

South Square Articles 2008

- 1 *Anti-suit Injunctions Against Foreign Insolvency Proceedings: AWB Geneva SA & Anor v North America Steamships Ltd & Anor* [2007] EWHC 1167 (Comm); [2007] EWCA Civ 739
Robin Dicker QC and Stephen Robins
- 7 *Re Cheyne Finance plc and Commercial Insolvency*
Richard Fisher
- 13 *Slimming Down Businesses: When Are Dismissals Unfair or Not?*
David Marks
- 16 *A Phoenix Syndrome in Every Sense of the Word ...*
David Marks
- 19 *Re Whistlejacket Capital Limited* [2008] EWCA Civ 575 and the Race to Priority
Georgina Peters
- 22 *Did Judge Lifland's Bear Stearns Decision Start a Revolution?*
Ronald DeKoven and Brian Hauck
- 24 *Josef Syska and Elektrim SA (in administration) v Vivendi Universal SA and others* [2008] EWHC 2155 (Comm)
Adam Al-Attar

Editor-in-Chief

Mark Fennessy, Proskauer Rose LLP, London

Publisher

Sasha Radoja, Travers Smith LLP, London

Editorial Board

Emanuella Agostinelli, Curtis, Mallet-Prevost, Colt & Mosle LLP, Milan

Scott Atkins, Norton Rose Fulbright, Sydney

James Bennett, KPMG, London

Prof. Ashley Braganza, Brunel University London, Uxbridge

Dan Butters, Deloitte, London

Geoff Carton-Kelly, FRP Advisory, London

Gillian Carty, Shepherd and Wedderburn, Edinburgh

Charlotte Cooke, South Square, London

Sandie Corbett, Walkers, British Virgin Islands

Katharina Crinson, Freshfields Bruckhaus Deringer, London

Hon. Robert D. Drain, United States Bankruptcy Court, Southern District of New York

Matthew Kersey, Russell McVeagh, Auckland

Prof. Ioannis Kokkoris, Queen Mary, University of London

Prof. John Lowry, University College London, London

Neil Lupton, Walkers, Cayman Islands

Lee Manning, Deloitte, London

Ian McDonald, Mayer Brown International LLP, London

Nigel Meeson QC, Conyers Dill Pearson, Hong Kong

Prof. Riz Mokal, South Square, London

Mathew Newman, Ogier, Guernsey

Karen O'Flynn, Clayton Utz, Sydney

Prof. Rodrigo Olivares-Caminal, Queen Mary, University of London

Christian Pilkington, White & Case LLP, London

Susan Prevezer QC, Quinn Emanuel Urquhart Oliver & Hedges LLP, London

Sandy Purcell, Houlihan Lokey Howard & Zukin, Chicago

Prof. Arad Reisberg, Brunel University, London

Jeremy Richmond, Quadrant Chambers, London

Daniel Schwarzmann, PricewaterhouseCoopers, London

The Hon. Mr Justice Richard Snowden, Royal Courts of Justice, London

Anker Sørensen, De Gaulle Fleurance & Associés, Paris

Kathleen Stephansen, New York

Angela Swarbrick, Ernst & Young, London

Dr Artur Swierczok, CMS Hasche Sigle, Frankfurt

Stephen Taylor, Isonomy Limited, London

Richard Tett, Freshfields Bruckhaus Deringer, London

William Trower QC, South Square, London

Mahesh Uttamchandani, The World Bank, Washington, DC

Robert van Galen, NautaDutilh, Amsterdam

Miguel Virgós, Uría & Menéndez, Madrid

Prof. em. Bob Wessels, University of Leiden, Leiden, the Netherlands

Maja Zerjal, Proskauer Rose, New York

Dr Haizheng Zhang, Beijing Foreign Studies University, Beijing

US Corner

Editor: **Maja Zerjal**, Proskauer, New York

Economists' Outlook

Editors: **Prof. Ashley Braganza**, Brunel University London, Uxbridge

Prof. Ioannis Kokkoris, Queen Mary, University of London

Kathleen Stephansen, Huawei Technologies U.S.A., New York

Mahesh Uttamchandani, The World Bank, Washington, DC

Case Review Section

Editors: **Charlotte Cooke**, South Square, London

Prof. John Lowry, University College London, London

Dr Arad Reisberg, Brunel University, London

Publishers

Chase Cambria Company (Publishing) Ltd

4 Winifred Close

Barnet, Arkley

Hertfordshire EN5 3LR

United Kingdom

Annual Subscriptions

A hardcopy subscription is EUR 730 / USD 890 / GBP 520; online: EUR 730 / USD 890 / GBP 520; and hardcopy + online: EUR 840 / USD 1045 / GBP 625. Rates per additional hardcopy or online user are: EUR 165 / USD 220 / GBP 145.

VAT is charged on online and hardcopy + online subscriptions. Hardcopy-only is zero-rated for VAT purposes. For package subscriptions, VAT is charged on the entire package.

For enquiries, please contact our sales department at: + 44 (0) 114 255 9040 or sales@chasecambria.com

Special Issues

Price for individual Special Issues for subscribers: EUR 125 / USD 175 / GBP 105; for non-subscribers: EUR 165 / USD 225 / GBP 135. Online access to all Special Issues for subscribers: EUR 375 / USD 535 / GBP 315; for non-subscribers: EUR 495 / USD 695 / GBP 420. Online subscription plus access to all Special Issues: EUR 995 / USD 1250 / GBP 740. Hardcopy + online subscription plus access to all Special Issues: EUR 1150 / USD 1450 / GBP 875.

Advertisements

For advertisements please contact:

ads@chasecambria.com

Copyright

ISSN: 1572-4638

© 2019 Chase Cambria Company (Publishing) Ltd

Permissions

All rights reserved. No part of this publication may be reproduced, stored in a retrieval system, or transmitted in any form or by any means, mechanical, photocopying, recording or otherwise, without prior permission of the publishers.

Permission to photocopy must be obtained from the copyright owner. Please apply to:

E-mail: permissions@chasecambria.com

Website: www.chasecambria.com

Disclaimer

The information and opinions provided on the contents of the journal was prepared by the author/s and not necessarily represent those of the members of the Editorial Board or of Chase Cambria Company (Publishing) Ltd. Any error or omission is exclusively attributable to the author/s. The content provided is for general purposes only and should neither be considered legal, financial and/or economic advice or opinion nor an offer to sell, or a solicitation of an offer to buy the securities or instruments mentioned or described herein. Neither the Editorial Board nor Chase Cambria Company (Publishing) Ltd are responsible for investment decisions made on the basis of any such published information. The Editorial Board and Chase Cambria Company (Publishing) Ltd specifically disclaims any liability as to information contained in the journal.

Anti-suit Injunctions Against Foreign Insolvency Proceedings: *AWB Geneva SA & Anor v North America Steamships Ltd & Anor* [2007] EWHC 1167 (Comm); [2007] EWCA Civ 739

Robin Dicker QC and Stephen Robins, Barrister, 3–4 South Square, Gray's Inn, London, UK¹

Introduction

Recently Field J and the Court of Appeal (Thomas, Chadwick and Latham LJJ) were called on to consider, amongst other things, whether a party to a contract governed by English law and subject to the exclusive jurisdiction of the English Courts was entitled to rely on those provisions to restrain the counterparty's foreign trustee in bankruptcy from seeking an order in foreign insolvency proceedings that certain conditions precedent to liability under the contract should cease to apply. This article explains the facts and the narrow 'contractual' decisions of Field J and the Court of Appeal before considering the issues in the wider domestic and international 'insolvency' context.

Background

The first claimant ('AWB') and the second claimant ('Pioneer') entered into a number of freight forward swap agreements ('FFAs') with North America Steamships Ltd ('NASL'), a company incorporated in Canada. The FFAs were governed by the ISDA Master Agreement and were subject to an exclusive jurisdiction clause in favour of the English Courts and an English governing law clause. Under section 2(a)(iii) of the ISDA Master Agreement, the obligations of any party were subject to the condition precedent that no event of default had occurred and was continuing in respect of the other party. The events of default included balance sheet insolvency, cash flow insolvency, non-payment of any sums due under the FFAs, the commencement of insolvency proceedings, and compositions and arrangements with creditors.

NASL became insolvent and entered into bankruptcy in Canada, its jurisdiction of incorporation. Its property was assigned to a Canadian bankruptcy trustee ('the trustee'). AWB and Pioneer, which but for NASL's

insolvency and bankruptcy would have become obliged to pay substantial sums to NASL under the FFAs if the transactions were closed out at that date, indicated that, rather than terminating the FFAs, they intended to rely instead on section 2(a)(iii) of the ISDA Master Agreement to contend that events of default had occurred and were continuing in respect of NASL and that accordingly no liability on their part could or would now ever arise.

In response, the trustee proposed to apply to the Canadian Court for NASL's restructuring under the Canadian Companies' Creditors Arrangement Act ('the CCAA'), which provides for majority-approved restructurings in accordance with a process that is broadly comparable with schemes of arrangement and CVAs under English law. The restructuring that was proposed was in the nature of a debt-for-equity swap. The trustee intended that the restructuring would, amongst other things, restore NASL to solvency (thus bringing an end to any cash-flow and balance-sheet insolvency events of default) and terminate NASL's bankruptcy proceedings (thus bringing an end to any bankruptcy event of default). In this way, the trustee hoped to remove the existence of any continuing events of default and, in consequence, the ability of AWB and Pioneer to rely on section 2(a)(iii) of the ISDA Master Agreement, so as to oblige them to pay the substantial sums to NASL which, but for its insolvency and bankruptcy, he anticipated would in due course become due and owing under the FFAs.

However, the trustee was concerned that the restructuring would itself amount to a further event of default (in the nature of a composition or arrangement with NASL's creditors) and, whilst 'wiping the slate clean' as regards the previous events of default, would itself provide AWB and Pioneer with a further ground for contending that section 2(a)(iii) of the ISDA Master Agreement prevented any liability on their part from arising.

Notes

¹ The authors were instructed as Leading and Junior Counsel for the Defendants at first instance and before the Court of Appeal.

Accordingly the trustee proposed to seek an order from the Canadian Court restraining contractual counterparties from relying on any insolvency, bankruptcy or restructuring related events of default. The Canadian Court's jurisdiction to make such an order existed under section 11 of the CCAA, which provided that the Canadian Court was entitled to stay 'proceedings'. Canadian Courts had interpreted the word 'proceedings' very widely to include extra-judicial conduct that could impair the ability of the debtor company to continue in business² and stays were commonly granted under section 11 of the CCAA to restrain counterparties to contracts with the debtor company from relying on insolvency, bankruptcy or restructuring related events of default. One ground upon which such an order would have been sought, although not a necessary ground, was that section 2(a)(iii) of the ISDA Master Agreement operated as a fraud on the bankruptcy laws under Canadian insolvency law. Accordingly, the trustee sought an order from the Canadian Court restraining any party to any agreement with NASL from refusing to 'perform any obligations or make any payments to NASL' by reason of any insolvency, bankruptcy or restructuring related events of default.

AWB and Pioneer commenced proceedings in England for declarations that events of default had occurred and were continuing in respect of the FFAs and for an anti-suit injunction restraining NASL and/or the trustee from seeking any order under section 11 of the CCAA which would have the effect of restraining them from relying on the events of default. They contended that: (1) the effect of an order of the Canadian Court under section 11 of the CCAA would be to deprive them of their contractual defence under section 2(a)(iii) of the ISDA Master Agreement; (2) the trustee was seeking to ride roughshod over the express terms of a standard form international agreement in an attempt to saddle them with liabilities which they would not otherwise have been under; and (3) in this way, the trustee's application to the Canadian Court was an attempt to re-write the contractual obligations of the parties and therefore fell within the scope of the exclusive jurisdiction clause.

The decision of Field J

At first instance, Field J dismissed the claim for an anti-suit injunction. He held that the exclusive jurisdiction clause under the FFAs applied only 'where one of the parties [was] seeking a judicial determination on the rights or obligations of one or both of them existing under the contract'.³

However, in applying to the Canadian Court under the CCAA, the trustee was not seeking such a determination, but was 'seeking relief in insolvency proceedings that is intended to prohibit various counterparties, including AWB and Pioneer, from relying on certain contractual rights which they might otherwise be entitled to rely on'.⁴ In other words, the trustee's petition under the CCAA was 'not an attempt by the trustee to assert NASL's contractual rights against AWB and Pioneer under the FFAs but [was] an application to the Canadian Court under the free-standing statutory regime of the CCAA'.

The Judge also held that the trustee's application to the Canadian Court was not vexatious or oppressive⁵ and that accordingly 'the trustee should be left free to apply to the Canadian Court'.⁶

Although AWB and Pioneer had relied on the decision of Hirst J in *Felixstowe Dock & Railway Co v United States Lines*,⁷ in which Hirst J had continued a freezing injunction in the face of a restraining order made by the United States Bankruptcy Court, Field J considered that the situation of that case was 'far removed from that now before the Court' and that, in the light of Lord Millett's extra-judicial criticism of Hirst J's approach,⁸ the decision of Hirst J was in any event 'unlikely to be followed today'.⁹ The Judge also stayed the claim for declaratory relief.¹⁰

The decision of the Court of Appeal

AWB and Pioneer sought permission to appeal. The Court of Appeal dealt with the matter on the basis that the application for permission to appeal and, if permission was granted, any substantive appeal, would be heard together at one hearing. The leading decision was given by Thomas LJ, with whom Latham and Chadwick LJJ concurred. He refused permission to appeal against

Notes

- 2 *Norcen Energy Resources Ltd v Oakwood Petroleum Ltd* (1988) 72 CBR (NS) 1; *Re T Eaton & Co* (1997) 46 CBR (3d) 293; *Re Playdium Enterprises Corp* (2001) 31 CPR (4th) 302; *Re Doman Industries* (2003) 41 CBR (4th) 29.
- 3 [2007] EWHC 1167 (Comm) at para. 28.
- 4 *Ibid.*
- 5 [2007] EWHC 1167 (Comm) at para. 31.
- 6 [2007] EWHC 1167 (Comm) at para. 35.
- 7 [1989] 1 QB 306.
- 8 See *Int. Insol. Rev.*, vol 6: 99-133 (1997) at 107-108.
- 9 [2007] EWHC 1167 (Comm) at para. 34.
- 10 [2007] EWHC 1167 (Comm) at para. 36.

the Judge's dismissal of the application for an anti-suit injunction on the basis that 'the proceedings in Canada were not within the scope of the [exclusive jurisdiction] clause'.¹¹ He said:

[26] ... Clearly, if the proceedings in Canada were proceedings which related to a dispute under the contract, then that would be characterised as a contractual issue and subject to the exclusive jurisdiction clause, which I accept is wide in its scope.

[27] However, that is not the nature of the proceedings in Canada. Those proceedings are part of insolvency proceedings and the issues that arise within them are governed by Canadian law ... It is, in my view, a matter for the Canadian Court to decide on the relief that it is prepared to grant within the scope of those proceedings as it is concerned with issues of insolvency and not with issues that relate to the contractual obligations under the agreement. The application in relation to the exercise of its insolvency jurisdiction is therefore not within the clause'.

However, Thomas LJ emphasised that it was 'important to distinguish between the issue of construction and the issues of the recognition and enforcement of any order [of the Canadian Court] ... in England and Wales'.¹² The question whether the English Court would ultimately recognise and enforce any order of the Canadian Court under section 11 of the CCAA, whether on an application by the trustee under section 426 of the Insolvency Act 1986 or on some other basis, was a question for another day. Thomas LJ said: 'These issues simply do not arise on this appeal; they relate to the effect of any order of the Canadian Court on the contractual rights and the recognition an English Court might give to such an order'.¹³

The Court of Appeal allowed the appeal against the stay of the claim for declaratory relief on the basis that the ISDA Master Agreement 'is widely used in all types of derivative transaction on the international markets and thus plays an important role in the efficient functioning of the international markets and their financial stability' and because any challenge to the effectiveness of section 2(a)(iii) as a matter of English law 'could, if correct, ... have wide ramifications for the financial markets'.¹⁴ In other words, if there was any argument that, as a matter of contract, AWB and Pioneer were

not entitled to rely on section 2(a)(iii) of the ISDA Master Agreement, that issue should be resolved as soon as possible.

Commentary

Field J and Thomas LJ dismissed AWB's and Pioneer's application for an anti-suit injunction on a narrow 'contractual' basis by considering, as a matter of construction, whether the trustee's application to the Canadian Court for relief under section 11 of the CCAA fell within the scope of the exclusive jurisdiction clause. They held that the exclusive jurisdiction clause related to the 'judicial determination on the rights or obligations of one or both of them existing under the contract' (per Field J)¹⁵ or, put another way, 'proceedings which related to a dispute under the contract' (per Thomas LJ)¹⁶ and that an application to the Canadian Court for relief under an insolvency statute was not within the scope of the clause.

It is respectfully suggested that this reasoning was plainly correct. Exclusive jurisdiction clauses embody 'a mutual agreement under which both parties agree with each other as to the relevant jurisdiction for the resolution of disputes' under the contract.¹⁷ However, the trustee's application to the Canadian Court did not seek the resolution of a dispute. The Canadian Court was not being asked to determine any dispute as to existing rights; rather, it was being asked to exercise its insolvency jurisdiction to create new rights. The proceedings before the Canadian Court were not in the nature of a *lis inter partes* and involved no adjudication on any dispute within the scope of the exclusive jurisdiction clause. Put another way, they were not a 'suit' against which an 'anti-suit' injunction could be granted.

However, it is suggested that the conclusion reached by Field J and Thomas LJ was also justifiable on the basis of wider non-contractual 'insolvency' considerations.

First, the English Court has a duty at common law, which has been reinforced by section 426 of the Insolvency Act 1986 and the Cross Border Insolvency Regulations 2006, enacting the UNCITRAL Model Law on Cross Border Insolvency, to provide assistance to foreign insolvency officeholders and foreign courts conducting insolvency proceedings.¹⁸ It would generally be

Notes

11 [2007] EWCA Civ 739 at para. 2.

12 [2007] EWCA Civ 739 at para. 22.

13 [2007] EWCA Civ 739 at para. 32.

14 [2007] EWCA Civ 739 at para. 37.

15 [2007] EWHC 1167 (Comm) at para. 28.

16 [2007] EWCA Civ 739 at para. 26.

17 *The Mahkutai* [1996] AC 650 at 666B-C.

18 See, for the position at common law, *Banque Indosuez SA v Ferromet Resources Inc* [1993] BCLC 122 at 117 (Hoffmann J) and *Cambridge Gas*

contrary to principle for the English Court to grant an injunction to restrain foreign officeholders from seeking relief from foreign courts under foreign insolvency statutes, particularly where the company in question was incorporated in the relevant foreign jurisdiction.

Secondly, it is to be recalled that the powers of courts to promulgate schemes of arrangement are delegated legislative functions, not purely judicial functions. Prior to the enactment of the Railway Companies Act 1867 and the Joint Stock Companies Arrangement Act 1870, it was necessary for schemes of arrangement in England to be achieved by way of a specific Act of Parliament.¹⁹ Even now, as a matter of English law, it is the Act of Parliament²⁰ which gives binding force to a scheme of arrangement.²¹ The position in Canada is essentially the same. Before the enactment of the CCAA in 1933, 'the old English practice of passing a special Act in each particular case' prevailed.²² If the CCAA had never been passed, NASL's restructuring would have been achieved by an Act of the Canadian legislature, and it is unreal to think that the English Court would have entertained the possibility of injuncting a foreign legislature from carrying out its ordinary legislative business. Since the delegation of that function from the legislature to the courts, in Canada as in England, has not changed the nature of the function, it is suggested that an injunction against the exercise of that function would continue to be contrary to principle.

Thirdly, the conclusion reached by Field J and Thomas LJ accords with the approach adopted, on wider 'insolvency' grounds, in the United States and the European Union. As a matter of US jurisprudence, it appears firmly established that the court of one State will ordinarily ignore an exclusive jurisdiction clause, even where such clause might purport to apply, and stay its own civil proceedings in favour of collective insolvency proceedings in some other State or foreign jurisdiction, which will be recognised as having an overriding effect.²³ Similarly, where main proceedings under Article 3 of Council Regulation (EC) No 1346/2000 (the Insolvency Regulation) have been commenced in one Member State, the courts of other

Member States are bound to recognise the overriding effects of the main proceedings, including on 'current contracts to which the debtor is a party' (Article 4(2) (e)) and 'the rules relating to the voidness, voidability or unenforceability of legal acts detrimental to all the creditors' (Article 4(2)(m)). Any proceedings deriving directly from main proceedings in one Member State and being closely connected with them will fall outside the scope of Council Regulation (EC) No 44/2001 (the Judgments Regulation) and may (if the law of the main proceedings so provides) override contractual rights irrespective of exclusive jurisdiction clauses in favour of some other Member State.²⁴ It is also suggested that the position in the United States and the European Union accords with the demands of comity and judicial restraint commended by Lord Millett, writing extra-judicially,²⁵ and ought therefore to be followed in England.

For these three reasons, it is suggested that wider 'insolvency' considerations provide a further basis for the decisions of Field J and Thomas LJ, in addition to the narrow 'contractual' grounds actually relied on.

Two further issues

The trustee's proposed proceedings in England to enforce the FEAs, following the proposed restructuring, would have been commenced pursuant to section 426 of the Insolvency Act 1986, on the basis of a letter of request from the Canadian Court asking the English Court to recognise and enforce the Canadian Court's order under section 11 of the CCAA restraining AWB and Pioneer from relying on section 2(a)(iii) of the ISDA Master Agreement. This proposal gave rise to two further interesting issues.

The first was whether, as a matter of principle, the English Court would recognise and enforce the Canadian Court's order, given that the FEAs were contracts governed by English law and subject to an exclusive jurisdiction clause in favour of the English Courts. AWB and Pioneer contended that any variation of English law obligations by operation of a foreign law would be

Notes

Transport Corp v Official Committee of Unsecured Creditors of Navigator Holdings plc [2006] UKPC 26, [2006] 3 All ER 829, at paras 20-21 (Lord Hoffmann); see also the observations of the Canadian Court in *Re Olympia & York Developments Ltd* (1996) 29 OR (3d) 626 at 633. For the position under s 426 of the Insolvency Act 1986, see *Hughes v Hannover Ruckversicherungs-Aktiengesellschaft* [1997] 1 BCLC 497 at 518G (Morritt LJ).

19 *Re Cambrian Railways Company's Scheme* (1868) LR 3 Ch App 278 at 294 (Lord Cairns).

20 Companies Act 1985, s 425; Companies Act 2006, ss 895-901.

21 *Devi v People's Bank of Northern India Ltd* [1938] 4 All ER 337 at 343 (Lord Romer) and *Kempe v Ambassador Insurance Co* [1998] 1 WLR 271 at 276D-E (Lord Hoffmann).

22 *Canada Southern Railway Co v Gebhard* 109 US 527 at 534 (Supreme Court, 1883).

23 See *In re Gercke* 122 BR 621 (1991) at 632; *Re Hopewell International Insurance Ltd* 238 BR 25 (1991) at 63-64; *JP Morgan Chase Bank v Altos Hornos de Mexico SA* 412 F Ed 418 (2nd Cir, 2005); see also *Kenner Products Co v Societe Fonciere et Financiere Agache-Willot* 532 F Supp 478 (1982) at 479-480; *Allstate Life Insurance Co v Linter Group Ltd* 994 F 2d 996 (2nd Cir, 1993) at 1000; *Re Vesta Fire Insurance Corp* 244 BR 209 (2000) at 216.

24 See Virgos & Garcimartin, *European Insolvency Regulation*, pp 121-122.

25 See *Int. Insol. Rev.*, vol 6: 99-133 (1997) at 107-108.

regarded by the English Courts as ineffective, by virtue of the principle in *Gibbs v Societe Industrielle des Metaux*.²⁶ The trustee contended that section 426(5) of the Insolvency Act 1986, which entitled the English Court to apply Canadian law, meant that the contractual obligations of AWB and Pioneer would be affected only by English law, the proper law of the FFAs, as enlarged by section 426(5) to include Canadian law, and not by Canadian law alone. Field J was inclined to agree with this analysis. He said:

‘There is ... force in [the trustee’s] submission that, in any event, the common law rule in *Gibbs* will not apply to prevent the English Court from recognising and giving effect to the Canadian plan of reconstruction and [the order of the Canadian Court under section 11 of the CCAA] on the trustee’s proposed application under section 426 of the 1986 Act. This is because under that provision the court can apply foreign insolvency law in an appropriate case and if it does so on the trustee’s application the effect of the foreign law on the FFAs would operate in accordance with and pursuant to English law. In other words, by virtue of the governing English law, including, as part of that law, section 426, the foreign order will affect the FFAs’.²⁷

In the Court of Appeal, Thomas LJ said that the issue ‘simply [did] not arise on this appeal’ and accordingly declined to consider it.²⁸ Accordingly Field J’s view remains the last word on this issue for the present.

The second issue was whether the effect of any order of the Canadian Court would be capable of being recognised by the English Court under section 426 of the Insolvency Act 1986, in particular given the terms of sections 426(5) and (10).

The trustee contended that the power of the Canadian Court to grant a stay of proceedings under section 11 of the CCAA, which had the effect of preventing a counterparty from relying on an insolvency related event of default, in the context of restructuring proceedings, ‘corresponded’ with English law for the purposes of section 426(10) of the 1986 Act.

The trustee also contended that section 2(a)(iii) of the ISDA Master Agreement was void as a fraud on the bankruptcy laws under Canadian insolvency law. The trustee’s expert evidence on Canadian law, from a former Justice of the Superior Court of Ontario, was to the effect that the Canadian Courts would be likely to decline to give effect to section 2(a)(iii) of the ISDA Master Agreement in any event (irrespective of any order under section 11 of the CCAA restraining AWB and Pioneer from relying on it) on the basis that any attempt to relieve a party of its duty to perform a contract when the other party was insolvent would constitute a fraud on the bankruptcy laws.²⁹

The position under English law³⁰ on this issue is less clear, although it is generally considered that there is an important (although perhaps at times rather fine) distinction to be drawn between, on the one hand, the prevention of an obligation from arising by reason of a bankruptcy event of default³¹ and, on the other hand, the deprivation of a vested asset on bankruptcy.³² The former is generally considered to be permissible;³³ the latter to be a fraud on the bankruptcy laws. However, the point has never been determined by the English Courts with regard to the operation of section 2(a)(iii) of the ISDA Master Agreement,³⁴ and Thomas LJ considered the argument to be one of fundamental importance,³⁵ adding: ‘The sooner the issues raised are determined the better’.³⁶

Notes

26 (1890) 25 QBD 338; see also *National Bank of Greece & Athens SA v Metliss* [1958] AC 509 and *Adams v National Bank of Greece SA* [1961] AC 255.

27 [2007] EWHC 1167 (Comm) at para. 33.

28 [2007] EWCA Civ 739 at paras 31-32.

29 See, for example, *Canadian Imperial Bank of Commerce v Bramalea Inc* (1995) 33 OR (3d) 692 (Ont. Gen. Div.).

30 See *Ex parte Mackay* (1873) LR 8 Ch App 643 and *British Eagle International Air Lines Ltd v Compagnie Nationale Air France* [1975] 1 WLR 758.

31 E.g. a condition precedent that no obligation to make payment will arise if a bankruptcy event of default in respect of the other party has occurred and is continuing.

32 E.g. a clause stating that all existing obligations to pay money will be terminated automatically by the bankruptcy of the creditor.

33 See, for example, Coleman, *Butterworths Journal of International Banking and Financial Law*, vol 8:1, pp 229-240, esp. pp 229-231.

34 It may be the case that, on a proper analysis, the rule prohibiting frauds on the bankruptcy laws has two sub-rules: one relating to assets in the estate, which provides that an interest determinable on bankruptcy is void as a fraud on the bankruptcy laws; and another relating to claims against the estate, which provides that any contractual provision for claims against the estate to be increased on bankruptcy is void as a fraud on the bankruptcy laws. Although *Ex parte Mackay* (1873) LR 8 Ch App 643 concerned the former aspect, James LJ also touched on the second aspect, saying that it would be a fraud on the bankruptcy laws for an ‘article sold to a bankrupt ... [to] be sold under the stipulation that the price should be doubled in the event of his becoming bankrupt’. This passage was cited by the House of Lords in *British Eagle International Air Lines Ltd v Compagnie Nationale Air France* [1975] 1 WLR 758. Accordingly, even having regard to the recognised distinction between the prevention of an obligation from arising by reason of a bankruptcy event of default and the deprivation of a vested asset on bankruptcy, there may (depending on the facts) be an issue as to whether section 2(a)(iii) of the ISDA Master Agreement eliminates the possibility of set-off and so is void by reason of increasing the quantum of the solvent counterparty’s claims against the estate.

35 [2007] EWCA Civ 739 at paras 15 and 37.

36 [2007] EWCA Civ 739 at para. 37.

On the trustee's application under section 426 of the 1986 Act, the differences (if any) between Canadian law and English law in these regards could have become of crucial importance. In order for Canadian insolvency law to be applied by the English Court pursuant to section 426(5) of the Insolvency Act 1986, it would have been necessary for the English Court to conclude that Canadian law 'corresponded' sufficiently with English law for the purposes of section 426(10) of the 1986 Act, notwithstanding the fact that English law may not have been precisely the same. This would in turn have raised an interesting issue as to the precise degree of 'correspondence' required under section 426(10) in order for the foreign law to qualify for application by the English Court under section 426(5). This is an issue which has not yet been considered by the English Courts in any detail.³⁷

Conclusion

The decisions of Field J and Thomas LJ provide a useful analysis of the scope of exclusive jurisdiction clauses as a matter of contract. However, the decisions may also be justified on the basis of the additional non-contractual

considerations identified above. The trustee's subsequent attempts to enforce the order of the Canadian Court in England under section 426 of the Insolvency Act 1986 would have given rise to perhaps even more interesting issues, including the applicability of *Gibbs* on an application under section 426 in light of the English Court's express statutory power under section 426(5) to apply foreign law, and whether the Canadian Court's power to grant stays under section 11 of the CCAA and the position under Canadian law on frauds on the bankruptcy laws corresponded sufficiently with the position under English law to be applicable under section 426(5) and (10) of the 1986 Act.³⁸ At an even more fundamental level, the case raised obvious tensions between the policy of the Courts to uphold commercial transactions, particularly ones which involve the swaps market, and the policy of assisting foreign insolvency proceedings which are taking place in the debtor's place of incorporation and centre of main interests. However, since the parties reached an amicable resolution of the issues between them following the decision of the Court of Appeal, no further proceedings will follow, and the resolution of these interesting points of principle will have to wait until another such case presents itself for determination.

Notes

37 However, see *Slim v Official Receiver* [2000] BPIR 847, in which the Court of Appeal of the Royal Court of Guernsey held that the Alderney Court did have power to comply with a request from the English Court by ordering the examination of an Alderney resident under section 236 of the Insolvency Act 1986, notwithstanding the fact that Alderney legislation contained no similar provision. The US jurisprudence on the proper approach under § 304 is illuminating: see, for example, *Re Blackwell* 270 BR 814 (2001), where the court held that precise 'congruence' was unnecessary.

38 See the various issues which Thomas LJ said 'simply [did] not arise on this appeal' and accordingly declined to consider: [2007] EWCA Civ 739 at paras 31-32.

Re Cheyne Finance plc and Commercial Insolvency

Richard Fisher, Barrister, 3–4 South Square, London, UK

I. Introduction

Section 123 of the Insolvency Act 1986 incorporates two tests for insolvency: the balance sheet test (whether liabilities exceed assets) and the commercial/cash-flow insolvency test (whether debts can be paid as they fall due).¹ Which of the two tests is relied upon frequently depends on the context in which the question of insolvency is raised, and the information available to the party seeking to establish insolvency. Most creditors' winding-up petitions are, for example, determined on the basis of commercial insolvency: that a company has failed to pay a debt currently due and owing, and in respect of which demand for repayment has been made. The failure to pay in circumstances where there is no genuine dispute as to whether the debt is owing in itself establishes a company's inability to pay its debts.²

Prior to the decision of the English High Court in *Re Cheyne Finance Plc* [2007] EWHC 2402 (Ch), the majority of commentators in this area had expressed the view that the wording of Section 123 was such that, in the context of the English legislation, the cash-flow test must be seen as focusing on a present inability to pay an accrued liability.³ The language of Section 123(1)(e) is phrased in the current rather than future tense ('is unable', as opposed to 'will be unable'). The typical dictionary definition of fall due is 'become immediately payable'⁴ and the notion of a debt being due is one which was thought to be such that 'debts payable in the future, prospective debts and contingent liabilities must all be ignored'.⁵ In this regard, Section 123(2) of the Insolvency Act 1986 (which contains the bal-

ance sheet test of insolvency) makes specific reference to prospective and contingent liabilities whereas there is no equivalent reference in Section 123(1)(e). The conclusion reached by academics such as Professor Fletcher was therefore that:⁶

'What is of the essence, for the purposes of Section 123(1)(e), is the demonstration, by suitable and credible evidence, that the company is failing to pay its mature liabilities within a reasonable time of their becoming due ...'

Not all agreed that this should be the approach to assessing commercial insolvency.⁷ Professor Goode argued that the Court could consider debts which fell due in the 'near future' or 'not too distant future'⁸ (i.e. that although contingent and prospective liabilities were excluded, the date of assessment was capable of including an element of futurity). But the majority view appeared to be that, as a consequence of the language used in Section 123(1)(e), there was little scope for consideration to be given to debts other than those immediately due and payable.

This was to be contrasted with the approach adopted in Australia. In a series of Australian cases commencing with *Bank of Australia v Hall* (1907) 4 CLR 1514, and extending to the current day, a wider approach had been adopted to the concept of commercial insolvency. Notably, that approach had been adopted in the context of a statutory scheme which did not make express provision for a test of balance sheet insolvency.⁹ It was therefore understandable from a practical perspective that an element of futurity had been injected into the

Notes

- 1 See, for example, *Re MDA Investment Management Ltd* [2004] 1 BCLC 217 at [121].
- 2 See *In re Bradford Tramways Company* (1876) 2 Ch D 373 per Malins VC and the reference to the inability or 'unreadiness' of a creditor to pay its debts. In many cases, non-payment of current debts will be (and has always been) the only and best available evidence of insolvency and that will suffice to prove insolvency: see *Lacey v Hill* (1870) 18 Eq 182 and the comments of Sir George Jessel MR therein.
- 3 See I. Fletcher, *The Law of Insolvency* (3rd edn, 2002) at para. 20-016, *McPherson's Law of Company Liquidation* (2001) at paras 11.20 to 11.23 and Sealy and Milman, *Annotated Guide to the Insolvency Legislation* (10th edn, 2007-2008).
- 4 See, for example, the Shorter Oxford English Dictionary, Vol 1 (6th edn, 2007) p. 774.
- 5 See R. Goode, *Principles of Corporate Insolvency Law* (3rd edn, Thomson, Sweet & Maxwell, 2005) at para. 4-18.
- 6 Fletcher, *op. cit.*, at para. 20-016.
- 7 See McPherson, *op. cit.*, at para. 11.20.
- 8 See Goode, *op. cit.*, at para. 4-16.
- 9 See Sections 95A of the Corporations Act 2001, and the comments of Dodds-Streeton J in *Crema Pty Ltd v Land Mark Property Developments Pty Ltd* (2006) 58 ACSR 631 at 652.

Australian application of the commercial insolvency test. But this is now achieved by expressly requiring the Court to take into account contingent and prospective liabilities when assessing commercial insolvency.¹⁰

II. Cheyne Finance Plc – the issues

The difference in approach, and the first consideration by the English courts of the scope and extent of the commercial insolvency test, came to a head in the litigation arising from Cheyne Finance Plc entering receivership. Cheyne is an Irish company operating as a structured investment vehicle. A significant part of Cheyne's assets consisted of securities backed by assets including United States of America equity loans, some of which had suffered as a consequence of the USA sub-prime mortgage crisis.

In September 2007, receivers were appointed over the business and assets of Cheyne pursuant to the terms of a security trust deed. The appointment occurred upon the breach by Cheyne of a major capital loss test.

Soon after appointment, the receivers of Cheyne sought directions from the Court as to whether they should continue to pay debts as they fell due from monies coming into their hands during the period following an enforcement event, but prior to the declaration of an Insolvency Event. Competing arguments were raised on behalf of those creditors with early maturing senior debts (who wanted the receivers to continue on a pay as you go basis) and those creditors with later maturing debts who argued that full provision for payment of all senior debts should take precedence over payment on time and in full of debts as and when they fell due. The Court resolved this question of construction of the relevant documents in a judgment dated 13 September 2007 [2007] EWHC 2116 (Ch), holding that the receivers were required to manage Cheyne's assets with the express objective of achieving the timely payment in full of debts to senior creditors as and when they fell due for payment (i.e. pay as you go). It was assumed for the purpose of that decision, but without deciding the point (see §7), that an Insolvency Event (as defined) had not occurred in circumstances where Cheyne was able to pay its debts as they fell due and would be able to do so in the near future, but not in the more distant future because of a balance sheet deficit.

The receivers subsequently returned to Court, seeking clarification of whether an 'Insolvency Event' within the meaning of the relevant documentation had occurred. Arguments on this point turned on the construction of the relevant clause in the agreements, as well as the scope of the test for insolvency found within

Section 123 of the Insolvency Act 1986. The key issue was whether Cheyne was insolvent for the purpose of the definition of Insolvency Event in circumstances where Cheyne could pay senior debts currently due, and those falling due in the very near future, but where it was regarded as inevitable in the middle or longer term future that default would occur.

III. The Insolvency Event

For the purpose of the Cheyne documentation, an Insolvency Event was defined as:

'a determination by the Manager or any Receiver that [Cheyne] is, or is about to become, unable to pay its debts as they fall due to Senior Creditors and any other person whose claims against [Cheyne] are required to be paid in priority thereto, as contemplated by Section 123(1) of the United Kingdom Insolvency Act 1986 (such subsection being applied for this purpose only as if [Cheyne's] only liabilities were those to Senior Creditors and any other persons whose claims against the Issuer are required under the Security Trust Deed to be paid in priority thereto.)'

It was common ground that the reference to Section 123(1) of the Insolvency Act necessarily excluded the balance sheet test. The only debts relevant in the context of the clause were those which were held by senior creditors, and it was those creditors (with short or long maturity notes) who argued the application. The debate focused on the degree of futurity incorporated within the notion of being unable to pay debts as they fall due within the meaning of Section 123(1), and the extent to which any degree of futurity could be said to be limited in the context of the documents in issue by the inclusion of the phrase 'is about to become' in the relevant clause.

IV. No, or limited, futurity

Certain of the creditors with short term debt argued that only those debts presently due were to be considered for the purpose of the cash flow test incorporated in Section 123(1), and that the language used to define Insolvency Event incorporated a limited degree of futurity by including the phrase 'is about to become' such that, even if there was an element of futurity in the cash-flow test incorporated in Section 123(1)(e), the extent of any futurity was governed and limited for the purpose of the clause by the wording adopted by the parties.

Notes

¹⁰ See Section 459D of the Corporations Act 2001.

It was noted that, where the draftsman of the 1986 legislation had intended to introduce an element of futurity and a focus on the ongoing and future ability of the company to meet debts as they fall due, clear language to that effect had been adopted.¹¹ The same could be said for other provisions in the companies legislation, all of which had adopted the words ‘will be’ when seeking to deal with the future ability of a company to meet its debts as they fall due.¹²

As a practical matter, those with short term debt submitted that there was no need for any wider construction to be given to Section 123(1)(e). The balance sheet test provided for by Section 123(2) of the Act ensures that, in any case where future and contingent liabilities exceed current assets, a company will be deemed to be unable to pay its debts. As commented on below, it is very difficult to conceive of any circumstances in which a Court could be satisfied that a company: (a) is able to pay its current liabilities; (b) is balance sheet solvent within the meaning of Section 123(2); but (c) will, at some stage in the future, be unable to pay liabilities then falling due.

That the question of prospective and contingent liabilities was only relevant to the balance sheet test appeared to have some support from the judgment of Nicholls LJ in *Byblos Bank SAL v Al-Khudhairy* [1987] BCLC 232 at 248G (i.e. they are relevant to an assessment of ‘what were the assets and liabilities of the company on a particular day’), whilst the argument that commercial insolvency remained focused on whether a company could pay all of its presently owing debts in respect of which payment had been demanded, arguably found support in the decision of Slade J in *Re Capital Annuities Ltd* [1979] 1 WLR 170 at 187/188. The Australian approach was argued to be a result of differently worded legislation, and an extended approach which was both inconsistent with the wording of the English legislation and unnecessary.

It was therefore submitted that the effect of the clauses in issue was, on their proper construction, to create a priorities agreement in favour of short maturity notes, and that there was nothing commercially surprising or wrong with such a conclusion. Indeed, such a construction avoided the need to make difficult judgments about the value of Cheyne’s assets.

V. Extended futurity

Despite this, Mr Justice Briggs rejected the arguments put forward by the holders of the short maturity notes. He held that, prior to the 1985/1986 reforms, English law posed the question of inability to pay debts without any rigid distinction between commercial cash flow insolvency on the one hand, and balance sheet insolvency on the other (paragraph 34 of judgment [2007] EWHC 2402 (Ch)). As such, a ‘submission that commercial insolvency could not be established by reference to future debts could not have succeeded’. He cited in support of this conclusion a passage from *Byblos* at page 247 where Nicholls LJ said:

‘Construing this section first without reference to authority, it seems to me plain that, in a case where none of the deeming paras (a), (b) or (c) is applicable, what is contemplated is evidence of (and, if necessary, an investigation into) the present capacity of a company to pay all its debts. If a debt presently payable is not paid because of lack of means, that will normally suffice to prove that the company is unable to pay its debts. That will be so even if, on an assessment of all the assets and liabilities of the company, there is a surplus of assets over liabilities. That is trite law.

It is equally trite to observe that the fact that a company can meet all its presently payable debts is not necessarily the end of the matter, because para (d) requires account to be taken of contingent and prospective liabilities. Take the simple, if extreme, case of a company whose liabilities consist of an obligation to repay a loan of £100,000 one year hence, and whose only assets are worth £10,000. It is obvious that, taking into account its future liabilities, such a company does not have the present capacity to pay its debts and as such it ‘is’ unable to pay its debts. Even if all its assets were realised it would still be unable to pay its debts, viz, in this example, to meet its liabilities when they became due.’

Briggs J rejected the argument that this passage, insofar as it dealt with future liabilities, was focused on the balance sheet test and stated that ‘Nicholls LJ is speaking about the ability of the company to meet its liabilities when they became due’. Hence what was said to be persuasive was the emphasis on the company’s present capacity to pay its debts whenever they fell due.

Notes

11 See, for example, section 8 of the Insolvency Act 1986 (‘is or is likely to become unable to pay its debts (within the meaning given to that expression by section 123 of this Act’) as discussed in *Colt Telecom Group Plc* [2003] BPIR 324 and section 89 (‘the company will be able to pay its debts in full’).

12 See, for example, sections 156(2) and 173(3)(b) of the Companies Act 1985 and sections 643(1)(b)(ii) and 714(3)(b)(ii) of the Companies Act 2006.

It is undoubtedly correct that the focus of Nicholls LJ was on the position of the company at the present time, and not in the future. But it is to be noted that the above passage as cited by Briggs J halts part of the way through what might be said to be the relevant paragraph. It continues:

'It might be that, if the company continued to trade, during the year it would acquire the means to discharge its liabilities before they became presently payable at the end of the year. But in my view para (d) is focusing attention on the present position of a company. I can see no justification for importing into the paragraph, from the requirement to take into account prospective and future liabilities, any obligation or entitlement to treat the assets of the company as being, at the material date, other than they truly are.'

Even if the focus of the inquiry is on the company's present capacity to pay, that does not answer the question of whether any inquiry regarding current ability to pay future debts is to be assessed on anything other than a balance sheet basis. It is certainly arguable that, read in context, this passage suggests that Nicholls LJ only took contingent and prospective liabilities into account for the purpose of conducting a balance sheet inquiry.

The main thrust of Briggs J's analysis was, however, based on the approach in the Australian cases (see paragraphs 41 *et seq.*). Briggs J observed that the question before him had never been analysed in English authorities in detail, probably because of the presence of the balance sheet test in the relevant legislation. He went on to comment that (paragraphs 51 and 52):

'It is clear from that brief review of the Australian decisions that in an environment shorn of any balance sheet test for insolvency, cash flow or commercial insolvency is not to be ascertained by a slavish focus only on debts due as at the relevant date. Such a blinkered review will, in some cases, fail to see that a momentary inability to pay is only the result of a temporary lack of liquidity soon to be remedied, and in other cases fail to see that due to an endemic shortage of working capital a company is on any commercial view insolvent, even though it may continue to pay its debts for the next few days, weeks or even months before an inevitable failure.

Furthermore, the common sense requirement not to ignore the relevant future was found to be implicit in the Australian case in the simple phrase "as they become due".'

Briggs J therefore reasoned that, first, although the English legislation had removed the reference to contingent and prospective liabilities when framing Section 123(1) (e), it had adopted 'what in Australia have always been regarded as the key words of futurity, namely the

phrase "as they fall due". In that context, "fall due" is, in my judgment, synonymous with "become due"' (paragraph 53). The learned judge went on to conclude that 'the Australian approach makes commercial sense, whereas the blinkered approach of ignoring the future does not' (paragraph 54).

Secondly, Briggs J considered that there may be cases in which a company is not balance sheet insolvent but would satisfy an Australian style test for commercial insolvency. The example given was a company with GBP 1000 in cash and a very valuable but very illiquid asset worth GBP 250,000 which cannot be sold for two years. If that company has present debts of GBP 500, but a future debt of GBP 100,000 due in six months, it is, Briggs J suggested, unable to pay its debts as they fall due but would be balance sheet solvent.

The conclusion was therefore reached that the commercial insolvency test incorporated in Section 123(1) (e) of the Insolvency Act 1986 was the same as that in the Australian authorities, and did permit consideration of whether a company would be able to pay debts falling due at some point in the future and not merely immediately payable.

Whether this is the right conclusion may be subject to some debate. For example:

- (1) A debt in existence but not due at the relevant date (see para. 51) is a contingent or prospective debt. It is in some regards strange as a matter of statutory construction if, having made express reference to such debts in Section 123(2), they are to be included in Section 123(1)(e) by reason only of the fact that the phrase 'as they become due' is used. The more natural reading, it might be argued, is that the absence of any such express reference actually makes it clear that the phrase 'as they fall due' cannot extend to debts which are not currently due.
- (2) The need to adopt a common sense approach which does not ignore the relevant future is, in the context of the English legislation, met by the balance sheet test for insolvency. That test will ensure that prospective and contingent liabilities are taken into account when assessing insolvency for the purpose of the Insolvency Act 1986. Under that act, there is no lacuna which requires filling by adopting an extended interpretation of the commercial insolvency test.
- (3) It is not clear that the example given by Briggs J works. The undefined illiquid asset would normally be capable of being used to raise finance, even if not sold. In fact, it is suggested that most hypothetical examples will, on analysis, indicate either a failure to value properly current assets or ignore the ability of a company to obtain alternative financing in order to provide liquidity. And, if an example of such a case were to occur where winding-up was thought to be appropriate, the proper basis might

well be under Section 122(1)(g) ('the court is of the opinion that it is just and equitable that the company should be wound up').¹³

In any event, as a matter of construction of the contract in issue, Briggs J went on to conclude that (regardless of the true position under Section 123(1)) it would be perverse to hold that the parties had intended to limit the scope of the Insolvency Event clause in the way suggested by the creditors with short maturing liabilities (see paragraph 59 *et seq.*). Briggs J stated that he could not 'envisage any reason why the parties to the Common Terms Agreement and Trust Deed should have intended to confer an absolute priority on the holders of early maturing Senior Debt' which would be the effect of limiting the scope of the clause in the way proposed by the holders of such debt. The consequence would be that the Receivers would be obliged to go on paying early maturing Senior Debts in full, knowing that a failure to pay anything in respect of later maturing debts of identical seniority was 'a racing certainty'.

Whilst Briggs J accepted that there was force in the argument that the phrase 'is about to become' in the Insolvency Event definition governed the extent of the futurity envisaged by the parties, he concluded in fairly brief terms that, in all the circumstances, the inclusion of that phrase must have been 'a piece of thoughtless drafting which adds little or nothing to "is"'. The learned judge was convinced that the consequences of the submissions made on behalf of the creditors with early maturing debts was so commercially unacceptable that the notion of Insolvency Event had to be construed so as to permit consideration of the fact that Cheyne would probably, on the assumed facts, be unable to pay its debts in full at some point in the future. Whilst it could be argued that the commercially unacceptable consequences were a result of the earlier decision relating to 'pay as you go', the fact that an Insolvency Event would only have occurred (on the basis of the submissions by the holders of early maturing debt) at a point shortly before the assets ran out (thus leaving little in the pot to be distributed *pari passu* upon the occurrence of the Insolvency Event) would suggest that the ultimate result achieved by Briggs J over the course of the two judgments is probably the right one. However, Briggs J's willingness to disregard the express wording of the contract in order to reach what he thought was the commercial result is a fairly remarkable illustration of the contemporary approach to construction adopted by the English courts.

VI. Conclusions

It is unlikely that many English cases will call for the application of Briggs J's extended commercial insolvency test. Normally, the balance sheet test will suffice.

If the test is to be applied, the facts of the particular case will be very important. In most cases, one will not be able to say with the certainty required that debts falling due in the future will not be capable of being paid. Indeed, this point was alluded to by Briggs J at paragraph 57 where he commented that 'in the case of a company which is still trading, and where there is therefore a high degree of uncertainty as to the profile of its future cash flow, an appreciation that s. 123(1) (e) permits a review of the future will often make little difference'. If one has to be 'satisfied (a state of mind which calls for careful and thorough enquiry), that inability to pay is more likely than not' (paragraph 74), there may be many cases in which a creditor will not be able to persuade the Court to reach the required conclusion.

In Australia, the cases have tended to focus on debts falling due 'in the immediate future'¹⁴ or 'the reasonably near future'¹⁵ such that there is 'pending insolvency'.¹⁶ The extent of any projection into the future has been described as being a matter of commonsense – that the conclusion of insolvency ought to be clear from a consideration of the debtor's financial position in its entirety and generally speaking ought not to be drawn simply from evidence of a temporary lack of liquidity: see *Sandell v Porter* [1966] 115 CLR 666 at 670 and *Quick v Stoland Pty Ltd* (1998) 29 ACSR 130. To this we can now add the comments of Briggs J at paragraph 50, where he noted that the question of how far into the future the enquiry as to present insolvency may go 'is a fact sensitive question depending upon the nature of the company's business and, if known, of its future liabilities.'

In the case of Cheyne, the Court's determination was based on certain assumed facts. It was plain that Cheyne would probably be unable to pay its senior debts in full as they fell due merely by letting its own investments run to maturity and collecting the resulting cash. Investments had to be sold and the sale process was likely to have a significant effect on the market itself.

Notably, Cheyne was in run-off rather than remaining a going concern. Where a company is still trading, the applicability of Briggs J's extended commercial insolvency test appears very difficult. Traditionally, the possibility of acquiring future assets has been ignored

Notes

13 See *In re European Life Assurance Ste* (1869-1870) 9 LR Eq 122 and *Re a Company* (No. 003028 of 1987) [1988] BCLC 282 at 294c (per Scott J).

14 Per Needham J in *Expo International Pty Ltd v Chant* [1979] 2 NSWLR 820 at 838.

15 Per Griffith CJ in *Bank of Australia v Hall* (1907) 4 CLR 1514 at 1527 and 1528.

16 *Supra*, per O'Connor J at 1537.

when assessing balance sheet solvency¹⁷ precisely because any such exercise is inherently speculative and uncertain. Yet the future trading prospects of a company which will affect future cash flow, and the ability of the company to pay its debts as they fall due, is in most cases an exercise which is also inherently speculative and uncertain. Concluding with the required degree of certainty that a company will be commercially insolvent

at some point beyond the immediate future is likely to be very difficult outside the context of companies in run-off. If that is the case, what appears at first glance to be a significant extension of the test for insolvency under the Insolvency Act 1986 may turn out to be nothing more than a hypothetical possibility which, due to evidential difficulties, has little relevance for most run of the mill cases that practitioners will encounter.

Notes

17 See *Byblos*, *supra*, at 247 as set out above.

Slimming Down Businesses: When Are Dismissals Unfair or Not?

David Marks, Barrister, 3–4 South Square, Gray's Inn, London, UK

If the sale of a business occurs in an insolvency there are special provisions which affect employees arising under the Transfer of Undertakings (Protection of Employment) Regulations 2006 SI 2006/246 commonly called TUPE.

All insolvency practitioners must address the need to transfer the business over which they are appointed and this can take the form of two principal techniques. The first is by disposal of the business to an unconnected third party. The second is by virtue of the hive down procedure although the latter is perhaps less common nowadays in the light of a dwindling justification to pursue tax losses. In either case there may be a need for swingeing dismissals.

If TUPE apply, the general rule applicable to the relevant transfer is that all liabilities owed by the insolvent company to or in respect of the employees employed in the relevant business will automatically transfer to the purchaser. Again as a general rule the liabilities which pass to the purchaser/transferee will include liabilities incurred both prior to and following the transfer. This involves a form of statutory novation but under the predecessor regime to the present TUPE, ie TUPE 1981, this novation was limited under that regime to employees employed in the business by the transferor 'immediately before the transfer': see Regulation 5(3) TUPE 1981. In *Litster v Forth Dry Dock* [1990] 1 AC 546 the House of Lords interpreted the phrase 'immediately before the transfer' to mean 'or would have been so employed if he [the employee] had not been unfairly dismissed in the circumstances' as prescribed by the previous TUPE Regulation 8(1), a Regulation that will be dealt with in further detail below.

TUPE 2006 followed and applied the effect of the *Litster* decision. In the wake of *Litster* there has been much debate, not least in the cases, as to when dismissals by an insolvent company are to be regarded as being by reason of a subsequent transfer. If a proposed purchaser asks for the dismissals then the dismissals would clearly be regarded as having arisen by reason of a subsequent transfer.

The real debate has been about those cases in which the dismissals by the insolvency practitioner can be said to have been for operational reasons. In other words, what is the approach to take when the insolvency practitioner takes the view that the company

simply cannot afford to transfer the workforce on and what about the position when such a view is taken prior to any contact with let alone transfer to the proposed purchaser?

The relevant Regulations are Regulation 7 and 8 of TUPE 2006. They were formerly in Regulations 7 and 8 of TUPE 1981. Regulation 7 of TUPE 2006 provides that:

'(1) Where either before or after a relevant transfer, any employee of the transferor or transferee is dismissed, that employee should be treated for the purposes of Part X of the 1996 Act (unfair dismissal) as unfairly dismissed if a the sole or principal reasons for his dismissal is –

- (a) the transfer itself; or
- (b) a reason connected with the transfer that is not an economic, technical or organisational reason entailing changes in the workforce.'

Regulation 7(2) provides as follows, namely:

'(2) This paragraph applies where the sole or principal reason for the dismissal is a reason connected with the transfer that is an economic, technical or organisational reason entailing changes in the workforce of either the transferor or the transferee before or after a relevant transfer.'

The phrase 'economic, technical or organisational' is called an ETO reason.

Regulation 8(1) of TUPE 1981 provided that:

'(1) Where either before or after a relevant transfer, any employee of the transferor or transferee is dismissed, that employee shall be treated ... as unfairly dismissed if the transfer or a reason connected with the transfer is the reason or principal reason for his dismissal.'

Regulation 8(2) provided that Regulation 8(1) shall not apply to a dismissal where:

'... an economic, technical or organisational reason ("ETO reason") entailing changes in the workforce or either the transferor or transferee before or after the relevant transfer is the reason or principal reason for dismissing an employee.'

It can be seen that the new Regulations are substantially the same as under TUPE 1981 although Regulation 7(3) now makes it clear in the legislation that where the dismissal is for an ETO reason this will be regarded as a redundancy dismissal.

If Regulation 8(2) of TUPE 1981 (now Regulation 7(2) and (3) of TUPE 2006) applies, the dismissal is not automatically unfair. However, it could still constitute an unfair dismissal under general employment law principles.

To summarise matters so far, if an insolvency practitioner upon his appointment or shortly thereafter arranges for the company to dismiss some or all of the employees and only subsequently decides to sell the business there will be no transfer of the relevant liability to the transferee/purchaser unless the employee can demonstrate that he or she was dismissed by reason of the transfer.

Prior to the recent Employment Appeal Tribunal decision of *CAB Automotive Ltd v Blake and others* (UK EAT/0298/07/CEA: 12 February 2008) there had been some confusion about these issues. In *Ibex Trading v Walton* [1994] IRLR 564, another decision of the Employment Appeal Tribunal (and somewhat unusually it might be thought) the transferee/purchaser went into liquidation during the original tribunal hearing. It was reasonably clear that the transferor company remained a more lucrative target than the transferee from the point of view of certain dismissed employees. The EAT upheld their claim that the relevant liabilities should not be treated as having been transferred. It stated at page 567:

'(1) ... we attach significance to the definite article in Regulation 8(1) 'that an employee shall be treated ... as unfairly dismissed if the transfer or a reason connected with it is the reason or the principal reason for dismissal'. The link, in terms of time, between the dismissals and transfers will vary considerably. In *Litster* the time difference was 1 hour; often it will be more. The transfer is not just a single event: it extends over a period of time, culminating in a completion. However, here, the employees were dismissed before any offer had been made for the business. Whilst it could properly be said that they were dismissed for a reason connected with the possible transfer of the business, on the facts here, we are not satisfied that they were dismissed by reason of the transfer or for a reason connected with the transfer. A transfer was, at the stage of the dismissal, a mere twinkle in the eye and might well never have occurred. We do not say that in every case it is necessary for the prospective transferee to be identified; because sometimes one purchaser drops out at the last minute and another purchaser replaces him.

(2) In any event, it seems to us, on the facts, to be difficult to say, by reason of the timing of the dismissal and the sale of the business, that the employees

would have been employed at the date of the completion but for their dismissal.'

In *Morris v John Grose Group Limited* [1998] ICR 655, another EAT decision, the employee was employed by the transferor until he was dismissed by reason of redundancy on 30 September 1996. It was decided to make him redundant three days before the date on which receivers were appointed. He and other employees were made redundant in order to cut down the workforce and make the company more saleable. Two months later the company was transferred and the employee made a claim against the transferee for unfair dismissal. The Tribunal found the defendant liable. Effectively it confirmed that since the receivers had not definitely decided to transfer the business to the transferee (although it was found that they clearly had that possibility in mind) the employee could not be regarded as having been dismissed by reason of 'the' transferee. The most that could be said was that the receivers had only 'a' transfer in mind.

The EAT disagreed with that analysis. It said the tribunal had made an error in law in attaching significance to the work 'the'. The true question was whether a transfer to any transferee who might appear or a reason connected with such a transfer constituted the reason or principal reason for the dismissal. The EAT allowed the employee's appeal and remitted the matter to a new tribunal.

In the CAB decision the evidence was that the day after the administrators' appointment one of the administrators informed a consultant responsible for the day to day management in the transfer or company that the latter's role 'was to tidy up the business to sell to somebody else'. One of the objectives of the administration was, as is commonly the case, to achieve a better realisation for the creditors as a whole than would be effected in a winding up. The employees claimed before the tribunal that they had been dismissed by reason of the transfer which occurred later, albeit a short time later. In particular the tribunal determined first that the evidence established that the administrators' motivation was not simply to reduce overheads but was part of an overall plan to reduce size with a view to sale. Secondly, on those grounds it found, therefore, that the dismissal was connected with the subsequent transfer even though the actual identity of the transferee was not then known.

The EAT disagreed. Regulation 8(1) means that it has to be decided whether the transfer of the slimmed down undertaking was the 'reason or principal reason' for the dismissal. The EAT held that the tribunal had mistakenly taken the view that the transfer or reason connected with it needed only to be one of the reasons for the dismissal. In addition Regulation 8(1) and Regulation 8(2) were not alternative. The latter came into play only if Regulation 8(1) had been specifically addressed and answered in the affirmative. Again the

tribunal had failed to do this. The case was remitted to a fresh tribunal.

The EAT expressed its preference for the decision in the *Morris* case over the early decision in *Ibex Trading*. The EAT observed the Regulation 8(1) could apply for example where there were a number of potential transferees expressing an interest but at the time of the dismissal matters remained at a very early stage.

The immediate upshot in practical terms of the CAB decision is that in most cases where workforces are

‘trimmed’ there is very likely to exist a potential for dismissal. There will have to be clear evidence indicating a desire to create general redundancies and not to trim the workforce with a view to subsequent onward sale. If there is any suggestion whatsoever that dismissal is likely to make a sale easier or more advantageous to the insolvency process then the case is unlikely to get through what could be called the ETO gateway. Whether this tightening up of the law and practice in this area is a good thing remains to be seen.

A Phoenix Syndrome in Every Sense of the Word ...

David Marks, Barrister, 3–4 South Square, Gray's Inn, London, UK

A recent but as yet unreported decision of the English High Court sitting in bankruptcy has reaffirmed what many have long regarded as being a basic principle of English insolvency law and practice. This is to the effect that the English courts have a discretionary common law ability and power to recognise and assist properly appointed foreign insolvency holders.

The basic principle has recently been authoritatively reasserted by the Privy Council in *Cambridge Gas Transportation Corporation v Official Committee of Unsecured Creditors of Navigator Holdings Plc* [2007] 1 AC 508. At paragraph 22 of the Opinion of the Board, Lord Hoffmann dealt with the assistance that the English can give to the courts of a foreign country by stating:

'What are the limits of the assistance which the court can give? In cases in which there is statutory authority for providing assistance, the statute specifies what the court may do. For example, section 426(5) of the Insolvency Act 1986 provides that a request from a foreign court should be authority for an English court to apply "the insolvency law which is applicable by either court in relation to comparable matters falling within its jurisdiction". At common law their Lordships think it is doubtful whether assistance can take the form of applying the provisions of foreign insolvency law which form no part of the domestic system. 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.'

In the matter of *Phoenix KapitalDienst GmbH* (Mr Registrar Jaques 8 April 2008: Case No 142 of 2008), the administrator of a German company called Phoenix had been appointed by the Frankfurt Insolvency Court on 1 July 2005 pursuant to insolvency proceedings opened on 12 March 2005. The administrator as applicant in the English proceedings sought an order that his appointment be recognised by the courts of England and Wales and that he be afforded the rights to exercise such rights and powers conferred upon insolvency

practitioners under the English Insolvency Act 1986 including the power to exercise the provisions of section 236 of the Insolvency Act, namely the right to conduct private examinations and conduct other statutory investigations into the affairs of Phoenix.

Phoenix traded in the German futures market using third party funds received from individual investors. Many investors resided abroad including England. The funds which were deposited with Phoenix were paid into a single collective fund known as the Phoenix Management Account. Phoenix traded at a loss effectively from the outset in the late 1970s. The directors covered up the losses by creating a fictitious account into which what were passed off as profits were reported. This was done through the medium of another account called the MAN account. The Phoenix trading position appeared to be a profitable one and in those circumstances the company continued to attract investors who in all amounted to about 40,000, not only in Germany but in many other countries apart from England. It was significant that recovery proceedings had been issued in Austria where some investors resided as well as in the Scandinavian countries and full details of those proceedings were put before the English court.

At the heart of what was clearly a fraud was the placing into the bank via the use of the accounts mentioned above of new deposits to discharge Phoenix's overheads and most importantly for present purposes to pay out 'old' investors the so called profits. These profits were, of course, fictitious. This is a well known scheme often called a Ponzi scheme.

The main individual perpetrator of the fraud was the Managing Director. He died shortly before the institution of insolvency proceedings in Germany but his principal assistant continued with the fraud. However, in due course as is perhaps inevitable in such cases the fraud was uncovered by the relevant authorities and criminal convictions followed as well as the insolvency administration of Phoenix itself. A number of old investors who received the fictitious payouts were the subject of the other overseas proceedings referred to above. Many of them reside in this country and formal demand has been made of them although no proceedings as such have as yet been instituted.

German insolvency law was described as characterising these payments out as gratuitous payments

under Article 134 of the German Insolvency Act. The measure of loss was the difference between the amount deposited and the subsequent payment out. There is a four year clawback time period in relation to German law. The administrator wanted the additional benefit and comfort of reserving the right if necessary and if so advised to resort to the provisions of English insolvency law, in particular the usual provisions regarding transactions at an undervalue to recover losses arising by virtue of the fictitious accounts.

No reliance could be placed upon the recent UNCITRAL Model Law recently incorporated into English law by virtue of the Cross-Border Insolvency Regulations 2006. This is because the four year period referred to above predated the implementation of the Regulation into English law which only applies to transactions for present purposes after the date of its incorporation into English law. Nor could the EC Insolvency Regulation be relied on since Phoenix was an investment undertaking within the meaning of that expression as expressed and contained in Article 1(2) of the Regulation and thus was not addressed in the Registrar's judgment.

However, many of the practical requirements introduced by the Cross-Border Regulations, eg the need for proper certified copies of the applicant's appointment and those canvassed by Mr Registrar Nicholls in *Re Rajapakse* [2007] BPIR 99 were regarded by the administrator as being applicable by analogy, eg a consideration of whether and if so to what extent the foreign court had made any order or direction permitting the English application to be made.

The Registrar in the present case gave a short judgment in acceding to the application. He noted that the German administrator was conscious of what some eminent commentators had pointed out as being a failing, if not at least some confusion, with regard to the proper distinction that existed between on the one hand recognition and on the other judicial assistance. The former technically refers to giving effect directly to the foreign law whilst the second notion reflects the use of local law to assist the foreign proceedings. On any view the *Cambridge Gas* decision as well as the Phoenix application dealt with the latter principle.

The administrator also drew the relatively self evident parallel with the way in which English courts have in the past recognised the appointment of a foreign court appointed receiver. There is no question but that the same principles still obtain even now with regard to such appointees. The abiding requirement lies in the English court being satisfied that the foreign court was jurisdictionally competent. In *Schemmer v Property Resources Limited* [1975] Ch 273 especially at 287 the principle had been put in terms of the need to demonstrate a 'sufficient connection' between in that case the target company, ie the company over which the foreign receivers were appointed and the jurisdiction in which the foreign appointee was appointed. There is much discussion in the text books and elsewhere about

the possible difficulties which arise when an appointment was made in a state which was not the state of incorporation but the same did not need to trouble the court in the Phoenix application. Phoenix was itself the subject of an administration order in its own State of incorporation.

However, in the present case the Registrar also went on to note that the potential UK defendants had themselves a sufficient connection with Phoenix but it may be thought with respect that he had no need to go that far even though he was apparently satisfied that they owned assets here as well as resided here on the basis of the evidence he saw. The common law regime which was being discussed here and which was being applied cannot on any basis be dependent upon the connection, if any, between potential defendants who may well be outside the jurisdiction and the jurisdictional basis on which the original appointment abroad was made.

The German administrator also addressed the view often expressed that reciprocity per se will not be a ground for recognition by adducing expert evidence from his German lawyers that a German court would apply English law and in the process receive expert evidence on that topic.

Of far greater significance, however, was the need to show that even if the appointing court had the necessary jurisdictional competence, generally well accepted conflict of law principles were also being respected. In *Schemmer*, the foreign receiver was a US court appointed receiver but one appointed under what was effectively a penal provision. In the circumstances the English court held that the American appointment was unenforceable in the English court. No such impediment existed in the *Phoenix* application.

Finally, the applicant argued again by way of analogy with the receivership cases that judicial assistance should be afforded as long as there was no prejudice to any creditors and as long as the provisions of English insolvency law were respected and satisfied. This is a point which was raised and discussed by the Privy Council in paragraph 26 of the *Cambridge Gas* decision. The German administrator provided formal evidence and confirmed through his German lawyers that there was no intention of taking any formal insolvency process in English law such as the institution of formal winding up proceedings in this country.

The Registrar stated that he regarded the *Cambridge Gas* decision as 'of very great persuasive authority' even though it was not strictly binding on him. He expressed himself entirely satisfied that on the evidence before him and on the basis that various authorities cited to him, the principal ones of which being set out in this note, the application was wholly justified and that the German administrator was entitled to 'all possible assistance' that the English court was able to give in circumstances such as those which pertained in the case before him.

The case is a welcome one on any basis: indeed it is difficult to see how it offends any principle of common-sense let alone any established legal principles.

If nothing else the case serves as an indirect warning to American courts that quite apart from the strict letter of the law contained in the Model Law as implemented in that jurisdiction the English courts are happy to have resort where necessary to discretionary common law principles. The US courts have so far refused to take such a discretionary basis into account in considering whether or not there should be a main proceeding in

the United States in addition to a main proceeding in an off shore jurisdiction so as to be able to address the case on a case by case basis with the appropriate relief attached. The problem has, of course, arisen vividly in the case of the *Bear Stearns* decision as well as in a case which has come to be called the *Basis Yield* case. It does admittedly seem odd that this country is prepared to be more flexible in exercising its common law jurisdiction where circumstances allow, a reality which apparently our American cousins are for the moment reluctant to recognise.

***Re Whistlejacket Capital Limited* [2008] EWCA Civ 575 and the Race to Priority**

Georgina Peters, Barrister, 3–4 South Square, Gray's Inn, London, UK

The vulnerability of structured investment vehicles ('SIVs') to the difficulties experienced in financial markets has attracted much attention. Issues arising out of their insolvencies required the consideration of the courts prior to the recent events which now dominate the UK press. Those issues, which stem largely from the security documentation governing the operation of SIVs, last year manifested themselves in the decision of the English High Court in *Re Cheyne Finance Plc (No. 1)* [2008] 1 BCLC 732. Cheyne was the first SIV to enter receivership. Following that decision, on 12 February 2008 receivers were appointed in relation to a second SIV: Whistlejacket Capital Limited, a Jersey-incorporated company. Thereafter the receivers of Whistlejacket sought judicial guidance in relation to the distribution of the company's assets, in circumstances where the assets of Whistlejacket were inadequate to meet its extensive liabilities.

Both *Cheyne Finance plc* and *Whistlejacket Capital Ltd* involved points of construction on documentation governing the operation of the SIV. They did not involve matters of general legal principle. However, the latest development in *Whistlejacket Capital Ltd* calls for comment as it is instructive for creditors of SIVs and other corporate entities with similar governing documentation seeking to identify their position in the priority of repayment. The issues arising for determination by the Court of Appeal in *Whistlejacket* related to the effects of a 'waterfall' priorities provision and of an acceleration provision relating to the stated maturity dates of senior notes on insolvency.

Factual background

The receivers brought an application for directions as to the manner in which they should manage and apply Whistlejacket's assets having regard to the interests of various noteholders. Several series of senior notes with a variety of maturity dates had been issued by Whistlejacket. The Security Trust Deed contained a priority provision, setting out the order of priority in which Whistlejacket's creditors were to be paid. The third level of priority provided that any monies received were to be applied to pay, 'pari passu and pro rata in accordance

with the respective amounts then owing thereto, any amounts due to Senior Creditors'.

The provisions governing the notes, contained in an Indenture, accelerated the stated maturity dates of the relevant notes on insolvency. If the Security Trustee delivered to Whistlejacket notice of an Insolvency Acceleration Event (an 'Insolvency Redemption Event'), Whistlejacket was obliged to pay the noteholders what was termed the Enforcement Redemption Amount on a date known as the Insolvency Redemption Date. That due date for payment was thirty days after the insolvency. On 15 February 2008 notice of an insolvency was delivered to Whistlejacket, the redemption date therefore being 16 March 2008. The redemption amount was however calculated by reference to the Redemption Price Calculation Date, itself defined under the Indenture as the date on which the Insolvency Redemption Event occurred. Therefore although the redemption date here was 16 March 2008, the amount required to be paid on that date was calculated by reference to the earlier date of 15 February 2008.

The issues

The dispute was essentially one as to priority as between different senior creditors. The issues were whether: (i) the waterfall provision provided, after insolvency, for a 'Pay as You Go' regime of payments to creditors by reference to the stated maturity dates of their notes (i.e. disregarding future claims of creditors whose notes did not yet fall due, and thus creating an order of priority as between different senior creditors based purely on date of maturity); and (ii) the 'acceleration' provision had the effect of postponing the stated maturity dates of certain notes.

As to the first issue, the receivers contended that they would be acting properly by making *pari passu* distributions to all senior creditors, taking into account amounts owing but not yet due among the whole class of senior creditors. As such, their contention was that the provision did not create any order of priority within the class of senior creditors. Holders of senior notes, appearing at the hearing as interested parties, argued that the receivers were bound to apply cash received by

them in full payment of creditors as their debts fell due (Pay As You Go), ignoring any amounts that had not yet fallen due for payment.

On the second issue, the receivers submitted that as a result of the insolvency all unpaid notes fell due for payment on the same date at the end of the thirty-day period, even though a particular note may have a stated maturity date on or between 15 February and 16 March 2008. The interested parties contended that the notice had no effect on the obligation to pay the principal amount of their notes on the relevant maturity dates. The notes remained due to be paid on the stated maturity dates falling before 16 March 2008, notwithstanding the provisions contained in the Indenture. Those provisions, they said, did not apply to them as their notes had already fallen due for payment.

The first instance decision

Mr Justice Etherton (as he then was) preferred the Pay As You Go construction. According to what he construed as the literal wording of the provision, the Deed envisaged that the receivers were obliged to distribute money received by them *pari passu* to senior creditors whose debts were then due for payment, without taking into account debts due to be paid in the future.

Etherton J also held that senior notes remaining unpaid yet which would have fallen due for payment within thirty days after the insolvency, but not those whose due date for payment coincided with the date of insolvency, were, in accordance with the provisions of the Indenture, postponed. The provisions were intended to set in place a regime in which there was an actual or notional acceleration of the due time for payment of the notes: in the case of notes with a stated maturity date on or before 15 February 2008, there could be no actual, or even notional, acceleration of the time for payment, and they should therefore be paid in full. In addressing the submissions of the interested parties that certain terms used in the Indenture indicated early payment and not postponed payment of noteholders, Etherton J relied on the provisions for calculation of the redemption amount and interest on that amount by reference to the date of the insolvency. As such, he held that the provisions substituted for the stated maturity dates of senior notes outstanding on the date of the insolvency, a deemed payment date of the insolvency event, with provision for interest from that deemed payment date to the date of actual payment (the Court of Appeal considered this 'somewhat artificial', it being clear from the Indenture provisions that a new redemption date for obligatory payment had been substituted).

The Court of Appeal decision

The receivers appealed and the appeal was allowed. In broad terms, the Court of Appeal held that: (i) the receivers had a discretion as to when to apply monies to the discharge of Whistlejacket's debts; and (ii) unpaid notes falling due for payment before the insolvency were postponed.

The first question was articulated by the Court of Appeal as being whether the Security Trust Deed, in setting out an order of priority for payments as between different creditors of Whistlejacket, went so far as to create an order of priority as between different senior creditors. Put differently, how after insolvency was the order of priority to operate, where different senior creditors had different amounts owing to them, with different maturity dates, some of which had not yet arisen?

Counsel for the receivers submitted that the receivers had a discretion as to when to pay senior debts. The clause was only concerned with priority; it did not impose any obligation to pay money out at a particular time, but rather an obligation prescribing how and to whom money should be paid out as and when it was available. As the clause did not impose an obligation as regards the timing of payment, it could not have the effect of prescribing priority within a class of creditors. It was further submitted that, although no money could be paid out in respect of amounts which had not yet fallen due for payment, nevertheless, when deciding how much was to be paid out, the receivers must take into account liabilities to senior creditors which had yet to fall due. The argument was that, whereas 'any amounts due' to senior creditors meant 'amounts due and payable', so as to exclude from payment any liabilities not yet due for payment, 'the respective amounts then owing thereto' meant something different, namely all sums due (whether or not yet payable) to the senior creditors as a class. It was agreed that 'amounts due' meant 'due and payable'. The meaning of 'owing' and 'thereto' remained a point of dispute.

The Court of Appeal accepted that the provision set out the order of priority as between successive classes of creditors, and did not impose any particular obligation as regards payment and as to time of payment. It could not therefore be construed as prescribing priority within the class of senior creditors on the basis of the chronological order of payment dates. If this was the intention, the clause would have been more specific about how it worked: for example, it did not say whether the governing date was that of receipt or application. In its reasoning the Court of Appeal was in large part persuaded by the anomalous differences of outcome which could occur if there were successive realizations and a sequence of partial payments, and also the fact that its preferred construction would work during the period of enforcement of security envisaged by the Indenture, when insolvency had not occurred.

The second question – although a matter of lesser import given the conclusion arrived at on the first question – was approached by the Court of Appeal from a different starting point than that taken by the court at first instance. Rather than articulating the issue as being whether the terms of the Indenture were intended to, actually or notionally, accelerate the due time for payment of the notes (undoubtedly the case in relation to notes with a stated maturity date later than 16 March 2008), the Court of Appeal made it plain that here it was a question whether the Indenture postponed the due payment date for notes whose stated maturity date was before 16 March. This tension was reflected in the submissions made by counsel for the Bank of New York, the Security Trustee. His contention was that there was nothing in the text which permitted a conclusion that notes otherwise payable at an earlier date would become payable on the (later) redemption date. That would be a postponement, not an acceleration.

The Court of Appeal nevertheless concluded that the provision applied a new obligatory payment date, the redemption date, to all notes which had not been paid in full – including those falling due for payment at the date of insolvency. It was considered that since notice to the company of an insolvency event was likely to be given either on, or immediately before, a day on which some obligation to a class of senior creditors arose for payment, it was not obviously sensible that that particular group of senior creditors should be regarded as having priority over others.

Future consequences

As stated at the outset, the case did not generate issues of general principle. This should not detract from its relevance to creditors of SIVs and corporate entities alike, the operation of which is governed by similar provisions. Security documentation applicable to other types of corporate entity inevitably contain similar ‘waterfall’ priorities provisions and acceleration provisions akin to those construed in *Whistlejacket* will also govern repayment of the debts of those entities. In a similar vein, the decision is instructive for officeholders seeking to advance the restructuring process and in so doing, to understand the obligations imposed on them.

Competing entitlement to large sums of money of different creditors, and different classes of creditors, may therefore turn on analogous issues of construction. The race to priority is intensified in the case of SIVs, which by virtue of their structure have extensive liabilities. The decision in *Whistlejacket* responds to this situation in two ways. First, it affords an insight as to how the courts will approach the construction of this type of documentation, notwithstanding that the terms of the documentation may not be identical. Secondly, it indicates the culture of the courts which is, insofar as possible, to prevent a race to priority.

Did Judge Lifland's *Bear Stearns* Decision Start a Revolution?

Ronald DeKoven, Associate Member, 3–4 South Square, Gray's Inn, London, and Brian Hauck, Associate, Jenner & Block LLP, Washington, DC, USA

In a well-publicised September 2007 decision, Judge Lifland of the Bankruptcy Court for the Southern District of New York refused to recognise an offshore proceeding, even when no party objected, when the foreign representative failed to prove that the debtor's presence in the Cayman Islands amounted to either a Centre of Main Interests ('COMI') or an 'establishment' under Chapter 15. Now another judge from that court has followed suit, in *In re Basis Yield Alpha Fund (Master)*, No. 07-12762 (REG). The ruling may not be as negative as a first reading would suggest, but it does present a challenging evidentiary obstacle for future offshore debtors.

In a decision issued on 16 January 2008, Judge Robert E. Gerber refused to grant summary judgment to a foreign representative seeking Chapter 15 recognition. The debtor, Basis Yield Alpha Fund, was incorporated in the Cayman Islands and maintains a registered office there. When it received several default notices in the wake of the sub-prime lending downturn in the United States, Basis Yield filed for liquidation under the Cayman Companies Law in August 2007. The firm's joint provisional liquidators (JPLs) then sought recognition under Chapter 15 in New York.

Under Chapter 15, US bankruptcy courts can recognise either 'main' or 'nonmain' foreign proceedings. The foreign proceeding is to be recognised as 'main' if it is in the country of the debtor's COMI, and nonmain if in a country where the debtor has an 'establishment' as defined in the bankruptcy law. Basis Yield sought recognition, first, as a main proceeding, and in the alternative as a nonmain proceeding.

Although no party objected to the JPLs' request, Judge Gerber announced that 'recognition under section 1517 is not a rubber stamp exercise.' The Court then put the JPLs through their paces: After a hearing on the JPLs' request for a preliminary injunction, Judge Gerber called for an evidentiary hearing on whether recognition was appropriate. Before the court scheduled the evidentiary hearing, the JPLs moved for summary judgment on the issue – a procedure under US law for matters in which a party claims there is no genuine dispute of material facts. Thus, the Court had to consider whether the JPLs had submitted sufficient evidence for recognition.

In their submission the JPLs sought to establish that the debtor had a COMI or 'establishment' in the Cayman Islands. The JPLs noted that Basis Yield was incorporated and has a registered office there; that its only two investors are feeder funds domiciled there; and that its administrator, investment manager, attorneys, and books and records are all located in the Cayman Islands. The JPLs said nothing about any of the factors that courts had highlighted as relevant to this determination: the location of the debtor's headquarters, managers, primary assets, the debtors and creditors who would be affected by the case, and the jurisdiction whose law would apply. As Judge Gerber put it, 'The silence is deafening.'

The JPLs did not hide their strategy. Rather than putting in evidence along those lines, they argued that no such evidence was required. They argued that under the Bankruptcy Code's Section 1516, unless another party objects, courts are *required* to treat a debtor's registered office as its COMI. The statute they relied on reads, 'In the absence of evidence to the contrary, the debtor's registered office ... is presumed to be the center of the debtor's main interests.' The JPLs argued that this provision bound the court to recognise the Cayman Islands as Basis Yield's COMI, and the proceedings there as foreign main proceedings. Based on evidence that their registered office was in the Caymans, and with an absence of evidence to the contrary, the JPLs argued that Section 1516 created an irrebuttable presumption that the Court was bound to apply.

The Court rejected that argument for two reasons. First, the Court found 'evidence to the contrary.' Basis Yield had argued that there was nothing else in the record about its operations. The Court disagreed and cited Section 193 of the Caymans Companies Law, which forbids 'exempted companies' like Basis Yield from conducting any trade on the Islands except as necessary to further its business abroad. That Basis Yield was subject to this law, the Court reasoned, was evidence that it had neither a COMI nor an establishment in that jurisdiction.

Second, the Court rejected the notion that, even absent other evidence, the location of a debtor's registered office created an irrebuttable presumption that courts are bound to apply. Interpreting Section 1516's

text, which provides that the registered office location 'is presumed' to be the COMI, as not binding may be questionable, but the Court bolstered its interpretation with reference to the text's legislative history. Documentation supporting the UNCITRAL Model Law on Insolvency, from which Chapter 15 derived, supports the Court's view; the official guide to that document advises that Section 1516's presumption can be 'called into question *by the court or an interested party.*' The Court refused to let the lack of objections from any party make recognition mandatory. Instead, the Court cited its obligation to satisfy itself that the Caymans were Basis Yield's COMI or had an establishment under Section 1517, and finding an insufficient basis to do so on the record the JPLs had created, denied their request for summary judgment on the question of recognition.

Judge Lifland's *Bear Stearns* decision (which has been affirmed on appeal and will be discussed in the next issue) and Judge Gerber's *Basis Yield* decision send an important message to insolvency lawyers. While these decisions may affect how recognition proceedings are litigated, the decisions should not be read as signaling the end of Chapter 15 proceedings for offshore debtors.

While rejecting the JPLs' argument for recognition, Judge Gerber went out of his way to make clear what he

was *not* deciding. Judge Gerber did not decide that the Cayman Islands proceeding could not be recognised. In denying the JPLs' motion for summary judgment, the Court only decided that there were sufficient issues of fact to warrant further inquiry. Because a summary judgment proceeding requires a court to draw all reasonable inferences *against* the moving party, it is possible that an evidentiary hearing (like the one Judge Gerber initially requested) will yield a different result. As Judge Gerber's decision points out, the JPLs' summary judgment motion pointed to little beyond the location of the debtor's place of registration. The decision goes out of its way to make clear that further evidence may change the Court's mind.

Of course, Basis Yield – like many other offshore entities – may have little other evidence to present, even given this further opportunity. 'Exempted companies' under Cayman Islands law are forbidden from engaging in extensive on-island business; any fact that would help a potential debtor to increase its activity offshore for COMI or 'establishment' purposes could result in a violation of the Caymans' corporate laws. It will definitely be an exercise in threading the needle, as insolvency practitioners try to find that 'Goldilocks' level of Cayman Islands operation that is active but not too active.

Josef Syska and Elektrim SA (in administration) v Vivendi Universal SA and others [2008] EWHC 2155 (Comm)

Adam Al-Attar, Barrister, 3–4 South Square, London, UK

In *Josef Syska and Elektrim SA (in administration) v Vivendi Universal SA and others* [2008] EWHC 2155 (Comm),¹ Mr Justice Clarke was required to consider the proper scope of articles 4(2)(e), 4(2)(f) and 15 of Council Regulation 1346/2000 on insolvency proceedings (the ‘Insolvency Regulation’) in deciding whether to set aside an English arbitral award handed down after the opening of main insolvency proceedings in Poland in respect of one of the parties to that award. This case-note explores some of the issues considered by the judge and the prospect of his reasoning being upheld on appeal.

The facts

Elektrim SA and its administrator (‘Elektrim’) applied under section 67 of the Arbitration Act 1996 to set aside an arbitral award in favour of Vivendi Universal SA and others (‘Vivendi’). The award held that the arbitration reference which was proceeding to trial before the arbitrators could proceed despite the supervening bankruptcy of Elektrim. The underlying dispute was based on a breach of an investment agreement by Elektrim pursuant to which Vivendi was to acquire an interest in PTC, a Polish mobile telephone company.

The investment agreement was governed by Polish law but contained an agreement to arbitrate governed by English law and which provided for arbitration in London under LCIA rules. The arbitration commenced on 23 August 2003 and the award was handed down after a hearing on the question of jurisdiction which preceded the trial on liability between 15 and 19 October 2007.

Elektrim had been declared bankrupt by order of the Warsaw District Court pursuant to its own petition on 21 August 2007 on the basis that it could continue as a debtor in possession, and, on this basis, Elektrim sought to rely on Article 142 of the Polish Bankruptcy and Reorganisation Law (the ‘Law’) to avoid the award. Article 142 provides:

‘Any arbitration clause concluded by the bankrupt shall lose its legal effect as at the date bankruptcy is declared and any pending arbitration proceedings shall be discontinued.’

It was common ground that if article 142 of the Law was applicable it had the effect of annulling the arbitration agreement. The critical question was: what law governs the effects of the Polish bankruptcy order?

The Insolvency Regulation

The Insolvency Regulation aims to secure a uniform system for the opening of insolvency proceedings and the effective administration of those proceedings. For this reason, it prescribes a series of jurisdictional rules and choice of law rules. In the absence of uniform choice of law rules, it would be difficult to secure effective automatic recognition of the powers of liquidators in main or secondary proceedings, or of any judgments given by the courts in those proceedings.

Article 4(1) is the basic choice of law rule and 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 ...’

This basic rule is supplemented by a non-exhaustive list of examples in article 4(2), of which articles 4(2)(e) and (f) were relevant to the particular facts:

‘The law of the State of the opening of proceedings shall ... determine in particular:

...

- (e) the effects of insolvency proceedings on current contracts to which the debtor is party;
- (f) the effects of the insolvency proceedings on proceedings brought by individual creditors, with the exception of lawsuits pending ...’

Notes

¹ Gabriel Moss QC was counsel for the claimants and Anthony Zacaroli QC was counsel for the defendants.

To protect certain rights and expectations, articles 5 to 15 set out a closed-list of exceptions to the basic rule, of which article 15 was relevant to the facts, corresponding to the exception in article 4(2)(f):

‘The effect of insolvency proceedings on a lawsuit pending concerning an asset or a right of which the debtor has been divested shall be governed solely by the law of the Member State in which that lawsuit is pending.’

Accordingly –

- (a) if the arbitration agreement was a current contract within article 4(2)(e) (‘issue (a)’); or
- (b) the arbitration proceedings were proceedings brought by an individual creditor within article 4(2)(f) and not –
 - (i) a lawsuit pending within the exception to that article, or
 - (ii) a lawsuit pending concerning an asset or a right of which the debtor has been divested within article 15 (‘issue (b)’),

article 142 of the Law would apply and the tribunal would have ceased to have jurisdiction.

Arbitration proceedings and lawsuits pending

The judge dealt with issue (b) first and found in favour of Vivendi. He concluded:

- (1) ‘*proceedings brought by individual creditors*’ within article 4(2)(f) referred to proceedings brought by individual creditors of whatever nature, including proceedings by way of ‘execution’ (in the sense of enforcement against the debtor’s assets, whether before or after judgment) and actions to establish the validity of a claim (paragraph 51);
- (2) the exception in that article – ‘*with the exception of lawsuits pending*’ – extended to actions to establish the validity of a claim against the insolvent’s estate, but not to execution (paragraph 51);
- (3) ‘*lawsuit*’ within article 4(2)(f) and 15 included arbitration proceedings as well as court proceedings (paragraph 52); and
- (4) ‘*concerning an asset or a right of which the debtor has been divested*’ within article 15 extended to a lawsuit involving:
 - (a) a claim by the debtor to a particular asset or a claim asserting any other right;
 - (b) a proprietary claim by a third party to the assets or rights of the debtor; and
 - (c) a claim by a third party which, if successful, would fall to be satisfied out of the assets

the subject of the insolvency proceedings, (paragraphs 36 to 38).

In so holding, the judge rejected Elektrim’s submission that article 4(2)(f) was concerned with *execution* by individual creditors against the debtor’s assets and that, correspondingly, the exception in that article and article 15 only referred to *execution* which required the assistance of the court. The draftsman could not sensibly have intended a distinction between cases in which proceedings for execution had commenced and those in which they had yet to be commenced. The purpose of the Insolvency Regulation was –

- (a) to ensure the effective administration of the debtor’s assets and to avoid one creditor gaining an advantage over others; and
- (b) to protect the legitimate expectations of parties and the certainty of transactions.

To accept the construction advanced by Elektrim would frustrate these objectives because execution proceedings should be subject to the law of the main proceedings, irrespective of the time or method of commencement; whereas pending proceedings which merely sought to establish the validity of a claim should be subject to law of the place where that lawsuit is pending, the parties having committed themselves to those proceedings (paragraphs 47 and 50).

Further, the judge considered there was no good reason why arbitration proceedings should not fall within articles 4(2)(f) and 15. Arbitration proceedings are extensively used and it was ‘archaic’ to regard such proceedings as somehow inferior to judicial proceedings, as indicated by the fact the UNCITRAL Model Law extended to arbitration proceedings (paragraphs 52 to 59).

Arbitration agreements and current contracts

Having resolved issue (b) in this way, in respect of issue (a), the judge concluded a conflict existed between articles 4(2)(f) (exception) and 15 on the one hand and article 4(2)(e) on the other. In particular, he considered that, as the validity of an arbitration agreement is a necessary precondition to the continuance of any reference and the making of an award, article 4(2)(e) would deprive articles 4(2)(f) (exception) and 15 of effect in *every* case (paragraph 80). On this basis, it was to be inferred the legislature intended article 4(2)(e) in the case of conflict was to give way to articles 4(2)(f) (exception) and 15, those articles being the more specific provisions and requiring the lawsuit to be governed ‘*solely*’ by the law of the member state in which it is pending (paragraph 96).

In so holding, the judge rejected Vivendi’s submission that a solution was to be found by distinguishing between substantive and procedural contracts and

applying article 4(2)(e) to the former category only, which did not include arbitration agreements. This would introduce a qualification without any basis in the language of the Insolvency Regulation (paragraph 99).

The judge also rejected Elektrim's submission that no conflict between articles 4(2)(e) and 4(2)(f) (exception) and 15 in fact existed, each article positing a discrete choice of law rule relating to a discrete choice of law problem. The fact that their effect was overlapping and contradictory on the facts of the present case was said by Elektrim to be irrelevant. It flowed from the apparently unique article of Polish law in issue. To fail to give full effect to article 4(2)(e) would deny effect to, for example, the power of a liquidator to disclaim a contract governed by foreign law and thereby provide the company in liquidation with an additional defence in the foreign proceedings (paragraph 72). Article 4(2)(e) dealt with substance, articles 4(2)(f) (exception) and 15 with procedure and could be applied successively or concurrently.

Analysis

The judge's reasoning on issue (b) is forceful and difficult to criticise. In terms of ensuring an effective administration of the debtor's assets, it is rational that only the law of the main proceedings (or any secondary proceedings) should apply to execution proceedings, which represent a direct threat to the integrity of the estate. By contrast, in respect of proceedings pending, any value to be obtained from application of the law of the state of the opening of proceedings should yield to the parties' expectation that, having commenced a lawsuit, only the law of that state should determine whether or not the lawsuit should continue after the insolvency of one party. An English creditor must be taken to expect that, should insolvency proceedings be opened against his French counterparty in France, English law will apply to determine whether any pending English proceedings are stayed.

The judge must also be correct in rejecting a distinction between substantive and procedural contracts. A choice of law clause or a choice of court clause or arbitration agreement is a promise not to do something and it is on this basis that the courts are beginning to develop a jurisdiction to award damages for their breach: see *Union Discount Co Ltd v Zoller* [2002] 1 WLR 1517. Such clauses cannot, as such, be distinguished as merely specifying how the parties' underlying dispute is to be resolved.

The judge's reasoning on issue (a) is less easy to follow and not so forceful. It is, firstly, difficult to accept any order of priority exists between articles 4(2)(e) and 4(2)(f) (exception) and 15. Article 4(2) supplements article 4(1) as a non-exhaustive list, and so a priority between the various examples cannot readily be inferred (unlike, for example, the various sub-rules under rules 4.218(1) and 2.67(1) of the Insolvency Rules 1986, cf. *re Toshoku Finance plc* [2002] 1 WLR 671) and, further, there is no express rule of priority. The judge's construction of the word 'solely' in article 15, at paragraph 95, is, in this respect, strained: the word connotes only that the law of the state in which the lawsuit is pending and no other shall apply to determine the effect of the opening of insolvency proceedings on that lawsuit.

There is, secondly, no contradiction in English law applying to the arbitration proceedings pursuant to one choice of law rule (article 4(2)(f) (exception) and 15) and Polish law applying to the underlying arbitration agreement under another law (article 4(2)(e)). The fact that the law applicable under article 4(2)(e) might have the effect of invalidating the proceedings is by-the-by, and it is not something which renders arbitration inferior to judicial proceedings. The law applicable under article 4(2)(e) may invalidate a choice of law or choice of court agreement in the same way that article 142 would appear to invalidate the arbitration agreement in this case, and, in this respect, any damage to the parties' expectations flows from the law properly applicable and not article 4(2)(e) itself.

The principal difficulty with the judge's reasoning is that, in effect, it deprives article 142 of the Polish Bankruptcy and Reorganisation Law of any application to the arbitration agreement as a current contract. The desire to reach this conclusion is readily understandable: the reference had been issued in 2003 and had produced an award shortly after the opening of insolvency proceedings. Article 142 is nonetheless a choice made by a foreign legislature in the interests of centralising all creditors' claims into the Polish bankruptcy court and, short of some public policy reason, it is not obvious why that choice should not be given effect to, being part of the law applicable to the main proceedings.

If the judgment is appealed and a reference subsequently issued to the Court of Justice, that court may decline to adopt a construction so focused on the litigation at hand and might reasonably seek to ensure the choice made by the law of the main proceedings is given effect to.

ORDER FORM – Please complete

I wish to subscribe to *International Corporate Rescue* from 1 January 2019 – 31 December 2019.

Hardcopy Online Hardcopy + Online (please tick)

I wish to have online access to all Special Issues

I wish to have online access to back catalogue (Volumes 1-15)

My preferred method of payment is:

Cheque Credit Card Bank Transfer Please invoice me (please tick)

Name

Address

.....

Postcode / Zip

For payment by credit card please complete the following details:

American Express Discover MasterCard Visa (please tick)

Name as it appears on the card:

Card no.

Issue Date: Expiry Date:

Security Code:

Signed *Date*

Payment notes / Cancellation

Returning this form constitutes the subscriber's agreement to subscribe to *International Corporate Rescue* for one year, on the following terms and conditions. Payment is due from each subscriber annually in advance by cheque, credit card (through PayPal), or bank transfer. Although any subscription may be cancelled at any time no refunds are made in any circumstances. A hardcopy subscription is EUR 730 / USD 890 / GBP 520; online: EUR 730 / USD 890 / GBP 520; and hardcopy + online: EUR 840 / USD 1045 / GBP 625. Rates per additional hardcopy or online user are: EUR 165 / USD 220 / GBP 145. If applicable, VAT is charged on online and hardcopy + online subscriptions. Hardcopy-only is zero-rated for VAT purposes. For package subscriptions, VAT is charged on the entire package.

Special Issues. Price for individual Special Issues for subscribers: EUR 125 / USD 175 / GBP 105; for non-subscribers: EUR 165 / USD 225 / GBP 135. Online access to all Special Issues for subscribers: EUR 375 / USD 535 / GBP 315; for non-subscribers: EUR 495 / USD 695 / GBP 420. Online subscription plus access to all Special Issues: EUR 995 / USD 1250 / GBP 740. Hardcopy + online subscription plus access to all Special Issues: EUR 1150 / USD 1450 / GBP 875.

Back Catalogue (Volumes 1-15). Price for single user online access to back catalogue: EUR 815 / USD 975 / GBP 750; Online subscription plus access to back catalogue EUR 1545 / USD 1865 / GBP 1270. Hardcopy + online subscription plus access to back catalogue EUR 1655 / USD 2020 / GBP 1375

Please complete and return this form to:

Chase Cambria Company (Publishing) Limited
4 Winifred Close
Arkley
Barnet EN5 3LR
United Kingdom

