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BARRISTERS' CHAMBERS

Insolvency Judgments

Produced in conjunction with

Cork Gully

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Contents

Introduction

This report is the second of our quarterly publications prepared in conjunction with Cork Gully, summarising some of the important insolvency decisions of the last 3 months.

This last quarter has seen some interesting developments in the case law. The Supreme Court heard *Rubin v Eurofinance* in late May and its decision is keenly awaited. Judging by the response of the various Law Lords, it might be fair to predict a split ruling!

Lower down the judicial ladder, the Court of Appeal heard 4 joined cases on appeal and considered the construction of the International Swaps and Derivative Association (ISDA) form of Master Agreement, in the context of interest rate and forward freight agreement swaps. The cases, reported under the name of *Lomas v JFB Firth Rixson*, gave the Court of Appeal the opportunity to consider the true effect of provisions in this commonly-used agreement. It held that section 2(a)(iii) of the agreement does not extinguish, but merely suspends the obligations of the defaulting party to pay and that suspensory effect did not breach either the anti-deprivation principle or the *pari passu* principle. That clears up some but not all of the areas of uncertainty surrounding this agreement, which High Court judges increasingly find themselves having to interpret.

The recent spate of football insolvencies has led to a surge in litigation in this field. In *HM Revenue & Customs v The Football League*, the Revenue challenged the *"football creditor"* rule as a device under which the FA and football clubs are paid in full whilst other creditors are left out. The Revenue submitted that these rules offended both the *pari passu* principle and the anti-deprivation principle. That submission was rejected; the Court held that the Football League's rules were acceptable and understandable.

In the case of *Edenwest v CMS Cameron McKenna,* the claimant company had been through an administrative receivership pre-pack. After the claimant gave the receivers their release, it came to believe that its assets had been undervalued on the sale, as the result of negligent advice from the receivers' solicitors. The solicitor applied for summary judgment on the basis that they had only acted for the receivers and could not be liable to the claimant company. The claimant argued that the receiver is an agent for the company so his solicitor must be the company's solicitor. The Court considered the position of a receiver in depth and concluded that the relationship of agency is primarily a device to protect the mortgagee, who is the receiver's true master, and that general agency principles are of limited assistance in identifying the duties owed by a receiver to the company.

In *Singla v Stockler*, solicitors had been instructed in litigation by a liquidator. The litigation was funded throughout by one of the creditors of the company and the solicitors had shared all the privileged material with the creditor. Subsequently the creditor brought misfeasance proceedings against the liquidator, who sought an injunction to restrain information being passed over to the creditor. The liquidator failed before the Master and on appeal: there could be situations in which there was such a community of interest between a litigant and a third party that the litigant's solicitor was not obliged to keep information arising in the performance of his retainer confidential from the third party.

Finally a recent decision (*Re Ultraclass Ltd*) of a deputy Judge has reiterated that, if justice requires it, a liquidator might be granted a freezing injunction without his having to provide a personal unlimited undertaking in damages, and without having to fortify the cross-undertaking by a bond or indemnity from creditors.

Lomas v JFB Frith Rixson (and 3 consolidated appeals)

[2012] EWCA Civ 419

Court of Appeal (Longmore, Patten, Tomlinson LJJ)

Construction of the ISDA 1992 Master Agreement. The true effect of the suspension of rights did not offend against anti-deprivation or pari passu principles.

The Court of Appeal was invited to construe derivatives in the form of interest rate swaps and forward freight agreements which were subject to the ISDA 1992 Master Agreement.

They had to decide whether obligations to make payments subsist after the party to whom payment is due has committed an event of default, and if so, for how long. The Court:

i) held that section 2(a)(iii) of the Master Agreement does not extinguish obligations of defaulting parties to pay or deliver under section 2(a)(i), but merely suspends its coming into existence until the event of default is cured;

ii) said that there was no implied term to the effect that suspension imposed by non-fulfilment of the condition precedent in section 2(a)(iii) would last only for a reasonable time or, until such time as all transactions between the parties governed by the Master Agreement had run their course;

iii) upheld *Pioneer Freight Futures Co Ltd* (*In Liquidation) v TMT Asia Ltd* [2011] 2 Lloyd's Rep 565 which decided that for the purposes of determining what was due on a particular settlement date, section 2(c) of the Master Agreement imposed an automatic netting process, without regard to whether one or other party had complied with conditions precedent in section 2(a)(iii); and

iv) explained that the suspensory effect of section 2(a)(iii) did not engage the anti-deprivation principle, nor did it offend the pari passu principle of insolvency distributions.

Recent case law in the High Court has given rise to uncertainty as to the effect of section 2(a)(iii) of the Master Agreement and this decision provides clarity by confirming the ISDA's view that section 2(a)(iii) suspends the payment obligations (potentially indefinitely) until the event of default is cured.

H.M. Treasury has expressed concerns that suspending payments to insolvent counterparties indefinitely creates an undesirable level of uncertainty and has an adverse impact on creditors. This remains a live issue in the wake of the decision of the Court of Appeal and it seems likely that further proposed ISDA amendments to the Master Agreement are needed to curtail the indefinite effect of section 2(a)(iii).

Office Metro; Trillium (Nelson) Properties v Office Metro

[2012] EWHC 1191 (Ch)

Companies Court (Mann J)

Article 3(2) of the EC Regulation on Insolvency Proceedings; the relevant date for the purposes of determining whether a debtor has an establishment in this country is the date on which the petition is presented and not the date upon which the petition debt arose.

Where a company has its centre of main interests ('COMI') in another EC state, whether the High Court has jurisdiction pursuant to Article 3 of the EC Regulation on Insolvency Proceedings to open insolvency proceedings in this country is to be determined by whether the company has an establishment in England and Wales on the date of the presentation of the winding-up petition.

Trillium sought to recover a debt owed to it by Office Metro. The debt became due in September 2011. Trillium presented its petition to wind-up the Company on 5 October 2011. By that time, insolvency proceedings had already been commenced in Luxembourg, the company's COMI.

Trillium argued that a broad interpretation should be applied to Article 3(2) in determining the relevant date for assessing whether the Company had an establishment in England. Trillium's case was that the relevant date was that of the transaction giving rise to the petition debt, rather than the date of presentation of the petition.

The Court held that the relevant date for the purposes of determining whether or not the debtor had an establishment in this country on construction of Article 3 itself was the date the petition was presented. Article 3(1) reads: '*The courts of the Member State within the territory of which the centre of a debtor's main interest is situated shall have jurisdiction to open insolvency proceedings'*; the Court observed: *"That seems to refer to a single moment in time, namely when the proceedings are opened"*. Indeed, were it otherwise, as the Judge noted, the Article would be unworkable because there could be a number of main proceedings. Article 3(2) follows the same theme. The petition was accordingly dismissed.

The case provides clarification of Article 3(2) of the EC Regulation on Insolvency Proceedings and in particular on the relevant date for the purposes of determining whether a debtor has an establishment in this country.

H.M. Revenue & Customs v The Football League

[2012] EWHC 1372 (Ch)

Chancery Division (David Richards J)

The "football creditor" rule; attempts to circumvent the principles of pari passu distribution and anti-deprivation; the application of those principles to administration.

The Revenue challenged provisions in the Football League's (FL) Articles as *"a device under which, on insolvency [of an FL club], 'football creditors' are paid in full whilst ordinary unsecured creditors of the same class receive a very modest dividend"*. The specified class of football creditors included the FL itself, other clubs, and employees.

The FL's device had two limbs, argued the Revenue. First, a club's entitlement to television revenues from the FL was stated to be conditional on completion of the football season, although payments were made on account throughout the season, and if the club defaulted on any payments to football creditors, the payments on account would be diverted to its football creditors until the debts were discharged. Secondly, upon undergoing an insolvency event (including entering administration) a club would be forced to give up its membership of the FL unless it paid its football creditors in full.

The Revenue submitted that these rules offended the pari passu principle and the anti-deprivation principle.

The Court determined that, in administrations, the anti-deprivation principle applies at the point of entry into administration while the pari passu principle applies only if and when the administrator makes a general distribution to creditors.

As to the first limb, a mere default on a debt did not engage the anti-deprivation principle, and anyway in the typical case of an insolvency during the season the conditionality of the Revenue's entitlement meant that there was no lost asset upon which either principle could bite.

As to the second limb, the club's membership of the FL ceased to have value upon insolvency, because the other members of the league had effectively agreed, as was their right, not to deal with such a club; so again the anti-deprivation challenge failed. Any preferential payment of the football creditors by an administrator under threat of losing membership was not in breach of the pari passu principle since it was not yet engaged.

The case provides useful clarification of the application of the pari passu and anti-deprivation principles to administrations.

Edenwest Limited v CMS Cameron McKenna

[2012] EWHC 1258 (Ch)

Chancery Division (Hildyard J)

The legal relationships between a company, its administrative receivers, and their advisers.

The claimant had been through a pre-pack administrative receivership.

During the pre-pack stage, the prospective receivers ("the Receivers") had taken advice about the value of certain of the claimant's assets by the defendant solicitors. Upon the Receivers' appointment, the pre-pack was put into effect and the assets sold.

Only after the claimant had granted the Receivers their release did it come to believe that the assets were worth more than they had been sold for, and more than the solicitors had advised. The claimant sued the solicitors in contract and tort.

The solicitors applied for summary judgment arguing that they had not contracted with the claimant and owed it no tortious duty of care. The claimant submitted that, because a receiver is an agent of the company, his contracts must be those of the company, including those entered into prior to his appointment, for the purpose of the receivership. The court held that the receiver was a limited and ambiguous species of agent: limited because the company cannot instruct or dismiss the receiver, and the receiver owes no contractual or tortious duties to the company; ambiguous because the receiver's primary duties are to the mortgagee who appointed him. The relationship of agency is primarily a device to protect the mortgagee, his true master; general agency principles are of limited assistance in identifying the duties owed by the receiver to the mortgagor.

Therefore, while it was possible for a receiver to contract either on his own behalf or on behalf of the company, the Court would require clear evidence that he had contracted on behalf of the company where there was likely to be a conflict of interest between the company and the receiver's true master. A realisation of the company's assets was just such a situation. In this case there was no reasonable prospect of the claimant establishing a contractual relationship with the solicitors.

The Court decided that the solicitors owed no tortious duty of care to the claimants. The proper cause of action was against the Receivers themselves, who had been released by the claimant before they were aware of the claim.

The case is useful for its general analysis of a receiver's obligations towards the company on the one hand and mortgagee on the other, and of the different capacities in which the receiver can deal with third party advisers. It is also a reminder of the need to take care before granting receivers their release.

Westwood Shipping Lines v Universal Schifffahrtsgesellschaft

[2012] EWHC 1394 (Comm)

Commercial Court (Christopher Clarke J)

Recognition of EC insolvency proceedings; costs consequences of failure to inform creditors of foreign proceedings.

Upon C's demand for payment of an arbitration award, D's lawyers assured C of its intention to pay but asked for time to pay. Four days later however, unbeknown to C, D applied to open insolvency proceedings (*Insolvensverfahren*) in Germany.

The German Court made an Order appointing a "*preliminary insolvency liquidator*" (*Vorläufiger Insolvenzverwalter*) over D. The Order set out the powers of the liquidator and prohibited or suspended any measures of enforcement over D's assets. The Court did not at this stage make an order to open *Insolvensverfahren*.

D failed to publically register the Order on the German Insolvency Register, or inform C of the proceedings, for two months. Meanwhile, C had applied to the English Court for the appointment of a receiver to enforce the arbitration award.

D now sought the dismissal of the English application in compliance with the German Order. The Court considered the EC Regulation on Insolvency Proceedings and in particular Article 16 which requires any judgment opening insolvency proceedings to be recognised in all other Member States. The question was whether the first step of appointing a Vorläufiger Insolvenzverwalter constituted such a judgment. The Court held:

1. The ECJ decision in *In re Eurofood IFSC Ltd* [2006] Ch 508 set out the requirements for a decision which does not formally describe itself as an opening decision to qualify nevertheless. The critical issue in this case was whether there had been a divestment of the debtor;

2. The Order qualified as a divestment despite the fact that preliminary liquidator had only acquired a power of veto over the disposal of D's assets, and could be removed by D withdrawing its own insolvency filing at any time prior to the formal opening of proceedings;

3. This conclusion accorded with the policy of recognition of international insolvency proceedings "*as soon as possible*" set out by the ECJ in *Eurofood*.

The Court therefore dismissed C's application.

D faced adverse cost consequences despite its success. The Court held that where D had given assurances of payment to C shortly before initiating the German proceedings, and could clearly have foreseen C's enforcement application in default of payment, D should have immediately informed C about the proceedings. It was ordered to pay C's costs up to the date on which C learnt of the appointment of the liquidator .

Ceart Risk Services Ltd; Bootes v Ceart Risk Services Ltd

[2012] EWHC 1178 (Ch)

Companies Court (Arnold J)

Appointment of administrators without the FSA's prior approval is a curable defect.

Ceart was a company authorised by the Financial Services Authority ("FSA") to carry on non-investment insurance intermediation.

Ceart appointed administrators under paragraph 22 of Schedule B1 to the Insolvency Act 1986 ("IA 86") without obtaining prior approval of the FSA as required by s.362A(2) of the Financial Services and Markets Act 2000 ("FSMA"). The FSA subsequently gave its written consent to the appointment of the administrators. Prior to filing the consent in court, the administrators sold the assets of Ceart. The owner and director of Ceart and the administrators sought a declaration from the court that the administrators were validly appointed.

Having considered the wording of s.362A of FSMA, the Judge found that a failure to obtain the FSA's prior approval constituted a curable defect, which was cured by the subsequent consent given by the FSA. The Judge took the view, applying R v Soneji (Kamlesh Kumat) [2006] 1 AC 340, that Parliament did not intend for the consequences of non-compliance with s.362A(2) to result in incurable invalidity

The Judge looked to paragraph 31 of Schedule B1, which states that an appointment under paragraph 22 is effective when the requirements of paragraph 29 are satisfied (i.e. when all necessary documents under s.362A have been filed with the Court).

The Judge declared that the appointment of the administrators took effect when all the necessary documents (including the FSA's written consent) were filed in court.

The Judge declared that the administrators' acts between the date of their defective appointment and the date when the FSA's consent to their appointment was filed in court were valid. The Judge found that the applicants could rely on paragraph 104 of Schedule B1 (which states that the acts of an administrator are valid in spite of a defect in his appointment) because the defect in the appointment was curable.

A defective appointment of an administrator due to a failure to obtain the FSA's prior approval is a curable defect. However, there is a difference of judicial opinion on the applicability of paragraph 104 in validating the acts of administrators prior to their appointment becoming effective in such circumstances. Care should be taken to ensure that all consent requirements have been satisfied prior to making an appointment.

Singla v Stockler

[2012] EWHC 1176 (Ch)

Chancery Division (Briggs J)

Displacing the ordinary duty of confidence owed to a liquidator by his solicitor.

The liquidator of a company called 9MD instructed a firm of solicitors in litigation, which was funded by 9MD's major creditor ("OSB"). Throughout those proceedings, the solicitors (with the liquidator's knowledge) disclosed to OSB material that otherwise would have been confidential to the liquidator.

A third party subsequently began an action against 9MD and the liquidator personally in California. For three weeks, the solicitors gave the liquidator legal advice falling short of a formal retainer. During that time the solicitors, the liquidator and OSB communicated about the proceedings. OSB subsequently commenced misfeasance proceedings against the liquidator, retaining the solicitors to act for it. The liquidator sought an injunction to restrain the solicitors from acting for OSB and passing information to it, together with disclosure of the information which they had passed over to OSB. The Master dismissed the liquidator's claims. The liquidator appealed.

On appeal Briggs J upheld the Master's order. The Court found that there could be situations in which there was such a community of interest between a litigant and a third party that the litigant's solicitor was not obliged to keep information arising in the performance of his retainer confidential from the third party. That release from the ordinary obligation of confidence could arise expressly, or could be implied by reason of the circumstances or the parties' conduct.

The Court said that the close correlation between a liquidator's duties in pursuit of litigation and the interests of a creditor funding that litigation was not of itself sufficient to displace the obligation of confidence owed to the liquidator by his solicitor. However, in the instant case, there had been such a high degree of co-operation and disclosure between the liquidator and OSB that the ordinary duty of confidence had been displaced by their mutual conduct.

The solicitors had not acquired information in the previous proceedings that had to be kept confidential from OSB and it could therefore act for OSB in subsequent proceedings against the liquidator.

Liquidators should be aware that the ordinary duty of confidence owed by their solicitors might be displaced if they share information and documents with creditors funding the litigation.

Ultraclass Ltd; Michael v Assemakis

Chancery Division (Mr Bernard Livesey QC sitting as a Deputy High Court Judge)

A liquidator need not give the Court his personal unlimited cross-undertaking in damages nor fortify it.

Where the justice of the case requires that a freezing injunction granted in favour of a liquidator continue on the basis of a limited cross-undertaking in damages, the liquidator will not be required personally to give an unlimited undertaking nor to make arrangements to fortify any cross-undertaking by way of a bond or indemnity from creditors.

Ultraclass's liquidator applied to continue a freezing injunction over the defendants' assets to the value of around £3.4 million. The defendants applied to have the injunction discharged or for a more extensive cross-undertaking in damages fortified by a bond or indemnity provided by creditors.

The Judge reviewed the authorities dealing with the requirements in respect of cross-undertakings from liquidators in support of applications to be granted, or for the continuation of, freezing injunctions, in particular: *Re: DPR Futures Limited* [1989] 1 WLR 778 (Millett J) and *RBG Resources v Rastogi* [2002] EWHC 2782 (Laddie J) and B*loomsbury International Ltd v Holyoake* [2010] EWHC 1150 (Ch) (Floyd J).

The Judge concluded that in deciding the appropriate extent of any cross-undertaking, the Court should make an order aimed at achieving practical justice between the parties. Relevant considerations include the strength of the case against the defendant and the resources both of the company in liquidation and its creditors.

Where, as in this case, there was strong prima facie evidence that the defendants were liable in fraud and misfeasance and the financial position of the company and its creditors was such that any increase in the cross-undertaking or a requirement that a bond or indemnity be provided would stifle the claim, it would be appropriate not to make any order for increasing the cross-undertaking or for the provision of a bond/ indemnity.

This case affirms that a liquidator's inability to secure funds to fortify his cross-undertaking in damages need not preclude his obtaining a freezing injunction.

About XXIV Old Buildings

XXIV Old Buildings is a long-established set of self-employed barristers based in Lincoln's Inn, near the High Court at the heart of legal London.

XXIV provide specialist legal advice and advocacy services in London, nationwide and worldwide to the financial, commercial and professional community as well as to private individuals.

The members of XXIV Old Buildings are particularly well-known for appearing in Court in off-shore and cross-border disputes and insolvencies. Members also advise individuals and companies, in the UK and abroad, on a wide range of contentious and transactional matters.

XXIV Old Buildings is recognised in the legal directories as one of the leading insolvency chambers. Our members deal with domestic corporate insolvencies and bankruptcies as well as complex international insolvency disputes. As such we have been involved in the major insolvencies of recent years including Lehman Brothers, Kaupthing, Madoff, Bear Stearns.

As self-employed barristers, we are able to take instructions directly from English solicitors, foreign lawyers and also from qualified accountants and other professionals.

Members are experienced in all aspects of insolvency law including:

- Administrations & liquidations
- Asset tracing and recovery in fraud cases
- Bankruptcy & bankruptcy restriction orders
- Cross-border insolvency
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- Directors' disqualification
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Further details are available on the website at: http://www.xxiv.co.uk/

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About Cork Gully LLP

In 1906 WH Cork established WH Cork & Co as an insolvency practice largely focused on helping businesses in the grocery trade. In 1935, WH Cork formed a partnership with his son Kenneth and another accountant, Harry Gully, creating Cork Gully. After WH Cork's death and a period of war service, Kenneth became the owner of the firm and built the business to become the leading name in the field of insolvency work.

Sir Kenneth Cork (as he later became known) was chairman of the Cork Committee, which published the Cork Report in 1982, leading to a change in primary legislation and subsequent introduction of the Insolvency Act 1986.

Stephen Cork now leads the business, representing the fourth generation to be in the field of restructuring. Stephen and the vastly experienced team he has brought to Cork Gully have advised both owner-managed businesses and main listed publicly quoted companies on the recovery strategies available to the Board as well as their financiers.

Cork Gully provide a comprehensive range of formal and informal corporate recovery and insolvency services. Their services are delivered by a team of seasoned professionals who have extensive experience of the restructuring environment. The current trading environment is increasingly complex and fast moving – so the solutions they provide to their clients are more creative, responsive and effective than ever.

More information can be found at www.corkgully.com

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- Return of capital

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- Managed exits
- Debt for equity swaps
- Compromise agreements

Recovery

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- Forensic accounting
- Investigation services
- Asset tracing and recovery
- Creditor services

Insolvency

- Contingency planning
- Advice to board of directors
- Administrations
- Company voluntary arrangement
- Receiverships
- Insolvent liquidations
- Personal insolvency

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