Nottingham Law School

Centre for Business and Insolvency Law

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The cross-border cases in this term's bulletin cover some interesting issues. In *Ebbvale,* the Privy Council had to consider whether the bringing of a winding up petition against a company in the Bahamas was an abuse of process where it also happened to give the petitioner a substantial advantage in its English proceedings against the company. Meanwhile, over in the Cayman Islands, the US Trustee in the *Madoff* case was trying to get some help in establishing a number of avoidance claims. The Cayman Islands court had to consider the nature and extent of its statutory and common law jurisdiction with regard to assistance and recognition in bankruptcy proceedings. Needless to say, this brought the impact of the Supreme Court decision in *Rubin v Eurofinance* into the spotlight.

The nature of the balance sheet insolvency test has always been a tricky matter, but now we know from the Supreme Court's decision in *Eurosail* that it is not "the point of no return" test suggested by Lord Neuberger in the Court of Appeal last year. We are pleased to note that Lord Walker was greatly assisted in his analysis by a friend of the Centre, Dr Peter Walton, through his article "*Inability to pay debts: beyond the point of no return?" [2013] JBL 212* which is worth a read for anyone teaching or studying this topic.

For interested parties, a report of the June conference held by NLS and the University of Leeds on the review of the European Insolvency Regulation is now available on the Centre's website.

Finally, we would like to remind you that on Wednesday 11 September we will be holding our annual International Insolvency Conference here at Nottingham Trent University. Full details can be found under the Centre's "News and Events" tab.

In the interim, have a great summer!

Paula

Paula Moffatt

In this Bulletin…

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CROSS-BORDER

Ebbvale Limited v Andrew Lawrence Hosking (Trustee in Bankruptcy of Andreas Sofroniou Michaelides) [2013] UKPC1

Executive summary

The Judicial Committee of the Privy Council dismissed an appeal from the company that the bringing of a winding up petition against it in the Bahamas represented an abuse of the process of the court, since, even though the winding up order was of substantial advantage to the petitioner in his capacity as a claimant in English law proceedings, it was also of advantage to him in his capacity as petitioning creditor.

Facts

Ebbvale Limited (the "Company") brought an appeal against an order of the Court of Appeal of the Commonwealth of the Bahamas (the "Court of Appeal"). The Court of Appeal had dismissed the Company's appeal against an order of the Commercial Division that the Company be wound up.

The Company was incorporated and registered in the Bahamas and its issued shares were held by a Cypriot resident. Mr Hosking had become a creditor of the Company in his capacity as Trustee in Bankruptcy of Mr Michaelides.

Prior to his bankruptcy in December 2000, Mr Michaelides had owned a property in London "Sunnyside" which was accepted by the Commercial Court as having substantial value. Two days before Mr Michaelides' bankruptcy hearing, Sunnyside was transferred to two brothers (the "Andreous brothers").

Following his appointment as Trustee in Bankruptcy, Mr Hosking took the view that the Andreous brothers did not exist or that, even if they did exist, their ownership of Sunnyside was entirely cosmetic. In his view, the ownership of Sunnyside remained with Mr Michaelides if not in law, at least in equity, with the Andreous brothers holding it on bare trust for Mr Michaelides. Mr Hosking registered a caution against Sunnyside.

In 2001, an allegation was made that the Andreous brothers had sold Sunnyside to the Company for £750,000. A loan of £450,000 for the purpose had been made by National Westminster Bank plc to the Company. Mr Hosking was told that the caution on the register meant that the Company had not been able to register Sunnyside in its name and that the bank had not been able to register its security interest (a mortgage on Sunnyside having been given to the bank as security for the loan).

Mr Hosking believed that Mr Michaelides was the true owner of Sunnyside. In 2003, he brought proceedings in England to establish the ownership of Sunnyside and made the Company and the bank defendants in the proceedings. These proceedings were stayed while separate criminal proceedings were brought against Mr Michaelides for conspiracy to defraud the creditor who had petitioned for his bankruptcy. Mr Michaelides was acquitted and the proceedings brought by Mr Hosking resumed.

The bank settled the claim brought against it by Mr Hosking. Under the terms of the settlement, Mr Hosking purchased the debt owed by the Company to the bank. The proceedings against the Company continued.

In March 2008, Mr Hosking served a statutory demand for payment of the debt plus interest on the Company at its registered office in Nassau. This was not paid, although the Company did not dispute its liability to make the payment. In June 2008, Mr Hosking petitioned the Bahamas court for an order that the Company be wound up for failure to respond to the demand.

A hearing date of October 2008 was given for the English proceedings against the Company. On 7 August 2008, Mr Hosking applied to the court for the hearing dates to be vacated on the grounds that the Company had been slow to file its defence and give disclosure which meant that he would have insufficient time to prepare for the trial. The Company opposed this and the judge refused Mr Hosking's application at a hearing in August 2008. At the same hearing, the judge was informed of the winding up petition. Although no transcript of the hearing was available, the evidence suggested that, in the judge's view, the presentation of the winding up petition was designed to secure Mr Hosking an advantage in the proceedings.

On 28 August 2008, an order was given by the Bahamas court that the Company be wound up. The Company subsequently appealed against the decision to make the order on the grounds that it was improperly brought and so an abuse of the process of the court. At around the same time, the trial of the English action was vacated, by consent.

The President of the Court of Appeal of the Commonwealth of the Bahamas upheld the winding up order. The Company appealed to the Judicial Committee of the Privy Council (the "Board").

Decision

The Board dismissed the appeal. The Company had failed to establish that Mr Hosking's petition represented an abuse of the process of the court. There was likely to be a substantial advantage to Mr Hosking in the English proceedings if a liquidator were to be appointed, but there was also a substantial advantage to him in his capacity as petitioning creditor if the company went into liquidation: it did not matter that this was not his principal purpose.

Comment

This case is a useful reminder of the circumstances in which a winding up petition may be considered to be an abuse of process, as the Board reiterated the established principles. A winding up petition is correctly brought where the debt is either undisputed or not able to be disputed. Where a debt is disputed on substantial grounds, however, the petitioner will be restrained from proceeding: the proper course of action is to establish the debt by an ordinary action in the appropriate court (*Mann v Goldstein* [1968] 1 WLR). In a case where a cross-claim based on substantial grounds is made against the petitioner, the court is likely to exercise its discretion to dismiss the petition (*In Re Bayoil SA, Seawind Tankers Corp v Bayoil SA* [1999] 1 WLR 147).

A classic example of a winding up petition being an abuse of process of the court is *Cadiz Waterworks Company v Barnett* (1874) LR 19 Eq 182, where an alleged creditor was enjoined from presenting a petition because his purpose was to pressurise the company into paying the debt he claimed rather than continuing to dispute it. Similarly, in *in re A Company* [1842] 2 Ch 349 it was held to be an abuse of process where a disaffected shareholder had sought a winding up order for the purpose of improving the management of the company. The judge held, at p351, that he would be obliged to stay a petition where it was not "presented in good faith and for the legitimate purpose of obtaining a winding up order but for other purposes, such as putting pressure on the company".

In the present case, the Company had relied on the authority of *in re A Company.* The Board took the view that, as Mr Hosking did want the winding up order to be made, this authority was not in point. Mr Hosking's purpose in presenting the winding up petition was to ensure that the direction of the Company's defence in the English proceedings was vested in a liquidator who would be an officer of the court and take an objective view as to how it should be run. The Company's continued defence of the action was costing a lot of money and potentially increasing its total liability to Mr Hosking. The appointment of a liquidator would result in a cost saving. It was also the case that a winding up order would be of advantage to Mr Hosking in his capacity as petitioning creditor as a secondary purpose: the Board concluded that it was not necessary that this should have been his principal purpose. The Company had therefore failed to establish that the petition was an abuse of process of the court.

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Trustee for the Liquidation of the Business of Bernard L. Madoff Investment Securities LLC (in Securities Investor Protection Act Liquidation) (1) and Bernard L. Madoff Investment Securities LLC (in Securities Investor Protection Act Liquidation) (2) (the "Plaintiffs") v Primeo Fund (in Official Liquidation)

In the Grand Court of the Cayman Island Financial Services Division Cause no FSD 275 OF 2010-AJJ

Executive summary

The Trustee for the Liquidation of the Business of Bernard L. Madoff Investment Securities LLC ("BLMIS") was entitled to recognition under Cayman Islands Companies Law and the Cayman Court had had a common law power to entertain the Plaintiffs' preference claim based on the application of domestic corporate insolvency law as though BLMIS was the subject of a winding up order in the Cayman Islands.

Background

The Court of the Cayman Islands ("Cayman") was required to determine, as preliminary issues of law, whether the US Trustee for BLMIS could establish avoidance and certain other claims against the Primeo Fund (in Official Liquidation) ("Primeo"). Primeo was a Cayman incorporated company and the only connection that BLMIS had with Cayman was through Primeo and two other Cayman domiciled investment funds, all of which had placed funds with BLMIS for investment. The issues before the Court raised important questions as to the nature and extent of the Court's statutory jurisdiction to make orders ancillary to a foreign insolvency proceeding as well as its common law jurisdiction to provide assistance in connection with foreign bankruptcy proceedings.

Facts

BLMIS was a New York incorporated company with its principal place of business in New York City. It was controlled and owned by Bernard L. Madoff ("Madoff") who had been operating it fraudulently throughout the relevant period. Madoff was arrested and subsequently pleaded guilty to 11 counts of fraud and was sentenced to 150 years in prison.

On 15 December 2008, the Securities Investor Protection Corporation filed an application in the New York District Court for the commencement of liquidation proceedings in respect of BLMIS. The statutory avoidance claims which the Trustee sought to assert against Primeo arose at that time.

In February 2010, the Cayman judge made a Recognition Order declaring that the Trustee was the only person entitled to act on behalf of BLMIS in the Cayman Islands. The Recognition Order bound all persons whether or not they had notice of the Trustee's petition. The only connection that BLMIS had with Cayman was through Primeo and two other Cayman domiciled investment funds, all of which had placed funds with BLMIS for investment. BLMIS was never licensed under the relevant Cayman legislation to carry on its business in Cayman and had no property located in Cayman. The Cayman court therefore had no jurisdiction to make a winding up order in respect of BLMIS under the Cayman Companies Law.

Primeo was incorporated in 1993 and operated as an open ended investment fund set up for non-US investors who wished to invest with a fund which, according to its offer document, emphasised the preservation of capital through the diversification of investments. Its participating shares were listed on the Luxembourg Stock Exchange. Between 1994 and June 2007, Primeo placed funds with BLMIS. After this, Primeo invested its assets in the participating shares of two investment funds "Herald" (incorporated in Cayman) and "Alpha" (incorporated in Bermuda). Herald and Alpha placed funds for investment with BLMIS. Primeo was the largest single investor in Herald.

Funds withdrawn from Primeo's account with BLMIS before June 2007 were paid direct to Primeo (the "Direct Transfers"). When Primeo redeemed shares in Alpha or Herald, it was assumed that they withdrew funds from their accounts with BLMIS and paid the redemption proceeds to Primeo, so that Primeo was indirectly paid by BLMIS (the "Indirect Transfers").

In view of Primeo's dependence on the integrity and investment performance of BLMIS, Primeo's directors suspended its business when Madoff was arrested. A special resolution to wind up Primeo was passed in January 2009. In April 2009, an order was made for Primeo's winding up to continue under the supervision of the Cayman court.

The Trustee asserted three different types of avoidance claim against Primeo in respect of both Direct and Indirect Transfers.

First, the Trustee asserted claims under the Cayman Companies Law and/or common law based upon the application of substantive US law. The claims were, broadly, two year fraudulent transfers under the US Bankruptcy Code; six year fraudulent transfers under New York Debtor and Creditor Law; and 90 day preference payments under the US Bankruptcy Code. The US law was materially different from the Cayman Companies Law, although the underlying policy objective of ensuring fair and equal treatment of creditors was the same.

Second, the Trustee asserted voidable preference claims under the Cayman Companies Law and/or at common law, as if the liquidation of BLMIS was occurring in Cayman, rather than the US. These were for Indirect Transfers made to Primeo in the six months preceding the foreign (i.e. US) liquidation on 18 December 2008 (the "Six Month Payments").

Third, the Trustee asserted claims for fraudulent trading but it was agreed by counsel that these failed as the legislation was not in force at the relevant time.

Having accepted that the third asserted claim failed and should be struck out, the Court sought to determine, as preliminary issues of law:

(1) whether, on the assumption that the Plaintiffs had avoidance claims against the Defendant under US insolvency law, the Court could apply US insolvency law under sections 241 and/or 242 of the Cayman Companies Law ("Companies Law") and/or at common law;
(2) whether the Court could apply the avoidance provisions of Cayman insolvency law in aid of a foreign insolvency proceeding as a matter of common law or under sections 241 and/or 242 of the Companies Law so as to avoid the Six Month Payments;
(3) Whether, in the event that the Plaintiffs had valid non-proprietary claims against the Defendant, these would be set-off under the Companies Law;
(4) Whether, in the event that there was no set-off available, the rule in *Cherry v Boultbee* applied; and
(5) What retainer, if any, the Defendant's Liquidators would be entitled to.

Decision

The judge held that the Court had no power to address the preference or transaction avoidance claims under the Companies Law as section 241(e) did not expressly enable the Court to assist with such claims. Even if the power had been found to exist, the Court had no power to apply foreign law. That part of the claim must be struck out as disclosing no reasonable cause of action.

The Trustee was entitled to recognition under section 241(1)(a) of the Companies Law. This meant that the Court had a discretionary power at common law to consider the Plaintiffs' preference claims. This would be based upon the application of domestic (i.e. Cayman) insolvency law as if BLMIS was the subject of a winding up order in Cayman. The Court's discretionary power was not dependent upon establishing that there was jurisdiction to make a Cayman winding up order in respect of BLMIS. This part of the claim therefore disclosed a reasonable cause of action.

Set-off was not available under Companies Law. The rule in *Cherry v Boultbee* did not apply so the Defendant's Liquidators had no right of retainer exercisable against the Plaintiffs.

Comment

I have always thought that the acronym BLMIS was resonant of something Ian Fleming would have cooked up as an enemy agency for James Bond to thwart, such as *SMERSH*. This case is worthy of a good look because the Cayman court had to consider first, the question of recognition and second, the scope of any assistance under common law in the light of the recent UK Supreme Court decision in *Rubin v Eurofinance SA* [2012] UKSC 46.

In order to understand the judgment, it is necessary to understand something of the development of the corporate insolvency provisions of the Cayman Island Companies Law. Until amended in 2007, they were based largely on the English Companies Act provisions of 1862. Thus there were no Cayman provisions addressing cross-border insolvency law until this point. The new legislation, which came into force on 1 March 2009, amended the domestic liquidation procedure. Prior to this, it was generally accepted that the Court had no jurisdiction to make winding up orders in respect of insolvent foreign companies even if they were carrying on business and had assets in Cayman.

The 2007 legislation also introduced a mechanism for the Court to assist a trustee or a liquidator of a foreign company which is the subject of bankruptcy proceedings in its country of incorporation. It enabled the Court to make certain ancillary orders, including orders recognising the right of the foreign representative to act in Cayman (section 241).

The new statutory provisions did not abolish the common law rules. Specifically, they reflected the English common law rule that the Court would only recognise the authority of a liquidator or trustee appointed under the law of the country of the company's incorporation (*Dicey, Morris & Collins, The Conflict of Laws 14th Ed Para 30R – 097*). As the judge noted, this approach contrasted with that of the UNCITRAL Model Law where recognition is dependent upon establishing a company's "centre of main interest" (which is not necessarily the country of incorporation). In practical terms, this meant that the Court could only recognise New York as the competent jurisdiction for the BLMIS bankruptcy proceedings. Accordingly, it recognised the Trustee as the appointed office holder. The Court then had to consider the scope of the assistance it could offer the Trustee. The judge began by considering the statutory provisions on assistance and went on to consider the common law position.

Cross-border insolvency cooperation under the Companies Law

The judge concluded that the list of possible orders for ancillary relief that the court could make under section 241 of the Companies Law, was an exhaustive list. 241(1)(e) permitted the Court to order the "turnover to a foreign representative of any property belonging to a debtor". The judge took the view that this did not cover preferential or fraudulent dispositions as if this had been the Legislature's intention they would have stated it expressly. In addition, he considered that "property belonging to a debtor" meant property of the company, which was different from "property of the estate". The former meant property belonging to the company at the moment it went into liquidation, whereas property of the estate meant property available for distribution to creditors.

He went on to consider whether, if the Trustee were entitled to pursue an avoidance claim under section 241, the substantive law would be Cayman (domestic law) or US (foreign law). He concluded that it would be domestic law.

Cross-border insolvency cooperation at common law

The judge began with a discussion of the Privy Council decision in *Cambridge Gas Transportation v Official Committee of Unsecured Creditors of Navigator Holdings plc* [2007] 1 AC 508. Lord Hoffmann had considered the scope of the assistance which the court could give at common law and stated that "the purpose of recognition is to enable the foreign office holder or the creditors to avoid having to start parallel 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". Lord Hoffmann expanded on this theme in *Re HIH Casualty and General Insurance Ltd* [2008] 1WLR 852 when he suggested that the common law principle of "modified universalism" operated to ensure that the debtor's assets could be distributed under one scheme of distribution (note that Lord Walker was the only other judge in *HIH* to consider that this common law power existed – the majority had relied on the English statutory power to assist foreign insolvency proceedings). The judge also noted the decision in *Schmitt v Deichmann* [2012] 2 All ER 1217 in which the court had held that a German administrator could assert avoidance claims based on substantive UK law.

The judge went on to consider whether these most recent statements of the common law had survived the decision of the UK Supreme Court in *Rubin*, bearing in mind that the majority had held that *Cambridge Gas* had been wrongly decided. The Supreme Court had rejected the conclusion reached in *Cambridge Gas* that the common law rules on submission to jurisdiction did not apply to foreign judgments made in transaction avoidance proceedings on the grounds that orders made in insolvency proceedings were subject to special rules and were neither judgments *in rem* nor judgments *in personam*. The judge noted that this decision was not, according to Lord Collins, a rejection of the proposition that recognition at common law "carries with it the active assistance of the court" (*per In re African Farms Ltd* [1906] TS 373, 377). He considered that Lord Collins had left open the possibility in *Rubin* that the office holder could, at common law, have pursued avoidance claims under English law. He concluded that the power to entertain a preference claim under the Companies Law fell within the scope of the assistance available at common law as had Mrs Justice Proudman in the *Schmitt* case.

The court in *Rubin* had not had to consider whether recognition carried the right to pursue actions which would not otherwise exist in the absence of a winding up order. Lord Collins appeared, however, to have approved the decision *In re Impex Services Worldwide Ltd* [2004] BPIR 564 in which a Manx order for the examination and production of documents was made in aid of the liquidation in England of an English company. Despite the fact that the statutory power did not apply, the Manx court had held that it had a common law power to order examination on the same terms as the statutory power. In the Cayman case of *Al Sabah – v- Grupo Torras SA* [2005] Lord Walker had remarked that in the absence of a statutory jurisdiction to aid a foreign bankruptcy, there may have been a limited inherent power to do so. It was clear from the authorities that, when using the inherent power, it could not be allowed to thwart a statutory purpose. The judge did not think that bringing a preference claim against BLMIS under section 145 of the Companies Law departed from or thwarted the statutory objective of the Companies Law.

The judge concluded that it was consistent with the general principle of modified universalism to treat BLMIS as being subject to a Cayman liquidation from the date of the foreign bankruptcy proceeding (i.e. 15 December 2008) even though there was no jurisdiction to make a winding up order. He did not think that this involved either applying the statute for an unintended purpose or for the thwarting of its intended purpose. So the Trustee can now at least have a stab at getting some cash back for Madoff's creditors.

As Professor Paul Omar writes, the fact that *Rubin* re-asserts an orthodox view of these matters does not mean that the common law rules will not be re-assessed at a later date. (Look out for Professor Omar's article on this topic: *Après Rubin: le Déluge? Thoughts on the Future of Common Law Insolvency Cooperation* due to be published in the forthcoming edition of International Corporate Rescue (2013) 10 ICR).

For more on the Rubin case, see the Centre's Autumn 2012 Bulletin.

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HSBC Bank v Tambrook Jersey Limited [2013] EWCA Civ 576

Executive summary

The Court of Appeal unanimously held that an English law administration order could be made by the English court in respect of a Jersey incorporated company under section 426 Insolvency Act 1986, since section 426(4) applied to courts having jurisdiction in relation to insolvency law; it did not matter that the jurisdiction was not being exercised.

Facts

Tambrook Jersey Limited (the "Company") was incorporated in Jersey and its business was to develop residential properties in England. It borrowed money from HSBC Bank plc (the "Bank") to develop properties in Margate. The Bank's loan was secured on the property.

The development was disastrous. The Bank was ultimately owed £8.2 million, most of which it was unlikely to recover. It was recognised that the appointment of administrators would achieve the best outcome. Neither the Jersey remedy of désastre nor English liquidation proceedings were considered to be advantageous for the Company or its creditors. Jersey does not have an insolvency procedure equivalent to administration.

It was accepted that the Company's centre of main interests was in Jersey so that the English courts had no power to make an administration order under Schedule B1 of the Insolvency Act 1986 (the "Act")[1]. The Bank, with the agreement of the Company, sought the assistance of the Royal Court of Jersey (the "Jersey Court").

In February 2013, the Bank presented a Representation to the Jersey Court explaining why administration was in the best interests of the Company's creditors. The Bank asked the Jersey Court to request assistance from the English High Court (the "English Court"), which the Jersey Court did.

The formal Letter of Request from the Jersey Court noted that the Company was insolvent and had substantial connections with England. It requested the English Court to hear and determine the application for an administration order and, if thought fit, to make an administration order.

The application for assistance was refused at first instance. The refusal was on the grounds that the English Court was not permitted to give assistance under s426 of the Act since the Jersey Court was not, itself, conducting any insolvency activity that could be assisted. Rather, it was being asked to provide insolvency proceedings in lieu of any Jersey insolvency proceedings.

The Bank appealed.

Decision

The Court of Appeal unanimously held that the judge at first instance had been unduly and unnecessarily restrictive in his interpretation of section 426 of the Act and allowed the appeal.

[1] The case refers to EC Regulation 1346/2006, but as this fixes the export refunds on poultry meat, I read this as a typographical error and assume that EC Regulation 1346/2000 on Insolvency Proceedings was intended.

Comment

Lord Justice Davis gave four reasons why the judge at first instance had misconstrued section 426 of the Act. First, in his judgment, section 426(4) applied to courts which *have* jurisdiction: it did not matter that the jurisdiction was not being *exercised*. He accepted that section 426 would not empower the courts to act on a request that was not related to insolvency (relying on the judgment of Lord Collins in *Rubin* at paragraphs 146 – 154). As a connected matter, the authorities indicated that sections 426(4) and (5) should be interpreted broadly, so that, in his judgment, there was scope for the English Court to assist the Jersey Court in the manner requested.

Third, he rejected the judge's view that any other interpretation than his would infringe the principle of "modified universalism": on the contrary, his approach would have led to separate insolvency processes which would result in increased costs. Finally, he rejected the judge's proposition that the Jersey Court was not exercising its corresponding jurisdiction in relation to insolvency law.

This seems a sensible outcome on the grounds that it would achieve the best results for creditors. The facts at first instance indicated that désastre would not have been an appropriate form of insolvency proceeding as it was likely to have ended certain contracts which needed to remain in place or be assigned or novated. There were also difficulties with the fact that, as a matter of Jersey law, the Viscount would be appointed to supervise the procedure in Jersey. Jersey law would vest the Company's property in the Viscount, whereas English law would not: this would cause problems were the Viscount to seek recognition in England. Lastly, unlike administration, désastre does not impose a moratorium.

For an interesting article that reflects on the history of the legislation and provides some insights into the Jersey regime, see "*Tambrook Jersey: There but for the Grace"* by Glen Davis QC in International Corporate Rescue, Volume 10, Issue 4.

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STRUCTURED FINANCE

BNY Corporate Trustee Services Limited and others (Respondents) v Neuberger Berman Europe Ltd (on behalf of Sealink Funding Ltd) and others (Appellants)

BNY Corporate Trustee Services Limited and others (Respondents) v Eurosail-UK 2007 – 3 BL PLC (Appellant)

[2013] UKSC 28

Executive summary

The Supreme Court unanimously dismissed the appeal and cross-appeal, holding that the Issuer was not balance sheet insolvent and that the test for balance sheet insolvency was not based upon whether the company had reached "the point of no return".

Facts

Eurosail (the "Issuer") had issued notes to the value of £660 million as part of a securitisation transaction relating to a portfolio of UK sub-prime mortgages with a face value of £650 million.

There were five classes of notes (A-E), divided into three sub-classes (1-3), issued in Euros, US dollars or sterling and with rates of interest that depended upon the class, currency and maturity of the note. The A1 notes matured in 2027 and the remainder in 2045.

The Issuer had entered into exchange rate and interest rate swaps with Lehman Brothers Special Financing Inc ("LBSF") and LBSF's obligations were guaranteed by Lehman Brothers Holdings Inc ("LBHI").

The terms of the transaction included a Post Enforcement Call Option Agreement ("PECO") which provided that, in the event that the security for the notes was enforced and found to be insufficient to pay all amounts due under the notes, then an associate company of the Issuer was to have a call option in respect of the benefit of all the notes at a nominal price.

Any monies received on the redemption or enforcement of the underlying mortgages were to be applied in accordance with the specified priority of payments prior to or post enforcement. The specified priority would be that of the pre-enforcement situation until BNY Corporate Trustee Services Ltd (the "Trustee") served an enforcement notice on the Issuer declaring the notes to be due and payable following an event of default. One such event was the Issuer's inability to pay its debts as they fell due within the meaning of section 123(1) or (2) of the Insolvency Act 1986 (the "Act"), as from time to time amended, with the proviso that the Trustee certified that such event was materially prejudicial to the interests of the Noteholders. Section 123(2) of the Act included the balance sheet test of insolvency which arises "if… the value of the company's assets is less than the amount of its liabilities, taking into account its contingent and prospective liabilities".

When LBSF and LBHI went into insolvency proceedings, the swap arrangements were terminated. Certain Noteholders contended that the failure of the Lehman Brothers Group and the changes in interest and currency rates since July 2007 meant that the Issuer should now be deemed to be unable to pay its debts within the meaning of section 123(2) of the Act.

The Issuer contended that, even if the Issuer were found to be insolvent, the existence of the PECO would have meant that it would not be deemed to have been insolvent within the meaning of section 123(2).

At first instance, the Chancellor held (i) that the Issuer was able to pay its debts within the meaning of section 123(2) of the Act; and (ii) that if he had decided otherwise, then the PECO would not have altered his conclusion.

The Court of Appeal upheld the Chancellor's decision, holding that section 123(2) should be interpreted broadly and in line with standards of commercial probity, Lord Neuberger

MR, considering that the test was satisfied when a company had reached the "point of no return".

The Appellants appealed to the Supreme Court.

Decision

The Supreme Court dismissed the appeal. Eurosail's ability or inability to pay its debts, present or future would not be finally determined until much closer to 2045. The movements of currencies and interest rates in the meantime were incapable of prediction. The court could not be satisfied that there would eventually be a deficiency. The "point of no return" should not pass into common usage as a paraphrase of the effect of section 123(2) of the Act.

Comment

Lord Walker gave the leading judgment. He reviewed the history of the legislation and was greatly assisted in his review by Dr Peter Walton's article "*Inability to pay debts: beyond the point of no return?" [2013] JBL 212* and which is worth a read for anyone interested in this area. Lord Walker noted that petitions by contingent or prospective creditors were rare and suggested two reasons for this. First, because of the difficulty of quantifying contingent and prospective liabilities to the satisfaction of the court and second, because well-advised commercial lenders tend to draft documents that ensure that deferred liabilities are accelerated in the event of financial difficulties.

He considered that the question as to whether the balance sheet insolvency test would be satisfied was dependent upon the evidence and the circumstances of a particular case. Eurosail's business was unlike the business of a trading company (the assets of which would fluctuate as it traded) and its current assets could, therefore, be seen to give a reasonable indication as to its ability to meet its long term liabilities. Set against that assumption, however, were three "imponderable factors", namely currency movements, interest rate movements and the UK economy and housing market, all of which were out of Eurosail's control and all of which would have an impact on the value of its current assets at any time over the next 30 years or so until the date of redemption. So the test is not simply a matter of accountancy; it requires commercial considerations to be brought to bear.

Lord Walker disagreed with Lord Neuberger MR's view that the test for section 123(2) could be outlined as being met when "the company had reached the point of no return because of an incurable deficiency in its assets". This characterisation of the balance sheet insolvency test had been set out by Professor Sir Roy Goode in the third edition (2005) of his *Principles of Corporate Insolvency Law.* Lord Walker preferred the more reserved comments of Toulson LJ who had considered that this construction did not paraphrase the section 123(2) test, rather it illuminated it. He considered, therefore, that the phrase "point of no return" should not pass into common usage and was not the correct test.

As the ILA Technical Bulletin No 484 (11 July 2013) cogently observes, it is a shame that the Supreme Court did not take the opportunity to set out the way in which balance sheet insolvency should properly be assessed. The position is much as it was before this case came to court: a high degree of proof will be required before a company will be deemed to be balance sheet insolvent.

A cross-appeal had also been brought in this case concerning the effect of the PECO on the application of section 123(2). In fact, as the Noteholders' appeal was unsuccessful, the cross-appeal did not need to be considered. Lord Hope commented, obiter, that the decision of the judges at first instance and on appeal had been correct: the PECO had no effect on the way in which the liability of the Issuer to the Noteholders was to be calculated for the purposes of establishing a default.

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ADMINISTRATION

Mr T Gaardsoe v Optimal Wealth Management [2012] EWHC (Ch)

Executive summary

Proceedings brought against a company in administration were not a nullity when commenced, despite the existence of the statutory moratorium, so that when the company subsequently went into liquidation, the court could give retrospective permission for the commencement of proceedings.

Facts

The claimant had been injured in 2005. He was a professional footballer and the injury ended his footballing career. He had been insured by Optimal Wealth Management (the "Company"), but it transpired that his particular injury had not been insured. The claimant contended that this was due to negligence or breach of contract on the part of the Company.

The Company was itself insured for negligence claims and the claimant sought to exercise his right to take the benefit of that insurance through the Third Parties (Rights Against Insurers) Act 1930. This required the claimant to establish a claim against the Company.

The claimant's solicitors issued proceedings against the Company on 26 August 2010. The solicitors undertook a search of the Company's register, but it did not reveal that the Company had gone into administration two weeks previously. As the Company was in administration, a moratorium was in place, so that no legal proceedings could be brought without the consent of the administrators or the permission of the court (para 43(6) of schedule B1 to the Insolvency Act 1986 (the "1986 Act").

In September 2010, the claimants solicitors discovered the administration and wrote to the administrators, who agreed to extend the time for service of the claim until March 2011. The administrators agreed to this without prejudice to their rights: (i) to refuse consent; (ii) to challenge the claim; and (iii) to assert that the claim was statute barred. The claim was subsequently served in February 2011.

The Company did not serve a defence but, in March 2011, applied to the court for a declaration that the court did not have jurisdiction over the claim and for an order that service of claim form be set aside for the claimant's failure to seek consent from the administrators or the permission of the court. The application was issued in June 2011, when the Company was still in administration, but the return date was August 2011, by which date it was in creditors' voluntary liquidation.

The administrators contended that the proceedings were a nullity on the grounds that they were commenced against a company in administration without the necessary permission or court consent. They argued that permission could not be granted after the administration had started, since the provision allowing the continuation of proceedings only applied to proceedings that had commenced before the administration began and that, even if this were wrong, permission could not be given retrospectively as the Company was now in liquidation.

Decision

The judge held that the proceedings were not a nullity when commenced and concluded that he had discretion to give retrospective permission for the commencement of the proceedings sought by the claimant's first application and granted it.

Comment

The judge's analysis was very interesting. He concluded, from a review of the cases, that the proceedings were not a nullity when commenced. They had existed, but had simply been in suspense whilst the administration was in progress. Once the administration ended and was replaced by the liquidation regime (under which there was no bar on litigation) the "procedural inhibition" that prevented them being pursued came to an end.

The judge went on to consider that, although it would only be in very rare cases that retrospective permission would be required, he did not consider that para 43 imposed any time limits. He considered it entirely appropriate to exercise a discretion in the claimant's favour. Which seems fair enough, really.

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LIQUIDATION

In the matter of Danka Business Systems PLC (in members' voluntary liquidation) and in the matter of the Insolvency Act 1986 [2013] EWCA Civ 92

Executive summary

The liquidators in a members' voluntary liquidation were entitled to proceed to a distribution to members on the basis of the debts admitted to proof and did not need to make provision for the potential maximum amounts of admitted, contingent claims.

Facts

The appellants ("Ricoh") were creditors of Danka Business Systems Plc (the "Company"). The Company went into members' voluntary liquidation in February 2009, anticipating a surplus in excess of US$66 million. Ricoh's claims in the liquidation were derived from various tax indemnities given under a sale and purchase agreement ("SPA") completed in 2007. Under the terms of the SPA, Ricoh acquired the issued share capital in a number of European companies. The Company agreed to indemnify Ricoh against any pre-completion tax liabilities for those companies for a period of 7 years.

At the time of the Company's liquidation, some contingent claims for potential liabilities in Germany, Italy, France and Spain remained. In March 2009, the liquidators gave notice to the creditors of their intention to make a final distribution and required them to prove their debts by the end of April 2009. Ricoh responded with details of its actual claims and an estimate of the maximum value of the contingent claims and asked the liquidators to "ring fence" a reserve from which the crystallised indemnities could be paid before if made any distributions to creditors or members.

The liquidators rejected Ricoh's request to defer any distribution until all of the tax claims under the indemnities had crystallised. They considered that they were obliged to value any contingent claims under Insolvency Rule 4.86 and that these could be valued reasonably accurately. Alternatively, a realistic estimate of the "worst case" outcome could be made so that an appropriate reserve could be set aside. They also rejected Ricoh's request to set aside a reserve of almost €12 million, considering that a realistic value for the claims was just under €270,000.

In April 2010, Ricoh applied to the court for a direction that the liquidators should be required to make a retention of £11 million which should not become available for distribution to members until the earlier of (i) the crystallisation of Ricoh's contingent claims, or (ii) the 31st January 2014 (being the end of the 7 year indemnity period).

The judge at first instance held that, once a contingent creditor had proved in the liquidation for its debts and they had been valued, there was no room in the statutory scheme to allow the liquidators to delay a distribution to members pending the crystallisation of the contingent liabilities.

Ricoh appealed to the Court of Appeal.

Decision

The court unanimously dismissed the appeal. The liquidators did not come under a legal duty to make the retention sought in the application. In the absence of such a legal duty, the application must fail. The liquidators were entitled to proceed to a distribution to members on the basis of the debts admitted to proof and did not have to wait until the contingent claims crystallised. The liquidators had not erred in their approach to the valuation of the claims.

Comment

As a members' voluntary liquidation is a situation where there is enough money to go around, it may seem surprising that a contingent claim could be compromised in this way. The question the case threw up was whether, once contingent claims have been admitted to proof, a liquidator can proceed to make a distribution to the members having first paid the creditors in accordance with the value of their claims: the court held that the liquidator can. The alternative was that the liquidators had a residual discretion to delay a final distribution until after the outcome of the contingency.

The judgment was delivered by Lord Justice Patten who began by considering the relevant legislation and rules. The starting point is section 107 of the Insolvency Act 1986 (the "1986 Act") which states the general rule for both creditors' and members' voluntary liquidation: "subject to … preferential payments, the company's property… shall on the winding up be applied in satisfaction of the company's liabilities… and … be distributed among the members according to their rights and interests…". The relevant Insolvency Rules ("IR") must then be considered. From this, it seems that in the case of a contingent liability, the estimate or valuation of the claim only becomes of critical importance when the liquidator comes to make a distribution to the members.

The function of IR 4.182A was considered (note that this particular rule applies to distributions in a members', but not a creditors', voluntary winding up). The purpose of the rule was to enable the liquidator to make distributions to creditors free from any challenge based on late claims. As his lordship noted, this effect would be particularly important in an insolvent liquidation as any additional claims would affect the available dividend. However, as the rule deals with late claims and not existing, known contingent claims which had been admitted to proof it was not relevant in this context: here, Ricoh had proved for its contingent claims in response to an IR 4.182A notice and the claims had been valued.

It was clear from IR 4.86 that contingent claims could only be admitted to proof if they were first valued. The IR 4.86 mechanism requires the liquidator to estimate the value of the contingent claim, notify the creditor of that estimate and use that as the valuation when proving the debt. In his lordship's view, the liquidator was required to make a genuine and fair assessment of the likelihood of the contingency arising and the liability occurring and was not required simply to "wait and see". There was nothing in IR 4.86 which required the liquidator to guarantee a 100% return on an indemnity by making a "worst case" assumption in favour of the contingent creditor: any such valuation would be unfair to any other creditors as well as the members. As the valuation provisions applied in the same form to both solvent and insolvent liquidations, it was hard to see how this mechanism could be considered to be appropriate, particularly in insolvent liquidations where the creditors would only be receiving a dividend.

His lordship took the view that the "company's liabilities" under section 107 must mean liabilities determined in accordance with the IR. The effect of the IR is then to allow the liquidator to distribute the assets of the company free from any further claims from creditors (having dealt with any appeals as to the valuation first).

This decision is consistent with previous authority although, as PLC Finance point out (see www.practicallaw.com/4-524-3138), it is the first time that the court has stated that a liquidator in a members' voluntary winding up has no more flexibility when it comes to distributing assets than has a liquidator in a creditors voluntary liquidation.

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EMPLOYMENT APPEAL TRIBUNALS

Mrs L Kavanagh & Others v Crystal Palace FC (2000) Ltd & Others UKEAT: 0354/12/SM, 0355/12/SM, 0356/12/SM & 0357 12/SM

Executive summary

The claimants had not been dismissed by the administrator for an ETO reason and had, therefore, been unfairly dismissed.

Facts

The Claimants had been employees of Crystal Palace Football Club (2000) Ltd ("CP 2000"). CP 2000 was put into administration by one of its lenders, Agilo, in January 2010. It was the intention of the administrator of CP 2000 (the "Administrator") to sell the club as a going concern. The second respondent, CPFC Ltd, owned the club's grounds and went into administration in February 2010. The main, secured creditor of CPFC Ltd was Lloyds Banking Group plc ("Lloyds") which effectively owned the grounds.

A consortium was identified as a potential buyer for both the club and the grounds. The buyer was incorporated as CPFC 2010 Ltd, but negotiations were difficult due to the fact that both the club and its grounds were owned separately and were in separate sets of administration proceedings.

In May 2010, the Administrator realised that the club was running into severe cash flow difficulties and approached the consortium for a loan, but this did not materialise as Agilo objected.

In the absence of imminent funding, the Administrator decided to identify staff for redundancy with a view to "moth balling" the club so that its basic functions could be maintained whilst a buyer was found. Twenty nine members of staff, including the four claimants, were made redundant on 28 May 2010. The Administrator gave a press release in which he explained that he had made staff redundant and had to consider selling players.

A public protest followed the Administrator's statement and pressure was put on Lloyds, in particular, to support a deal to enable the consortium to buy both the club and the grounds. As a result, the club and the grounds were sold to CPFC 2010 Ltd in August 2010.

The claimants contended that the transfer was a TUPE transfer and that they had been unfairly dismissed; they contended that liability for their dismissal passed to CPFC 2010 Ltd on the basis that the reason for their dismissal was not an economic, technical or organisational ("ETO") reason under Reg 7 of TUPE.

Held

The appeal was upheld. The employment tribunal had erred in law in concluding that the claimants had been made redundant for an ETO reason since the Administrator had had no intention of continuing to conduct the business: on the contrary, his decision to moth ball the club was effectively a decision not to conduct any business, but to preserve it so that, if a new buyer came along it could resume the conduct of the business.

Comment

This was a case where, in making people redundant, the Administrator had made the company a more attractive proposition for a potential buyer. Where employees are dismissed because the business they work for is transferred, under Reg 7 of TUPE, their dismissal will be automatically unfair unless it can be shown that the dismissal was for an ETO reason. Where a dismissal is found to be unfair, liability for the dismissal will pass to the transferee.

Reg 7 of TUPE can be disapplied under Reg 8(7) of TUPE in some cases where a business is insolvent. This will be the case if the transferor "is the subject of bankruptcy proceedings or any analogous insolvency proceedings which have been instituted with a view to the liquidation of the assets of the transferor". The scope of the term "analogous insolvency proceedings" was determined by the Court of Appeal in *Key2Law (Surrey) LLP* *v De'Antiquis [2011] EWCA Civ 1567.* The Court of Appeal adopted an absolutist approach: administration was not undertaken with a view to the liquidation of a transferor's assets, so TUPE cannot be disapplied in an administration. However, as the EAT noted, *Key2Law* did not address the issue as to whether a decision made by an administrator to dismiss employees could never be for an ETO reason, if made in connection with a transfer.

Nor did the EAT consider that *Spaceright Europe Ltd v Baillavoine and Anor [2011] EWCA Civ 1565* supported a conclusion that no administrator could ever dismiss for an ETO reason. Rather, they considered that *Baillavoine* posed alternative situations: the first was one where the reason for a dismissal was an intention to change the workforce and to continue to conduct the business; and the second was where the dismissal was part and parcel of a process, with the purpose of selling the business. In the first case, there could be a dismissal for an ETO reason, but in the second case, there could not.

The EAT concluded that the case fell into the second category: all the facts pointed to the conclusion that the dismissal of the claimants was to preserve the business for the purpose of selling it in the future.

As the Insolvency Lawyers Association point out in their analysis of the case (see ILA Bulletin No 485 at ila@ilauk.com), an administrator wanting to dismiss fairly for an ETO reason, will have to show that improving the prospects of a potential sale is not a factor at the time of dismissal. As a practical matter, this is going to be very difficult to demonstrate in a trading administration and, for commercial reasons, may lead to more "liquidation pre-packs" in order to disapply Reg 8(7) of TUPE.

For some background on the *Key2Law* case, see Etukakpan, S. and Moffatt, P. "Key2Law (Surrey) LLP v De'Antiquis & Another: A return to certainty, but at what cost?" Nottingham Law Journal Vol 22, 2013.

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