic went into insolvent liquidation in Greece in October 2009. Olympic's COMI being in Greece, the Greek proceedings were main proceedings.

Olympic's liquidation left the pension scheme of which its UK employees were members with a deficit of over GBP 15 million. The pension did not, however, fall within the scope of the Pension Protection Fund ('the PPF') because the Greek liquidation of the company did not constitute a qualifying insolvency event for the purposes of English pensions legislation. Only if insolvency proceedings were commenced in England could the PPF assume responsibility for the scheme.

That being the case, the trustees of the pension scheme presented a petition to wind up Olympic in England (opening secondary proceedings) on the basis that the company was unable to pay its debts. In order for the petition to succeed the trustees needed to show that the company had an establishment in England at the relevant time (an establishment being necessary for opening of secondary proceedings in a Member State as explained above). The relevant time was the date on which the petition to open the secondary proceedings was presented (see *Re Office Metro* [2012] EWHC 1191 (Ch)), 20 July 2010.

Olympic's Greek liquidator opposed the trustees' petition, arguing that the company did not have an establishment in England on or after 20 July 2010. If the Greek liquidator was right, it would follow that

the English Court would have no jurisdiction to make the winding up order sought by the pension scheme trustees.

## Relevant facts

As at the relevant date, Olympic's Heathrow ticket office had closed and its Manchester premises had been vacated, though a London office had been retained. The employment contracts of Olympic's UK staff had been terminated on 14 July 2010. A couple of staff (the London branch's financial manager and former general manager) had, however, been re-employed on short term contracts to assist with the company's winding up; they were not selling tickets to customers.

## High Court decision

At first instance the Morritt C held that Olympic did have an establishment in England at the relevant date (see [2012] EWHC 1413).

Olympic's Greek liquidator appealed on the ground that for there to be an establishment for the purposes of the Regulation there needs to be more than Chancellor found. In other words, it was argued that 'the desultory internal running down of a business such as may have been indicated by the Chancellor's findings did not count'. What is needed for there to be an establishment for the purposes of the Regulation, the Greek liquidator argued, was some more than transitory economic activity that is external or market facing. The Chancellor had rejected an argument along those lines, concluding that the word 'economic' does not carry any external market overtones.

## The Court of Appeal's decision

The Court of Appeal reviewed what case law there is on the meaning of 'establishment' for the purposes of the Regulation, noting that in *Re Office Metro Ltd* [2012] EWHC 1191 (Ch) Mann J held there was on the facts of that case a place of operation and some activity by human means, but there was nothing that amounted to economic activity and therefore no establishment. It is worth noting what Mann J said in this regard at [31]:

'... By the time of the petition it seems that the only "activity" (and I deliberately put it in inverted commas) was to sit there being liable on guarantees, sometimes paying out on them, and perhaps doing whatever else was necessary to keep itself alive in terms of compliance with formalities such as company filings. Mr Wetheral (or perhaps his staff) occasionally sought legal or accounting advice, but there is no evidence it was doing anything else. Being

in a state of liability, with the need sometimes to pay out on that liability and take a bit of advice, is not an economic activity for the purposes of the Regulation. Neither is seeking accounting or legal assistance on other matters. Forwarding post (which is said to have happened at Chertsey) is not an economic activity carried on there. It is something which goes on so that someone can carry it on somewhere else. Utilising the guidance given in the Virgós-Schmit report, *it is not conducting activities on the market.*' (emphasis added)

The Court of Appeal also referred to the decision of the European Court of Justice ('ECJ') in *Interedil SRL (in liq.) v Palimto Interedil SRL* (Case C-396/09) [2012] BCC 851. In that case the ECJ said at [64]:

'The answer to the second part of Question 3 is therefore that the term "establishment" within the meaning of art.3(2) of the Regulation must be interpreted as requiring the presence of a structure consisting of a *minimum level* of organisation and a *degree* of stability necessary for the purpose of pursuing an economic activity. The presence alone of goods in isolation or bank accounts does not, in principle, meet that definition.' (emphasis added)

On behalf of the trustees of the Olympic pension scheme it was argued that the ECJ in that case was indicating by such language as 'minimum level' of organisation and 'a degree' of stability that the requirements were minimal as well as minimum. It was submitted that the definition of establishment in the Regulation was intended to be very broad and was easily met, with there being no need to show outward facing economic activity.

The Court of Appeal (Sir Bernard Rix with whom Moore-Bick LJ and Sir Stephen Sedley agreed), however, rejected the trustees' argument in this regard, saying that in *Interedil* the ECJ was, if anything, underlining the possible inadequacy of evidence of economic activity in Italy, despite the existence there of leasing and banking agreements.

Moreover, the Court of Appeal considered that the High Court's decision that market facing economic activity was not required was wrong. That decision, the Court of Appeal said, failed adequately to take into account the fact that the Virgós-Schmit report, an authoritative commentary on the Regulation, refers to economic activity being 'exercised on the market'.

The Court of Appeal also considered that the High Court had failed adequately to take into account the fact that the Regulation is concerned with insolvency proceedings of all kinds, not just winding up. On this latter point, the Chancellor had noted that in general companies in liquidation do not engage in external market activities any longer. However, the Court of Appeal placed emphasis on the fact that, even though secondary proceedings which follow the opening of

main proceedings must be winding up proceedings, secondary proceedings which precede the opening of main proceedings do not have to be winding up proceedings. The Court of Appeal also noted that even a company in liquidation may continue to trade for a while.

The Court of Appeal also considered that its conclusion was supported by the rationale behind secondary proceedings, saying at [31] that:

‘... secondary proceedings may also be opened in a different state but only where the debtor has an “establishment” as defined. This establishment plainly does not amount to a centre of main interests, but it provides the analogous requirement “on the ground” to make it appropriate to invoke the jurisdiction of the local supervisory courts. As recital (19) of the Regulation indicates, the primary purpose of secondary proceedings is “the protection of local interests”, namely the interests of creditors who have been dealing with an establishment which survives as such up to the date in question. If, however, such an establishment could be provided by the desultory winding-up of any business with a former “place of operations” as long as the location of such has, at the critical date, not yet been disposed of, and as long as some “human means” activity is involved (such as could be provided by almost a single caretaker of a dormant operation, or even by the obtaining of ad hoc legal or accountancy advice) and as long as some assets survive, perhaps, as in this very case, no more than the worthless detritus of a defunct operation, then there would hardly ever be secondary proceedings which did not come within the definition: which is plainly not intended to be the case.’

As such, the Court of Appeal concluded that economic activity being exercised on the market was required for there to be an establishment. On the facts there was no such activity, so there was no establishment. It followed that the English Court had no jurisdiction to make the winding up order sought by the pension scheme trustees. The Greek liquidator’s appeal was therefore allowed.

## Conclusion

Perhaps suggesting a higher test than might previously have been envisaged, the case obviously provides guidance as to what constitutes an establishment for the purposes of the Regulation.

The decision is, however, not ideal insofar as its impact on UK pension schemes for employees of companies with a COMI in another Member State is concerned. There is clearly a hole in the protection afforded by UK pensions legislation in this regard in that the opening of main proceedings in the Member State of the company’s COMI does not constitute a qualifying insolvency event.

The trustees have applied to the Supreme Court for permission to appeal, but have yet to hear back at the time of writing. In the event that the trustees do not succeed in an appeal to the Supreme Court, it may be necessary to amend the UK’s pensions legislation, unless the Regulation is amended to provide that the relevant date is the date of the opening of the main proceedings (which might on the facts have led to a different result).

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