Nottingham Law School

Centre for Business and Insolvency Law

Insolvency Bulletin
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Volume 1

Welcome to the first ever edition of our Insolvency Bulletin which we hope that you will enjoy!

There has been some extremely interesting insolvency activity lately on a wide range of issues. From a cross-border perspective, *Phoenix Kapitaldienst* raises the question (considered but unanswered in *HIH*) as to the extent of the common law jurisdiction to grant assistance and recognition in an overseas insolvency. The Court of Appeal has now, in two separate cases, clarified some of the conflicting cases on TUPE. We are also delighted to observe that three of our Visiting Professors have been directly involved in a number of the high profile cases discussed in this term's bulletin:

- Hamish Anderson (Norton Rose LLP) acts for the US Trustee of Lehman Brothers Inc. and represented the Trustee in the recent Supreme Court case relating to the interpretation of the FSA's Client Money Rules;

- Richard Sheldon QC (3-4 South Square) represented the administrators of Hellas II in an application for directions following the achievement of the purposes of the administration; and

- Mr Justice Norris has delivered two judgments (*Bezier Acquisitions* and *Virtualpurple*) in the run of conflicting cases on defective appointments of out-of court administrators.

Do come and visit us in Nottingham if you can: **we will be hosting the INSOL Europe Joint Insolvency Conference on 28th and 29th June 2012**. Otherwise, please look out for the next edition or our Bulletin which will be posted in the Summer term.

With best wishes for a lovely Easter break,

Paula
Paula Moffatt

1. Cross-Border

Zaza Retail [2011] EU ECJ-112/10

Lornamead Acquisitions [2011] EWHC 2611 (Comm)

PrimaCom Holdings [2011] EWHC 3746 (Ch), [2012] EWHC 164 (Ch)

Phoenix Kapitaldienst [2012] EWHC 62 (Ch)

2. Structured Finance

In the matter of Lehman Brothers International (Europe) (in administration) [2012] UKSC 6

In the matter of Kaupthing Singer & Friedlander Limited (in administration) [2011] UKSC 48

In the matter of Hellas Telecommunications (Luxembourg) II SCA (in administration) [2011] EWHC 3176

3. Defective Appointments

Messrs Baker & O'Reilly v London Bar Company Limited [2011] EWHC 3398 (Ch)

In the matter of Virtualpurple Professional Services Limited [2011] EWHC 3487 (Ch)

In the matter of Bezier Acquisitions Limited [2011] EWHC 3299 (Ch)

National Westminster Bank plc v Msaada Group [2011] EWHC 3423 (Ch)

4. TUPE

Spacewright Europe Limited [2011] EWCA Civ 1565

Key2Law (Surrey) LLP [2011] EWCA Civ 1567

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1 CROSS-BORDER

Zaza Retail (Area of Freedom, Security and Justice) [2011] EU ECJ C-112/10

Executive summary

A Public Prosecutor acting in the public interest but not as a creditor or on behalf of any creditors did not fall within the definition of "creditor" for the purposes of Art 3(4)(b) of the EC Insolvency Regulation nor was the Public Prosecutor empowered to bring territorial insolvency proceedings under the exception in Art 3(4)(a).

Facts

This was a preliminary ruling on the interpretation of Arts 3(4)(a) and (b) of the EC Regulation on Insolvency Proceedings No 1346/2000 (the "Regulation").

Zaza Retail BV ("Zaza") was a company incorporated in the Netherlands and which had its centre of main interests ("COMI") there.

In November 2006, the Public Prosecutor ("PP") filed an insolvency petition in respect of Zaza's Belgian establishment in the Belgian court. No insolvency proceedings were opened in the Netherlands. In February 2008, the Belgian court declared Zaza insolvent.

In October 2008, the Court of Appeal in Antwerp ruled that neither it nor the Belgian court had jurisdiction to rule on the opening of territorial insolvency proceedings against Zaza on the basis of its Belgian establishment.

The PP appealed to the Hof van Cassatie van België on two grounds: (i) that it had a public interest duty to bring proceedings. This meant that the definition of "creditor" under Art 3(4)(b) of the Regulation should be construed widely to include the PP so that the PP could request the opening of insolvency proceedings; and (ii) that the exception in Art 3(4)(a) applied[1] to the PP since, if it was not a creditor, it would not be able to bring main proceedings in the Netherlands.

The Hof van Cassatie stayed the proceedings and referred the following questions to the European Court of Justice for a preliminary ruling as to:

(i) the meaning of the term "conditions laid down" in Art 3(4)(a) of the Regulation; and

(ii) whether the term "creditor" under Art 3(4)(b) could be interpreted widely to include the power for a national authority (such as the PP) to request the opening of territorial insolvency proceedings and, if so, whether it required the national authority to be acting in the public interest.

1 This exception allows territorial proceedings to be opened before main proceedings in a case where main proceedings could not be brought because of "conditions laid down" by the law of the Member State within the territory of the debtor's COMI.

Decision

The ECJ ruled that:

(i) the term "conditions laid down" did not refer to conditions which excluded particular persons from the category of persons empowered to request the opening of such proceedings; and

(ii) the term "creditor" did not include an authority of a Member State whose task under the national law of that state was to act in the public interest, but which was not intervening as a creditor or on behalf of creditors.

Comment

This case appears on the face of it slightly odd: how did the PP get so far when the judgment seems to be a statement of the obvious? One possibility (suggested by my esteemed colleague Gary Wilson) is that he was simply following a principle of Belgian law allowing a public interest winding up.

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Lornamead Acquisitions Limited v Kaupthing Bank HF [2011] EWHC 2611

Executive summary

English proceedings against an insolvent Icelandic bank would not be stayed or struck out since (i) following *Rawlings,* the Icelandic bank was not in reorganisation or winding up proceedings for the purposes of the Credit Institutions (Reorganisation and Winding Up) Regulations 2004 at the time that the proceedings were brought; and (ii) for the purposes of the Lugano convention, it was clear that the dispute fell to be governed by English law in accordance with the jurisdiction clauses agreed by the parties in the transaction documents.

Facts

Kaupthing Bank HF (the "Bank"), was both the agent and a lender in respect of various senior syndicated secured loan facilities and mezzanine finance amounting to £100 million granted to Lornamead Acquisitions Limited (the "Company"). The original transaction documents included a Security Trust Deed and a hedging agreement which provided that the Company's obligations under the hedging arrangements would be secured. All the documents were governed by English law.

The Bank was an Icelandic company and the Company was incorporated in England. Following the collapse of the Icelandic banking system in October 2008, the Icelandic Financial Supervisory Authority appointed a Resolution Committee for the Bank. The Bank later transferred its rights and obligations under the facilities to an affiliate, GE. The transfer was completed in April 2009 and in June 2009, the Company entered into new hedging arrangements with GE.

In March 2010, despite almost a year without contact, the Bank demanded sums due from the Company under nineteen open hedging positions and required the Company to post collateral for the contingent liabilities arising under those positions. The Resolution Committee for the Bank called an event of default which terminated the hedging arrange-ments and stated an intention to bring recovery proceedings against the Company.

In May 2010, the Company brought proceedings in England for a declaration that the proper construction of the 2009 transfer documents had discharged it from all liabilities under the hedging arrangements.

In March 2010, the Bank applied for an order that:

(i) the English proceedings be stayed or struck out on the basis of Article 116 of the Icelandic Bankruptcy Act and Regulation 5(1) of the Credit Institutions (Reorganisation and Winding Up) Regulations 2004 (the "2004 Regulations");

(ii) the English court had no jurisdiction over the English proceedings under Article 17 of the Lugano Convention;

(iii) that the English court should not exercise any jurisdiction that it may have and should stay the proceedings on *forum non conveniens* or case management grounds.

Decision

The judge followed the case of *Rawlinson & Hunter Trustees SA v Kaupthing Bank HF* [2011] EWHC 566(Comm) (*"Rawlinson"*) and held that, in May 2010 when the Company had issued proceedings, the Bank was not subject to an EEA insolvency measure within the meaning of the 2004 Regulations because the Bank had been found in *Rawlinson* to be subject neither to "reorganisation" nor "winding up" proceedings. The Bank's application to stay or strike out the English proceedings on that ground therefore failed.

As the decision in *Rawlinson* was subject to an appeal, the judge went on to consider the position in the event that *Rawlinson* was wrongly decided. She considered that, if this were the case and the Bank was subject to an EEA insolvency measure in May 2010, then the English proceedings should be stayed in accordance with 5(1) of the 2004 Regulations and the Company's claim should be resolved in the Bank's liquidation in accordance with Icelandic insolvency procedures. In view of this, she granted the Bank leave to appeal on this issue.

The judge went on to consider whether, if the Bank was not subject to an EEA insolvency measure, the Icelandic court had exclusive jurisdiction under Article 17 of the Lugano Convention. She dismissed the Bank's application and held that, in the light of the transaction documentation as a whole, the English proceedings fell within the scope of the English jurisdiction clauses so that the English court had exclusive jurisdiction by virtue of Articles 17 and 21 of the Lugano convention.

The judge rejected the Bank's application that the proceedings should be stayed on the grounds of *forum non conveniens* as it was doubtful whether the court had any residual discretion in this area.

Comment

The first issue was a tricky one: the judge had doubts about the decision of the judge in *Rawlinson* but could not say that she was "convinced" that he was wrong and so followed his decision. She gave thorough consideration to the possibility that *Rawlinson* might be wrong and was clear that the Bank would have won if this were to be the case – hence the leave to appeal.

With regard to the application of the Lugano convention, the judge was clear that, objectively, the parties should be taken to have intended that a dispute as to the construction of the transaction documents (i.e. the dispute as to whether the Company had been released from the hedging arrangements or not) was subject to the English court under the jurisdiction clauses.

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PrimaCom Holdings GmbH (1) Alcentra Group and others (2) v A Group of the Senior Lenders & Credit Agricole [2011] EWHC 3746(Ch) and [2012] EWHC 164(Ch)

Executive summary

The English court had jurisdiction to sanction a scheme of arrangement under the Companies Act 2006 even though none of the scheme creditors were domiciled in the UK.

Facts

PrimaCom Holdings GmbH (the "Company") was a German company. Following the insolvency of its German parent company in 2010, it had been acquired by a Luxembourg company "Medfort".

Medfort and its group companies provided cable television, internet and telephony products in Germany. In 2011, the group experienced a decline in financial performance.

The Company owed approximately €240 million to several categories of lenders and was due to make interest payments in December 2011 and January 2012 which it would struggle to meet. It applied to the court for approval to convene four creditors' meetings with a view to entering into a scheme of arrangement under part 26 Companies Act 2006 (the "Scheme").

The Scheme was part of a wider restructuring of the group as a whole to improve its liquidity and enable it to restructure its debts. None of the creditors were domiciled in England.

The directors of the Company considered that if the Scheme was not approved by 25 January 2012, then the Company would have to be placed in insolvency proceedings in Germany. The advantage of the proposed Scheme was that it would result in greater returns for creditors than would be achieved by German insolvency proceedings.

The issue was whether English court had jurisdiction to deal with the Scheme and, if so, what guidelines should be borne in mind.

Decision

The judge considered the proposed classes of creditors and held that they seemed reasonable: nothing indicated that the persons within each class had rights in relation to the Company that were so dissimilar that it would make it impossible for them to consult together within the class with a view to their common interests. The question of fairness generally would need to be considered at a later fairness hearing.

He held that the English court had jurisdiction to approve the Scheme on the following grounds:

(i) a German company was a "company" within the meaning of section 895 of the Companies Act 2006 as the definition extended to a company liable to be wound up under the Insolvency Act 1986 and a German company could be such a company;

(ii) the fact that all the finance documents and inter-creditor agreements were governed by English law provided a sufficient connection to the jurisdiction to warrant the exercise by the English court of its jurisdiction under section 895; and

(iii) having considered expert evidence, the exercise of the English court's jurisdiction in this matter, would be given effect in Germany.

Comment

This decision is interesting for the discussion about the EC Judgments Regulation (EC Regulation 44/2001 on the Jurisdiction and Enforcement of Judgments in Civil and Commercial matters).

Mr Justice Hildyard relied on the decision of Mr Justice Briggs in *Rodenstock GmbH* [2011] EWHC 1104 when delivering his first judgment as to the jurisdiction of the English court. He did not, however, specifically consider the primary rule in the Judgments Regulation: i.e. that the appropriate forum for the adjudication of a dispute is, in the ordinary course, the forum of the domicile of the defendant. Realising his omission, he went on to consider it at the second Scheme hearing (which would not normally have required him to give a judgment).

In *Rodenstock*, Briggs J did not have to consider whether there were defendants domiciled in the UK as more than 50% (by value) of the scheme creditors were domiciled in England. He recognised, however, that it would be an issue in a case where all the affected members or creditors were domiciled in Member States other than the UK.

PrimaCom was a case which fell into this category. Counsel for PrimaCom suggested four possible ways to address the matter:

(i) to take the view that Article 2 of the Judgments Regulation has no application to a scheme of arrangement as no-one is being sued;

(ii) to rely on Article 23, on the basis that the transaction documents contained exclusive jurisdiction clauses evidenced in writing;

(iii) to rely on Article 24, on the basis that the defendants had appeared in the English court and therefore it automatically had jurisdiction; or

(iv) as suggested in *Rodenstock* that, by analogy with Article 4, the English court should accept jurisdiction.

The judge concluded that his preferred view was that Article 2 did not apply to schemes of arrangement, but that if he were wrong then Article 2 could be read subject either to Articles 23 or 24, both of which were satisfied on the facts. He preferred these options to the Article 4 solution.

Also of interest is that at the first hearing, Credit Agricole sought an adjournment as it considered the proposed Scheme would be a waste of time. Rejecting the application, Mr Justice Hildyard expressed his unease. He clearly felt that he was caught in the cross-fire as the different creditors each tried to secure their own maximum possible advantage. In the end, he took the view that the adjournment would prevent even the possibility of rescue if the directors were correct that the Company was on the brink of German insolvency proceedings – which must have been the right view. He was later vindicated when three out of the four classes of creditors approved the Scheme with majorities of 100% and the fourth came in just under 100% both by number and value.

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In the matter of Phoenix Kapitaldienst GmbH and in the matter of the Insolvency Act 1986 [2012] EWHC 62(Ch)

Executive summary

Applying a principle of modified universalism, the English court had jurisdiction to authorise a German administrator to use section 423 of the Insolvency Act 1986 enabling him to set aside transactions entered into for the purpose of defrauding creditors.

Facts

Phoenix Kapitaldienst GmbH (the "Company") was a German company which had been involved in a world-wide "Ponzi" scheme.

The Company went into insolvency proceedings in Germany and an administrator was appointed. In 2008, the administrator successfully applied to the English court for a Recognition Order granting him recognition under the common law and authority to exercise the powers afforded to licensed insolvency practitioners under the Insolvency Act 1986 (the "1986 Act).

In 2010, the administrator applied for relief against the original investors in the Company (the "Appellants") in accordance with the Recognition Order. He sought to set aside certain transactions entered into by the Appellants under section 423 of the 1986 Act. The administrator's aim was to claim back the original investments plus profits for the Company's creditors.

The EC Regulation on Insolvency Proceedings (1346/2000) did not apply as the Company was an investment undertaking. The Cross-Border Insolvency Regulations 2006 (SI 2006/1030) did not apply because of the date it was incorporated into English law. The administrator could, therefore, only rely on common law principles.

Section 426 of the 1986 Act contains provisions for co-operation between courts exercising jurisdiction in relation to insolvency law and assistance for any "relevant" country or territory. Germany is not listed as a relevant country. The law to be applied means the law under the 1986 Act.

The Appellants appealed against the Recognition Order claiming that the English court has no inherent common law jurisdiction to allow the statutory power under section 423 of the 1986 Act to be applied to a foreign administrator who would not otherwise fall within the express scope of the 1986 Act.

Decision

Reading together *Cambridge Gas*, *HIH*, *New Cap Reinsurance* and *Rubin v Eurofinance SA*[2], the judge derived the following principles:

(i) there is a power to use the common law to recognise and assist an administrator appointed overseas;

(ii) assistance includes whatever the English court could have done in a domestic insolvency;

(iii) bankruptcy proceedings are collective proceedings for the enforcement (not the establishment) of rights for the benefit of all creditors even where those proceedings include proceedings to set aside antecedent transactions; and

(iv) proceedings to set aside antecedent transactions are central to the purpose of the insolvency.

Relying on the judgment of Lord Hoffmann in *HIH* she considered that, where there is conflict between black letter law and broad commercial support of international comity, the latter should prevail. She dismissed the appeal and held that the court had jurisdiction to grant recognition and assistance. She held that it would be perverse to refuse relief on discretionary grounds in a case where recoveries of proceeds of the alleged fraud had been made in the context of insolvency proceedings in over 20 other major jurisdictions. There was no prejudice to creditors resident in England.

Comment

There was an interesting debate about this case at the ILA Academics Colloquium in Luton last week. How far can the common law be stretched to fill the gaps when the EC Insolvency Regulation, the Cross-Border Insolvency Regulations and section 426 don't apply?

Paul Omar from the University of Sussex takes the view that the decision in *Phoenix* was an attempt to ensure that the common law develops in tandem with section 426 so that the relief and remedies they offer are harmonised.

The ILA Technical Bulletin No 391 picked up on the distinction between the establishment and the enforcement of rights. To date, the cases in this area have either recognised the foreign office-holder's ability to maintain actions to enforce pre-existing rights or recognised and enforced rights deriving from a foreign judgment. In other words, no cases exist in which the common law has established new rights. The ILA Bulletin looks at this both ways round. On one hand, the decision is debateable: does the making of a Recognition Order actually establish rights? On the other hand, the decision could be viewed as a natural progression from the principles in *Cambridge Gas*: it assisted the German court, saving the administrator from having to bring English proceedings to enforce its rights. (Although whether the administrator would have been able to bring English proceedings is not clear).

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[2] *Cambridge Gas Transportation Corporation v Official Committee of Unsecured Creditors of Navigator Holdings plc & Others* [2007] 1 AC 508; *Re HIH Casualty and General Insurance Limited, McGrath v Riddell* [2008] UKHL 21; *New Cap Reinsurance & Anor v AE Grant & others* [2011] EWHC 677 (Ch); *Rubin & Anor v Eurofinance SA and others* [2011] Ch 133

It is worth noting that more commentary may be forthcoming in this area when *Rubin* and *New Cap Reinsurance* hit the Supreme Court later this year.

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2 STRUCTURED FINANCE

In the matter of Lehman Brothers International (Europe) (in Administration) and in the matter of the Insolvency Act 1986 [2012] UKSC 6

Executive summary

Upholding the decision of the Court of Appeal by a majority of 3:2, the Supreme Court held that (i) a statutory trust under CASS7 arose as soon as client money was received by the firm; and (ii) that all monies in the firm's account, whether segregated or not, formed part of the pool available to clients and should be distributed on a "claims" rather than a "contributions" basis.

Facts

This case began in 2009 when the administrators of Lehman Brothers International (Europe) ("LBIE") applied to the court for directions under para 63 of Schedule B1 to the Insolvency Act 1986. Although it was not a licensed deposit-taker, LBIE was authorised to hold client funds. Following its administration, the ownership of these funds became a matter of dispute.

At first instance, Mr Justice Briggs was required to determine a range of issues concerning the client money rules in Chapter 7 of the Financial Services Authority Client Assets Sourcebook ("CASS7")[3] which create a statutory trust. The appointment of the administrators in September 2008 caused a "primary pooling event" ("PPE") for the purposes of CASS7 which meant that all client funds were notionally pooled. This then triggered a requirement for client funds to be distributed in accordance with section 9 of CASS7.

Although CASS7 required client money to be identified and paid into segregated accounts so that: (i) it could not be used by the firm for its own account; and (ii) on the firm's insolvency it would be immediately repaid to clients, this had not happened. LBIE had failed to identify and segregate client money.

The administrators needed to know how the non-segregated funds should be distributed. Mr Justice Briggs considered that funds should be distributed on a "contributions" rather than a "claims" basis. This meant that the client money pool should be shared in accordance with the amount that the firm had actually segregated for the client. This amount would be determined by the last internal reconciliation that had taken place before the PPE.

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[3] CASS7 was the result of the Markets in Financial Instruments Directive ("MiFID") and the MiFID Implementing Directive. These directives sought to achieve a harmonised degree of protection for investors based on the domestic rules of property and insolvency law.

Four of the issues raised at first instance were the subject of an appeal.

The Court of Appeal held that Mr Justice Briggs had been correct to conclude that, under CASS7, a statutory trust was created as soon as client money was received by the firm. He had been wrong, however to conclude that client money which formed part of the pooled assets, whether segregated or not, should be shared on a "contributions" basis as it should be shared on a "claims" basis: in other words, a client would be entitled to the amount that should have been segregated at the date of the PPE.

Permission to appeal to the Supreme Court was granted on three of the issues.

Issues

The issues raised in the Supreme Court were as follows:

(i) did the statutory trust under CASS7 arise at the time that the money was received from the client or at the time that it was segregated?

(ii) did the primary pooling arrangements apply to client money in house accounts?

(iii) was participation in the pool dependent on actual segregation?

The second and third issues were addressed together.

Decision

On the first, issue, the Supreme Court (Lords Hope, Walker, Clarke, Dyson and Collins) unanimously upheld the decision of the Court of Appeal that the statutory trust under CASS7 arose at the time that money was received from the client.

On the second and third issues, the Supreme Court was divided.

Lords Dyson, Clarke and Collins upheld the decision of the Court of Appeal holding that money that had not been segregated for clients could form part of the client funds for distribution and therefore that distributions should be on a claims basis. Lords Hope and Walker dissented.

Comment

This is a fiendishly complicated case to follow but one that reminds us of some elementary principles of trusts law. Lord Hope began his (dissenting) judgment by reiterating how, as a matter of English law, a trust may be established over funds in a bank account. A declaration of trust by itself will not protect a beneficiary if the funds are not segregated as it will not be possible to trace the beneficiary's interest into a mixed fund. Nor is it enough simply to segregate the funds as this will not establish a proprietary interest in anyone other than the account holder. A beneficiary will only be protected in the event of the bank's insolvency if there has been a declaration of trust and the funds have been segregated.

So the CASS7 rules were eminently sensible: if client money comes in, declare a trust, segregate it and all will be well if the bank crashes. All quite simple, until you find yourself in a situation where this has not been done - and as Mr Justice Briggs remarked, there had been "a falling short in the achievement of both these objectives on a truly spectacular scale" (making one rather wonder where the FSA was in all this). The CASS rules did not even consider the possibility that firms would not be segregating client money and this lack of foresight caused much difficulty for the courts.

But this case was not decided on general trusts principles. The majority of the Supreme Court took a purposive approach to CASS7 on the basis that it was intended to protect clients from a firm's insolvency. This meant that the funds that were found to be subject to the trust were not limited simply to those client funds that had been properly segregated, but included funds held in the firm's general (or "house") accounts which *should* have been segregated.

Although this case has provided a degree of clarity as to how the money should be treated, it remains a complex task for the administrators to establish the correct amount of each client's claim.

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In the matter of Kaupthing Singer and Friedlander Limited (in administration) and in the matter of the Insolvency Act 1986 [2011] UKSC 48

Executive summary

On a leapfrog appeal, the Supreme Court unanimously held that the rule against double proof excludes the rule in *Cherry v Boultbee.*

Facts

Kaupthing Singer & Friedlander ("KSF") and its subsidiary SFF went into administration in October 2008. SFF raised money for KSF and its other group companies through the issue of loan notes. Under the terms of the Trust Deed constituting the notes, KSF had guaranteed the payment of principal and interest on the notes as well as the performance of SFF's other obligations under the Trust Deed.

SFF advanced the proceeds of the note issues to KSF by way of unsecured loan. When KSF went into administration, it owed SFF approximately £240m.

In March 2009, an event of default was declared in respect of the notes making them immediately due and payable. The Trustee submitted proofs of debt to the administrators of both SFF (as principal debtor) and KSF (as guarantor) for £248m each in respect of principal and interest due under the notes.

SFF submitted a proof of £240m to the administrators of KSF. SFF had no assets other than its claim against KSF and its only liability was to the Trustee.

The administrators sought directions from the court as to how they should treat the claims as the administrators of KSF wanted to make a distribution to creditors.

At the first instance hearing, the Trustee recognised that the Chancellor was bound by the decision of the Court of Appeal in *In re SSSL Realisations (2002) Ltd* [2006] EWCA Civ 7 (*"SSSL"*) where the rule in *Cherry v Boultbee* had been applied.

The effect of the application of the rule in *Cherry v Boultbee* was that the Trustee would only receive 84% of the sum due under the loan notes rather than 100%.

The differential arose because the rule in *Cherry v Boultbee* meant that KSF would only be required to pay the amount equivalent to the sum it would be indemnified for by SSF in its capacity as principal debtor.

The Trustee sought leave to appeal on the basis that *SSSL* was wrongly decided and was granted permission to bring a leapfrog appeal to the Supreme Court.

Decision

The rule in *Cherry v Boultbee* was excluded by the rule against double proof. The Trustee would be in paid in full by KSF before KSF (as guarantor) could bring a proof of debt against SFF (as principal debtor) for an indemnity under the guarantee.

Comment

The rule against double proof is entirely logical: no insolvent estate should pay out two dividends in respect of the same debt. Where a guarantor pays a creditor's debt as surety for the principal debtor, the guarantor will be indemnified by the principal debtor and – if the debt is not paid in full – must subordinate its claim against the principal debtor until the creditor is repaid in full.

The equitable rule in *Cherry v Boultbee* produces, as Lord Walker said, a "netting-off effect" which will apply unless there is a good reason for it not to. Good reasons include the principle that a company's guarantor must not be paid in priority to the company's creditors and the principle against double proof. Accepting the submission of the Trustee's counsel (Gabriel Moss QC) Lord Walker went on to say that "it would be technical, artificial and wrong to treat the rule against double proof as trumping [statutory] set-off (as it undoubtedly does) but not as trumping the equitable rule" (*para 53).*

This decision overrules the decision in *SSSL.*

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In the matter of Hellas Telecommunications (Luxembourg) II SCA (in administration) and in the matter of the Insolvency Act 1986 [2011] EWHC 3176

Executive summary

The court directed that, on completion of its administration, Hellas II should go into creditors' voluntary liquidation rather than straight to dissolution to enable a liquidator to make further enquiries on behalf of the unsecured creditors.

Facts

Hellas II was a company registered in Luxembourg and had a subsidiary, WIND Hellas Telecommunications SA ("Wind"). Wind was the main operating company within the Hellas group and carried on a mobile telephone operating business in Greece.

Hellas II issued €77 million of convertible preferred equity certificates with a par value of €100 ("CPECS") to its parent Hellas I. In April 2006, some were redeemed leaving Hellas I with CPECs in issue with a par value of €33.8 million.

The CPECs were subordinated to all other present and future obligations of Hellas II and would mature at par 30 years after the issue date. The par value of the CPECs was subsequently reduced from €100 to €1.

In December 2006, the Hellas group issued €97 million of secured loan notes through Hellas V, an indirect subsidiary of Hellas II, which acted as guarantor for the issue. Hellas II also issued subordinated loan notes to the value of €960 million and US $275 million.

The funds raised from the issue of the subordinated loan notes were used to redeem the CPECs for €978 million.

The 2006 year end stand alone accounts of Hellas II showed a negative balance of €997 million and the consolidated balance sheet a negative equity balance of €1,008 million.

Hellas II was sold to Weather in 2007. In 2009, it suffered financial difficulties and moved its centre of main interests to the UK. This enabled it to enter into a pre-pack administration in November 2009 and its only valuable asset, Wind, was sold to Weather III.

On its administration, Hellas II owed €1.8 billion to secured senior loan note holders and €1.24 billion to subordinated (unsecured) loan note holders.

In November 2011, the Administrators applied to the court for directions as to how to proceed as the purposes of the administration were at an end.

The Administrators took the view that the court should direct them to serve a notice on the companies' registrar that, under para 84(1) of Schedule B1 to the Insolvency Act 1986, Hellas II had "no property which might permit a distribution to its creditors". Under para 84, the effect of this would be that, three months after registration, the company would be deemed to be dissolved (but only as a matter of English law – further steps would need to be taken in Luxembourg) and the administration would automatically end.

The subordinated note holders (being unsecured creditors) agreed that the administration should end, but on different grounds. They considered that the court should terminate the Administrators' appointment under para 79 of Schedule B1 on the grounds that the purpose of the administration had been sufficiently achieved and require the Administrators to petition to put Hellas II into compulsory liquidation.

Decision

The judge held that Hellas II should be put into compulsory liquidation and that the Administrators should be discharged from liability under para 98 of Schedule B1, 28 days after filing their final report. In the event that a good arguable case of improper conduct or misfeasance came to light after their discharge, then it could be proceeded with in accordance with para 98 of Schedule B1 read with para 75.

Comment

The judge was clear that the Administrators had conducted proper investigations into the affairs of Hellas II and that it was reasonable for them to conclude that there were no viable claims likely to lead to an increase in the property available for distribution to creditors. He did not, however, consider that this determined the matter, which is why he went for the creditors' voluntary liquidation option (with which the Administrators were more than happy to comply).

As the judge pointed out, Hellas II had suffered "very large and catastrophic losses" (para 91). The effect of the issue of the notes and the early redemption of the CPECs was that "deeply subordinated funding" provided by investors to the Hellas group was repaid and replaced by subordinated funding from the general bond market (para 30).

The document containing the valuation of the CPECs at the time of their redemption had not been located. Although there may have been good reason to think that the redemption of the CPECs was at a market rate, no clear explanation or justification had been given for the valuation made. So the judge took the view that there was room for a liquidator to make further enquiries on behalf of the subordinated creditors.

Unsurprisingly, perhaps, in a case where a lot of money has been lost, feelings seem to have been running high with some of the subordinated creditors making "wild and very serious allegations against the Administrators… which were… wholly without merit" (para 98). If any post discharge claims against the Administrators are proposed, the permission of the court will have to be obtained before they may be brought.

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3 DEFECTIVE APPOINTMENTS

Messrs Baker & O'Reilly v London Bar Company Limited [2011] EWHC 3398 (Ch)

Executive summary

Following *Minimar*, para 105 of Schedule B1 to the Insolvency Act 1986 could not cure a defect in the appointment of administrators arising from a failure to properly convene or conduct a directors' meeting

Facts

The directors of an insolvent company (the "Company") purported to appoint administrators under para 22(2) of Schedule B1 to the Insolvency Act 1986 (the "1986 Act").

At a quorate board meeting, three of the Company's directors had resolved to appoint Messrs Baker and O'Reilly as administrators. A Form 2.9B notice of appointment was lodged under rule 2.23 of the Insolvency Rules 1986.

It later transpired that a fourth director of the Company had either not been given notice or had not been given effective notice of the board meeting and was unaware that an administration order had been made. This was in breach of the Company's articles of association and so rendered invalid the decision taken at the board meeting to put the Company into administration.

Decision

The judge held that, following *Minimar (929) Limited and another v Freddie Khalastchi and another* [2011] EWHC 159 (Ch), para 105 of Schedule B1 to the 1986 Act could not override the provisions which normally applied to the proper constitution and conduct of directors meetings. It could not, therefore, be used to cure a defect arising from the failure properly to convene a directors' meeting.

As the matter was urgent and the judge considered that it was appropriate to put the company into administration, the administrators were appointed by the Company's bank in its capacity as a qualified floating charge holder under para 35 of Schedule B1.

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In the matter of Virtualpurple Professional Services Limited and in the matter of the Insolvency Act 1986 [2011] EWHC 3487 (Ch)

Executive summary

A director could make an immediate appointment of an administrator under para 22 of Schedule B1 to the Insolvency Act 1986 without giving a Form 2.8 notice of intention to the Company.

Facts

Virtualpurple Professional Services (the "Company") was a software company. In February 2011 it was in serious financial difficulties and its sole director held a meeting noting that it was in the best interests of the Company's creditors for it to go into administration. As there were no qualified floating charge holders, the director was able to make the appointment under para 22 of Schedule B1 to the 1986 Act.   She filed Form 2.10B (Notice of Appointment of Administrator by Company or Directors (where a notice of intention to appoint has not been issued)) at court.

The director had made the appointment using the correct form but had not given notice through Form 2.8B to "such other persons as may be prescribed" under para 26(2) of Schedule B1. Details of "other persons" are set out in Rule 2.20(2) Insolvency Rules and include "the company if the company is not intending to make the appointment". No notice period is required for a company in these circumstances.

The director applied to the court for a declaration that the administrators were validly appointed in the light of conflicting cases.

Hill v Stokes Plc [2010] EWHC 3726 had held that an appointment would not be rendered invalid or ineffective due to the failure of the directors to notify distraining landlords under Form 2.8B (the distraining landlords being "other persons" for the purpose of Rule 2.20(2)).

Conversely, obiter remarks of the judge in *Minimar* indicated that administrators would not be validly appointed where notice of intention had not been given to the company, even though there was no floating charge holder to whom five days notice had to be given under para 26 of Schedule B1.

Decision

Mr Justice Norris held, disagreeing with the obiter remarks in *Minimar*, that the directors could make an immediate appointment under para 22 of Schedule B1 without giving notice of intention to the Company.

He also held that, even if it were a requirement for directors to give notice of intention to appoint an administrator to a company in a case where there was no floating charge holder, such a failure would not render the administration process a nullity and the appointment of the administrator void.

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In the matter of Bezier Acquisitions Limited and in the matter of the Insolvency Act 1986 [2011] EWHC 3299 (Ch)

Executive summary

The appointment of administrators by the directors was valid for two reasons, despite the fact that the Company had not been separately notified of the Intention to Appoint: first, because the service of notice on the Company's solicitors was sufficient for Rule 2.8 Insolvency Rules; and second, because as a matter of broader company law, service had been given which provided full and complete information to every body to whom information ought to have been given.

Facts

Bezier Acquisitions Limited (the "Company") was the holding company for nine subsidiaries in the field of advertising and marketing. In 2011, it got into financial difficulties and attempted a restructuring with its lenders. Anticipating a formal demand for repayment of its loan facilities, on 18 August 2011, the directors resolved to appoint administrators and approved a Notice of Intention to appoint an administrator (Form 2.8B) and a Notice of Appointment (Form 2.9B).

The Notice of Intention was sent to the Security Trustee as a qualifying floating charge holder and the Notice of Appointment was filed at court on 19 August 2011. The business and assets of Bezier were immediately sold on by the administrators. The entire process was consensual: the ordinary shareholders were aware of the proposed administration.

The validity of the appointment came into question, however, because the Notice of Intention had not been sent to the Company in addition to the Security Trustee. Insolvency Rule 2.8 required the Notice of Intention to be delivered to the Company's registered office, but this procedure had not been followed.

Decision

Mr Justice Norris held that the failure to lodge the Notice of Intention with the Company's registered office did not invalidate the appointment of the administrators for two reasons. First, the receipt of the Notice of Intention by the Company's solicitors constituted sufficient service for the purposes of Rule 2.8 Insolvency Rules. Second, as a matter of broader company law, in this case, service had been given to ensure "full and complete information to every body to whom information ought to be given" (*Re Regent United Service Stores* (1878) LR 8 ChD 75, applied).

National Westminster Bank Plc v Msaada Group and others [2011] EWHC 3423 (Ch)

Executive summary

The requirement to notify the persons listed in Rule 2.20(2) of the appointment of an administrator applied even where there was no requirement to give a notice of intention under para 26(1) of Schedule B1.

Facts

In October 2011, an administrator (the "Administrator") was appointed out of court by the partners of the Msaada Group (the "Partnership") under the Insolvent Partnerships Order 1994 ("IPO"). Three applications were made to the court by the Bank, which was a substantial creditor of the Partnership:

(i) first, for a declaration that the Administrators' appointment was invalid;
(ii) second, if the application were to be found invalid, for a declaration that the Bank's nominees be appointed as administrators (the "Nominees"); and

(iii) if the appointment were to be found valid, that the Administrator be removed and the Nominees be appointed in his place.

The issues arose because the partners did not give notice to any other party before appointing the Administrator. Para 26 of Schedule B1 to the Insolvency Act 1986 (which applies to insolvent partnerships) requires notice to be given to a person entitled to appoint an agricultural receiver or a person entitled to appoint an administrator of the partnership under para 14 of Schedule B1. In this case, there was no such person.

At the time of the appointment, the Partnership was subject to a Partnership Voluntary Arrangement under which two of the respondents were joint supervisors. They were not given notice of the intended appointment. The issue arose as to whether they should have been (in their capacity as supervisors) under Rule 2.20(2)(c) of the Insolvency Rules 1986 or under para 26(2) .

Decision

The judge held that the requirement to notify the persons listed in Rule 2.20(2) of the appointment of an administrator applied even where there was no requirement to give a notice of intention under para 26(1) of Schedule B1. The judge followed the decision in *Minimar*, preferring it to *Hill v Stokes.* The Administrator had, therefore, been invalidly appointed.

As the Bank was the major creditor of the Partnership, the Bank's choice of the Nominee as administrator should take precedence over the choice of the partners. The judge made an order accordingly.

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Comment

What is very clear from reading these cases is that there are real difficulties in trying to determine how the requirements of Schedule B1 are to be read in conjunction with the Insolvency Rules. (Which becomes even more complicated when an insolvent partnership is thrown into the mix).

So there are now four, inconsistent decisions on the subject of out of court administration appointments, two of which were decided on the same day and reached opposite conclusions.

It is not clear how this is best resolved: the Insolvency Service may be able to improve its guidance, but that is all it is: as Mr Justice Norris pointed out in *Virtualpurple* it is still the role of the court to interpret the rules. It may be that the Court of Appeal will need to determine this definitively.

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4 TUPE

Space wright Europe Limited v Mr Bruno Baillavoine (1) and Secretary of State for Business Innovation and Skills (2) [2011] EWCA Civ 1565

Executive summary

On the facts, the dismissal of a claimant prior to a TUPE transfer was automatically unfair so that the transferee company was liable for the dismissal. In future, the Employment Tribunal and the Employment Appeal Tribunal should follow the approach to regulation 7(1) of TUPE that was taken in *Harrison Bowden* and *Morris*.

Facts

In May 2008, Utralon Limited and its parent (together the "Companies") went into administration. The Claimant and 43 other employees of the Companies were dismissed. The administrators sold the business and assets of the Companies to Spaceright Europe Limited ("SEL") and the Companies subsequently went into liquidation.

The Employment Tribunal (the "ET") upheld the claim brought by the Claimant that his dismissal had been automatically unfair under Regulation 7(1) of the Transfer of Undertakings (Protection of Employment) Regulations 2006 ("TUPE"). The ET held that the reason for the Claimant's dismissal was connected with the relevant transfer of his employer's undertaking.

It was common ground that any liability for unfair dismissal had passed to SEL under TUPE as SEL was the transferee from the Companies. SEL contended that changes to the workforce had been necessary for economic, technical or organisational reasons, but the ET rejected this defence.

SEL appealed against the decision of the ET, but lost before the Employment Appeal Tribunal ("EAT"). SEL was granted leave to appeal to the Court of Appeal.

SEL appealed on three grounds: (i) perversity, in that the ET had, without giving reasons, rejected the administrators' evidence suggesting that the cost-saving resulting from the dismissal amounted to a reason unconnected with the transfer; (ii) that the ET had misdirected itself in the proper construction of regulation 7(1) of TUPE; and (iii) that the ET had erred in its approach to the ETO defence.

Decision

The Court of Appeal unanimously dismissed the appeal on all three grounds. Mummery LJ delivered the judgment.

(i) The decision of the ET had not been perverse as there was evidence before the ET that the administrators had decided that the business should continue to trade and that the Claimant was not considered to be important in the sale of the business.

(ii) The ET had not misdirected itself in applying regulation 7(1) of TUPE: the natural and ordinary meaning of the language did not require a particular transfer or transferee to be in mind at that the time of the dismissal.

(iii) There was no ETO defence available. An ETO defence would require an intention to change the workforce and to continue to conduct the business as distinct from the purpose of selling it.

The Court of Appeal approved the approach taken to the interpretation of regulation 7(1) TUPE followed in *Harrison Bowden v Bowden* [1994] ICR 186 and *Morris v John Grose* [1998] ICR 655*.*

Comment

The Court of Appeal used this case to clarify which of two conflicting rulings of the Employment Appeal Tribunal should be followed when determining whether the reason for the dismissal of a claimant was "connected with the transfer" under regulation 7(1) TUPE.

The conflict dated from two 1994 decisions of the Employment Appeal Tribunal in which the wording of regulation 8(1) of TUPE 1981 (the predecessor legislation to TUPE 2006) had been interpreted.

In *Ibex Trading v Walton* [1994] ICR 907, the EAT took the view that although the employees had been dismissed for a reason connected with a *possible* transfer, they had not been dismissed for a reason connected with the *actual* transfer, which had taken place four months after the dismissal.
The contrary view was taken in *Harrison Bowden*, when the EAT held that dismissals could be for a reason connected with the transfer, even though no transfer was in prospect at the time of the dismissal. This approach had been followed in *Morris* and a number of later cases.

In the *Spaceright* case, the Claimant was the Chief Executive Officer of the Companies. He was paid £120,000 a year which could have been a problem for a purchaser. The ET took the view that the CEO had been dismissed simply to enable a purchaser to acquire the business and assets of the Companies without having to continue to employ him.

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Key2Law (Surrey) LLP v Gaynor De'Antiquis (Secretary of State for Business, Innovation and Skills intervening) [2011] EWCA Civ 1567

Executive summary

The appointment of an administrator is not made with a view to the liquidation of a company's assets since an administrator's first objective (under para 3 of Schedule B1 to the Insolvency Act 1986) is to rescue the company as a going concern. Administration is not, therefore, analogous to "bankruptcy proceedings" for the purposes of regulation 8(7) TUPE and so, on a business transfer, employee rights could not be ignored.

Facts

On 21 July 2008, the Claimant and others were made redundant from the firm of solicitors where they worked ("DK"). On 25 July, DK went into administration and on 28 July, the administrators entered into a management agreement with another firm of solicitors, Key2Law (Surrey) LLP, ("Key2"), for the management of two of DK's offices.

The Claimant brought a claim against Key2 on the basis that Key2 was liable for unfair dismissal and sex discrimination under regulations 7 and 4 of the Transfer of Undertakings (Protection of Employment) Regulations 2006 ("TUPE").

Key2 submitted that as DK was in administration, regulations 4 and 7 were disapplied by regulation 8(7) of TUPE as DK was "subject to… analogous insolvency proceedings… instituted with a view to the liquidation of [its] assets".

In a reserved judgment, the Employment Tribunal ("ET") held that, for the purpose of TUPE there was a transfer to Key2 of part of DK's undertaking and a change in service provision. He held that regulations 4 and 7 of TUPE had not been disapplied by regulation 8(7). In reaching this conclusion, the ET judge applied the guidance of the Employment Appeal Tribunal ("EAT") in *Oakland v Wellswood (Yorkshire) Ltd* [2009] IRLR 250. This guidance required a fact based enquiry to determine whether or not DK was subject to insolvency proceedings with a view to liquidation and the judge concluded that DK was not.

Key2 appealed to the EAT. The EAT considered that the issue before them was whether administration proceedings under Schedule B1 Insolvency Act 1986 constituted "insolvency proceedings which have been instituted with a view to the liquidation of the assets of the transferor" within the meaning of regulation 8(7) and concluded that they could not. The EAT rejected the ET's fact-based approach to the question as being inappropriate and applied what it called an "absolute" approach and so dismissed Key2's appeal. On this analysis, the EAT did not need to consider Key2's challenge to the ET's findings of fact.

Key2 was given permission to appeal to the Court of Appeal on the grounds that, as TUPE gave domestic effect to the EC Council Directive 2001/23/EC (the "Directive"), the case raised an important issue.

Key2 submitted that: (i) the EAT was wrong to hold that administration proceedings cannot be "analogous insolvency proceedings" within the meaning of regulation 8(7); (ii) the ET had been correct to follow a fact-based inquiry; and (iii) the ET had made a perverse finding of facts.

The main issue before the Court of Appeal was, therefore, whether the Directive applied to administration.

Decision

The Court of Appeal unanimously dismissed the appeal.

Rimer LJ held that, bearing in mind that the first objective of administration under para 3 of Schedule B1 to the Insolvency Act 1986 is to rescue the company as a going concern, it was not possible rationally to conclude that the appointment of an administrator was made with a view to the liquidation of the transferor company's assets.

The EAT's absolute approach had been correct.

Comment

It is now clear that if a company goes into administration, the rights of its employees cannot be disregarded under regulation 8(7) TUPE where the company's business is transferred.

Regulation 8(7) determines the circumstances in which employee rights can be ignored on the transferor company's insolvency. It applies to insolvency proceedings that are "analogous to bankruptcy" and "instituted with a view to the liquidation of the assets" of the transferring company.

Lord Justice Rimer spent some time in his judgment considering what was intended by the use of the word "bankruptcy" in regulation 8(7), only to observe that doing so was "probably substantially pointless" as the real issue was how to interpret article 5.1 of EC Directive 2001/23.

He considered that a purposive rather than a semantic approach was necessary and concluded that it was clear that the term "bankruptcy proceedings" under article 5.1 was intended to include the insolvent liquidations of corporate transferors. Only in such cases was it appropriate
for the protection of the interests of employees to be "sacrificed to the superior commercial interests of the transferor's creditors" (para 85).

It was clear from EU case law that the rights of employees had been upheld in a number of cases where the corporate entity did not go into insolvent liquidation, but into some other form of insolvency proceeding (for example, the Dutch SvB procedure in the *Abels* case: Case C-135/83 [1985] ECR 469). In these cases, the court had looked at the "purpose of the procedure in question" (*d'Urso:* Case C-362/89 [1991] ECR 1-4105 at para 26). As Rimer LJ put it, the focus was on the "object" of the procedure.

This then led to a discussion as to whether the object of the procedure could be determined as a question of fact, or whether, with regard to administration, there was an absolute position: i.e. it either was or was not analogous to bankruptcy.

Rimer LJ concluded that when trying to determine whether administration proceedings were "analogous" to bankruptcy proceedings it was "unsatisfactory in principle" and "wrong" to identify the purpose of the appointment of administrators by reference to pre-appointment con-side rations as to the objectives to be achieved.

In reality, an administration order is made "with a view to" an administrator implementing para 3 of Schedule B1 to the Insolvency Act 1986. In the hierarchy of objectives, rescuing the company as a going concern is the first. This objective may or may not be achieved in fact, but must mean that the appointment is not made “with a view to the liquidation” of the transferor’s assets.

30 March 2012