FIRE *MAGAZINE*

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ISSUE 10

FIRE UK: Welcome Back

Contentious Insolvency Edition 2022

BACK TO SCHOOL, BACK TO WORK

INTRODUCTION

"The end-of-summer winds make people restless"

Sebastian Faulks

Following the summer break, we are delighted to present Issue 10 of FIRE Magazine, discussing a variety of issues and developments for professionals working in the insolvency field. This edition also presents a feature article from community partner Mourant, where they look at the enforceability of an agreement to negotiate as a matter of both English and Jersey law.

Thank you to our community partners and members for their continued support as we head into Q4. It has been a busy year for the FIRE community, and we look forward to connecting with you at our remaining 2022 events.

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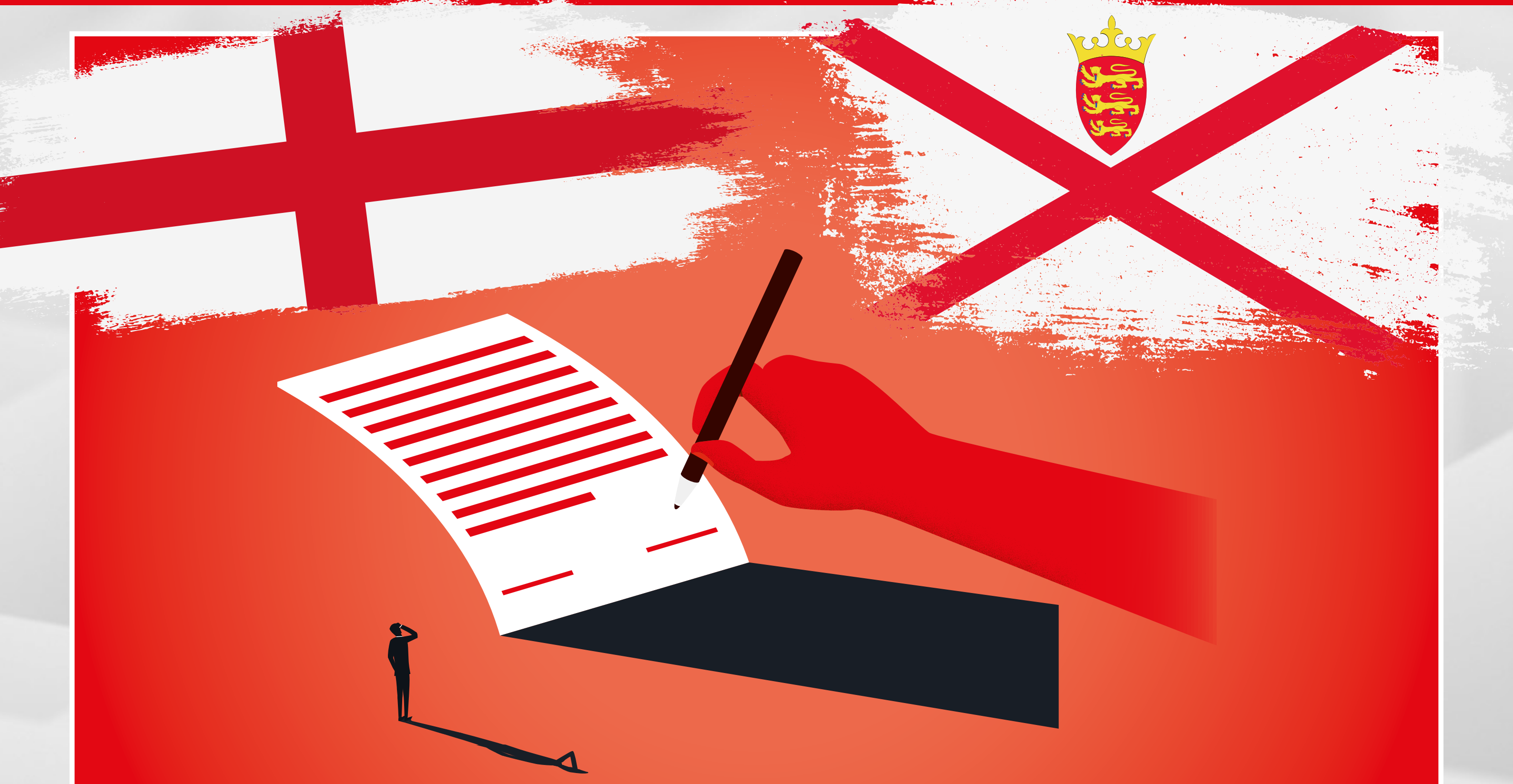
FIRE Americas

FIRE Americas: Cayman

12th - 14th March 2023 | The Westin, Grand Cayman

Bringing together experts from across North America, South America and the Caribbean

Featured Article



CAN AN AGREEMENT TO NEGOTIATE BE A VALID CONTRACTUAL OBLIGATION?

Authored by: Stephen Alexander and Andrew Bridgeford - Mourant

In this article we look at the enforceability of an agreement to negotiate as a matter of both English and Jersey law. Agreements to negotiate in good faith are often included by commercial parties in a variety of contexts, including heads of agreement, clauses for price review in the event of a change in circumstance, and mechanisms for the resolution of disputes before they go to arbitration or litigation. In order to create an enforceable obligation, it is fundamental in both England and Jersey that the parties intend that the agreement has contractual effect. But even if that hurdle is overcome, the issue remains whether the law recognises an agreement to negotiate at all. The traditional view is that it does not. In the words of Lord Denning, an agreement to negotiate is 'not a contract known to the law' [1]. Is this still the case? Is Jersey law any different from English law?

We start by looking at the leading Jersey case, namely the 2014 decision of the Jersey Court of Appeal in Minister for Treasury and Resources v Harcourt Developments Ltd and Ors 2014 (2) JLR 353. On certainty of contract, English law was followed; and the traditional view was taken. The case therefore stands as an example of that approach. We then look at other developments, both in England and elsewhere in the common law world, as well as the significant extra-judicial observations which have more recently been made by Lord Leggatt[2]. These developments suggest that the leading authority in England and Wales – the House of Lords decision in Walford v Miles [1992] 2 AC 128 – might well be departed from as and when a suitable case reaches the Supreme Court. In a jurisdiction such as Jersey, where decisions of the English courts are not binding, but merely persuasive, and where it is open to advocates to build arguments on the basis of other authorities, we suggest that the courts could also take a different approach and recognise that an agreement to negotiate can be a binding contract.

1 Courtney & Fairbairn Ltd v Tolaini Brothers (Hotels) Ltd [1975] 1 WLR 297

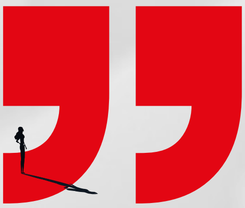
2 George Leggatt, 'Negotiation in Good Faith: Adapting to Changing Circumstances in Contracts and English Contract Law', Jill Poole Memorial Lecture, Aston University 19 October 2018. https://www.judiciary.uk/wp-content/uploads/2018/10/leggatt-jill-poole-memorial-lecture-2018.pdf. The present authors have gratefully drawn generally on Lord Leggatt's argument and have been guided to many of the cases he refers to.

Minister for Treasury and Resources v Harcourt Developments Ltd and Ors

Harcourt concerned 'Heads of Terms' entered into between a property development company (Harcourt) and a company established by the States of Jersey in order to implement a development strategy for public land on the St Helier waterfront (WEB). The Heads of Terms, entered into in 2007, set out in outline what had been agreed but envisaged that a development agreement was in due course to embody the contractual arrangements 'intended to be entered into between the first defendant and the plaintiffs in relation to the proposed development . . .' The crucial provision was Clause 3.4. This stated that 'by their execution of these heads of terms the parties are hereby agreeing to act in good faith and with all due diligence with a view to seeking to agree the terms of the development agreement'.

WEB was entitled under the terms to terminate the Heads if a development agreement had not been signed by 30 June 2008. Negotiations continued beyond this point but by July 2009 they had broken down. WEB gave formal notice of termination. Harcourt considered that WEB was responsible for the failure to reach agreement and that it had, in particular, breached its obligation in Clause 3.4 to negotiate the terms of the envisaged development agreement in good faith and will all due diligence. They sued the Minister for Treasury and Resources for the tort of inducing WEB to breach the contract and sought damages of approximately £100m.

The Minister applied to strike out the claim on the basis that it disclosed no reasonable cause of action. It was contended that Clause 3.4 constituted a mere agreement to agree or agreement to negotiate and that such agreements lacked the certainty required in order to amount to a contract; and, if there was no contract, the Minister could not have committed the tort of inducing a breach of contract. In the Royal Court, Birt, Bailiff, found considerable force in these submissions. He nevertheless declined the strike out application. Bearing in mind the high threshold required for a strike out application, he noted that he had not heard evidence on the full factual context which might be relevant to interpretation of the Heads, that certain scenarios could be envisaged where Clause 3.4 could amount to an enforceable contract and that this was a developing area of law. The Minister appealed to the Court of Appeal.
This time he was successful. Like the court below, the appeal judges noted that Jersey customary law requires a contract to have an 'objet' (the content of each parties' obligations) and that the objet of a contract must be sufficiently certain. The resulting position with regard to certainty of contractual terms is then the same as English law. Reviewing both English and Jersey case law, and in particular relying on the persuasive value of House of Lords decision in Walford v Miles, the Jersey Court of Appeal concluded that it was 'incontrovertible that in Jersey law an agreement properly characterised as an agreement to agree or agreement to negotiate is not one which can create a contractual obligation and therefore is incapable of enforcement'. Clause 3.4 could not create a legal obligation even if the parties intended it to do so.



Comment

In line with dicta in previous English cases, the Jersey Court of Appeal treated 'an agreement to agree' and 'an agreement to negotiate' as essentially falling into the same category; indeed, for convenience, both were expressly defined to as 'an agreement to agree'. But there is surely a significant difference. As Lord Leggatt has remarked extra-judicially in a talk given in 2018, 'Parties who agree to negotiate do not agree to agree. They agree to engage in a process – a process of holding discussions with a view to trying to reach an agreement. They give no undertaking about what the result of the process will be. They do not promise that the negotiations will be successful and that they will then enter into a contract[3]'

There is also a difference (as the Jersey Court of Appeal pointed out) between two bases upon which a party to Heads of Agreement of this nature could assert a claim. The first is to argue that Heads amount as a whole to a sufficiently certain contract, with any gaps sufficiently filed in by a process set out in the Heads, and with the Heads being construed as immediately operative and not conditional upon the entry into of the envisaged, more detailed contract. The second is to contend that a provision to engage in good faith negotiation, such as that in Clause 3.4, is itself valid as a standalone obligation, one in respect of which, in the event of breach, damages could be awarded (on what basis is considered further below).

The Court of Appeal considered that there might have been an enforceable obligation if the parties had 'stipulated a process for arriving at making the of the development agreement with terms yet to be agreed, and although the process might not in the event lead to a concluded development agreement, nevertheless the process itself was sufficiently defined so that a breach of the process could give rise to a claim in damages'. In this case, the Court of Appeal said, the process stipulated by the parties – negotiation in good faith with due diligence – lacked the necessary certainty. One could not find the required certainty 'simply in the indication that the negotiations are to be in good faith and with due diligence as the meaning of "good faith" in negotiations is itself inherently uncertain … [and] the addition of the requirement of due diligence as an additional feature of the required negotiations does not remove the inherent uncertainty'.

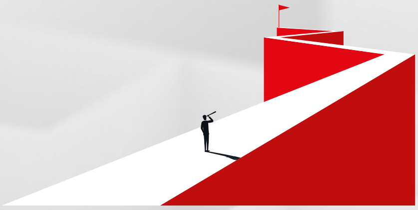
Yet is that really so? It is not the concept of good faith that is particularly uncertain; courts regularly have to decide whether a person, such as a fiduciary, has or has not acted in subjective good faith or with honesty. A perhaps greater difficulty lies in answering the more specific question whether a party has pursued or broken off negotiation in good faith, particularly in cases where a time frame for parley has not been specified. This was one of two reasons given by Lord Ackner in Walford v Miles for not recognising agreements to negotiate at all. Some agreements might indeed be so inherently uncertain as to be incapable of founding a claim for relief; but each can be considered in own terms, in its own context, and then measured against the charge

3 George Leggatt, 'Negotiation in Good Faith'.

of uncertainty. As noted above, the parties in Harcourt expressly obliged themselves to negotiate not only in good faith but 'with due diligence' and there was also a backstop date allowing WEB to withdraw if the negotiations did not come to fruition. The claimant's difficulties in establishing lack of good faith in negotiation would have been more narrowly evidential. The agreement itself has content – negotiation in good faith[4]. Evidential difficulties are not generally a reason for the law to refuse to recognise at all obligations to which parties have contractually obliged themselves for what they perceived at the time to be perfectly sound commercial reasons. To decide otherwise is (as Teare J remarked in Emirates Trading Agency LLC v Prime Mineral Exports Private Ltd [2014] 2 Lloyd's Rep 457) to frustrate their reasonable expectations[5]. Lord Leggatt, this time robed as Leggatt J (as he then was) in Astor Management AG & Anor v Atalaya Mining plc & Ors [2017] EWHC 680 (Comm) [2017] 1 C.L.C. 724 described the court's role such cases in the following way: 'The role of the court in a commercial dispute is to give legal effect to what the parties have agreed, not to throw its hands in the air and refuse to do so because the parties have not made its task easy. To hold that a clause is too uncertain to be enforceable is a last resort or, as Lord Denning MR once put it, 'a counsel of despair': see Nea Agrex SA v Baltic Shipping Co Ltd [1976] QB 933, 943.'

It is, moreover, quite possible to envisage cases in which bad faith can be proved without difficulty[6]. The application of a blanket restriction then becomes particularly indefensible. Should the law really deny a remedy to a party who is the victim of a provable and egregious breach of contract simply because other claimants, in different circumstances, would have greater evidential difficulty in establishing their case?

The second reason given by Lord Ackner in Walford v Miles for refusing to recognise an agreement to negotiate in good faith is that such an agreement is 'inherently repugnant to the adversarial position of parties involved in negotiations'. In response, Lord Leggatt observes that this is only a general description of the position under English law when parties have not entered into self-imposed contractual constraints. There is no reason why parties should not chose, at some appropriate stage in their discussions, to enter into a binding agreement to negotiate with each other in good faith for a stated or implied period of time. They would thereby be agreeing mutually to take genuine and honest positions, with a view to reaching a deal if at all possible, and to limit the circumstances in which they can walk away. The recognition of such an agreement is not a departure from the principle of freedom of contract. It is an application of it.



Further developments

In a 1996 lecture, only four years after Walford v Miles, Lord Steyn expressed surprise that the House of Lords had held that an agreement to negotiate in good faith was unenforceable. He hoped that the highest court might one day have the opportunity to re-examine the matter[7].

That opportunity has not yet arisen in England. But elsewhere in the common law world Walford v Miles has not met with universal favour. It has been followed in some jurisdictions, including New Zealand[8] and Hong Kong[9]. But in United Group Rail Services Ltd v Rail Corpn New South Wales [2012] 4 SLR 378, the New South Wales Court of Appeal examined the issues in detail and found Walford v Miles unpersuasive. It upheld an agreement under which the parties, in the event of a dispute or difference, would 'meet and undertake genuine and good faith negotiations with a view to resolving the dispute or difference'. The judgment of Allsop P is described by Lord Leggatt as impressive and it reflects much of his own thinking. It was also influential on the judgment of Teare J in Emirates Trading Agency LLC v Prime Mineral Exports Private Ltd [2014] 2 Lloyd's Rep 457, which is mentioned further below.

In Singapore, an agreement to negotiate in good faith the amount of the new rent on the occasion of a rent review has also been held to be enforceable: see HSBC Institutional Trust Services (Singapore) Ltd v Toshin Developments Singapore Pte Ltd [2012] 4 SLR 378.

In Walford v Miles there was, in fact, no express term of contract requiring negotiation in good faith; rather it was argued by the plaintiffs that an agreement to negotiate was implied term in a lockout agreement entered into between the parties in the course of their (subject to contract) discussions for the sale and purchase of a business. The House of Lords was clear that an agreement to negotiate would not have had legal effect, had they found it existed, and the case remains binding in England. But the unusual circumstances in which the issue arose in Walford v Miles have left some leeway for subsequent courts to distinguish it.

This was notably so in Petromec Inc v Petroleo Brasileiro SA Petrobuxs (No 3) [2005] Lloyd's Rep 161. Here the parties expressly agreed to negotiate in good faith the 'reasonable extra costs' of upgrading an oil rig. Longmore LJ, giving the judgment on this issue of the Court of Appeal, recognised that Walford v Miles was binding 'for what it decides'. But he went on to consider the 'traditional objections' to the enforceability of an agreement to negotiate and concluded that they were not sufficient to support a principle of blanket unenforceability. In an appropriate case, and Petromec was one, Walford v Miles could be distinguished. It was relevant inter alia that the extra costs, and thus any loss flowing from a breach, were on the facts comparatively easy to assess and that the obligation to negotiate in good faith was an express obligation contained in a complex binding contract.

The way thus lit by the Court of Appeal, lower courts have followed in a number of cases. One such is the case already mentioned of Emirates Trading Agency LLC. The clause in question expressly required the parties to 'first seek to

4 See United Group Rail Services Ltd v Rail Corpn New South Wales [2012] 4 SLR 378 at [65]. Allsop P giving the judgment of the New South Wales Court of Appeal observed: 'An obligation to undertake discussions about a subject in an honest and genuine attempt to reach an identified result is not incomplete. It may be referable to a standard concerned with conduct assessed by subjective standards, but that does not make the standard or compliance with the standard impossible of assessment.' The case is referred to further below,

5 See also per Longmore LJ in Petromec Inc v Petroleo Brasileiro SA Petrobuxs (No 3) [2005] Lloyd's Rep 161 at [121].

6 George Leggatt, 'Negotiation in Good Faith'.

7 Sultan Azlan Shah Law Lecture delivered on 24 October 1996.

8 Wellington City Council v Body Corporate 51702 (Wellington) [2002] 3 NZLR 486.

9 Hyundai Engineering & Construction Co Ltd v Vigour Ltd [2005] 3 HKLRD 723.

resolve the dispute or claim by friendly discussion' before an arbitration clause was triggered. Teare J distinguished Walford v Miles. Referring in particular to Petromec and the judgment of Allsop P in the New South Wales case of United Group Rail Services, he held that the clause was enforceable. The clause was not uncertain; it was right to uphold the parties' expectations; and in this case it was also in the public interest to uphold an agreement whose object was the avoidance of expensive and time-consuming arbitration. These reasons have more recently been endorsed obiter by Fraser J when considering a similar clause in The Football Association Premier League Limited v Pplive Sports International Limited [2022] [2022] EWHC 38 (Comm).

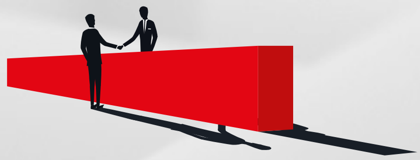
Walford v Miles nevertheless remains binding and has been duly followed in England in cases where it cannot be distinguished. Its shadow cannot always be avoided; nor do all judges seek to do so. It is hoped that the Supreme Court will have an opportunity before long to consider again the status of agreements to negotiate, and not merely agreements to agree, and to clarify the law generally on this issue.

Bases and assessment of damages

Lord Denning, giving the judgment of the Court of Appeal in Courtney & Fairbairn Ltd v Toliani Brothers (Hotels) Ltd [1975] 1 WLR 297, considered that, since no one can tell whether negotiations would have been successful, a court cannot estimate damages for breach of an agreement to negotiate[10]. But Lord Leggatt makes the point in his talk that there are various bases, depending on the case, on which damages could be awarded in the event of breach of an agreement to negotiate. The fact that no loss can be shown, or damages are impossible to estimate, is not a reason for holding that no contract known to the law exists. Nominal damages may be awarded. In other cases, the outcome of negotiation, had it properly ensued in good faith, might in fact be provable and the innocent party's loss quite capable of being established on the balance of probabilities. If no other basis apples, damages might at least be awarded for wasted expenditure. There are then also cases where it may be appropriate to award substantial damages on a loss of chance basis – that is, the loss of the opportunity of successfully concluding a profitable contract.

It was on this last-mentioned basis that a substantial claim was recently successful in Brooke Homes (Bicester) Ltd v Portfolio Property Partners and Ors [2021] All ER (D) 68 (Nov). The parties had entered into Heads of Agreement, expressed to be a binding contract, with a view to the acquisition and development of land for housing. The Heads included an obligation on the parties 'to use all reasonable endeavours to enter into a final binding agreement which captures legally these Heads of Agreement acting in good faith towards each other by 31st March, 2015.'[11] It was contended by the claimants that the defendants had breached both this agreement and a related Exclusivity Agreement. In these circumstances the defendants conceded that the provision above was enforceable. Remarking on this concession, Hugh Sims KC, sitting as a deputy High Court judge, noted that cases such as Petromec 'show that the courts will now be more willing to recognise an obligation to negotiate on some matter, using reasonable endeavours, or in good faith, where it is found in a binding agreement.' His judgment includes an instructive analysis of the differences between 'reasonable endeavours, 'all reasonable endeavours'; and 'best endeavours' and the content of a contractual duty of good faith. On the facts he found that both this agreement and the Exclusivity Agreement had been breached.

As to the question of causation of loss, an important question was whether causation needed to be established as a matter of the balance of probabilities or on a loss of chance basis, requiring only a causative breach giving rise to the loss of a real and substantial chance of benefit. Since the outcome of the negotiation would have depended not only on what the parties to the proceedings would have done, but also the decisions of third parties, it was appropriate to deal with causation on the loss of chance basis, rather than the balance of probability that a contract would have been concluded[12]. Causation was established on this basis for the loss of the opportunity to enter into a particular profitable contract. Discounted damages in the sum of £13.4m were then awarded for the loss of this chance.



Some further considerations of Jersey law

An agreement to negotiate should, in principle, be capable of forming the valid objet of a contractual obligation for the purposes of Jersey contract law and there is no reason why Lord Leggatt's powerful reasons for recognising such agreements should not equally apply in Jersey. There are, moreover, two additional reasons. The first is that Jersey law places great weight on the maxim la convention fait la loi des parties (the contract makes the law between the parties). Accordingly, very good reason needs to be shown why the court should relieve parties of an agreement which they have freely entered into[13]. The second is that the concept of good faith and the need to act in good faith probably (the point has not yet been conclusively determined) has a much more fundamental and inherent role in Jersey contract law, because of its civilian roots, than it does in English contract law. It is therefore strange that the Jersey courts should so readily have declined to recognise a freely chosen contractual agreement to negotiate in good faith.

It is also relevant that the technical doctrine of consideration under English law does not apply in Jersey. Rather,

10 Like Lord Ackner in Walford v Miles, Lord Denning gave two reasons for the blanket unenforceability of agreements to negotiate. But the two reasons are not (as Lord Leggatt also pointed out in his talk) the same as Lord Ackner's. Lord Denning's first reason draws an analogy between agreements to agree and agreements to negotiate. We have quoted Lord Leggatt's analysis above by way of counter argument. The second concerns the assessment of damages,

11 It was acknowledged by the parties that the specified date, falling in fact before the Heads were executed, was a mistake. The judge found on the facts that the period extended to the end of an exclusivity period under the related Exclusivity Agreement.

12 Applying Perry v Raleys Solicitors [2019] UKSC 5, [202] AC 352 at [20].

13 See, for example, Makarenko v CIS Emerging Growth Ltd 2001 JLR 348, at [32].

contracts must have a valid cause (or reason). This is a broader concept than consideration and it is usually not difficult to find; agreements to negotiate that might fail for want of consideration in England are unlikely to do so where the contract in question is governed by Jersey law.

Conclusions

We have referred above to the continued readiness of the English courts to distinguish Walford v Miles where possible and to the forceful extra-judicial comments of Lord Leggatt, now a Justice of the UK Supreme Court. Together these considerations suggest that, given an opportunity, the Supreme Court may well chose to follow the example of New South Wales in United Group Rail Services Ltd v Rail Corpn New South Wales and thus depart from Walford v Miles and recognise the general enforceability of an agreement to negotiate or at least clarify the conditions under which they are enforceable.

As for Jersey, the reasoning underlying this change of approach is not merely reflected in the local law; it is reinforced for the reasons mentioned above. Although Walford v Miles was followed by the Jersey Court of Appeal in Harcourt Developments it is still open to the Royal Court, as a matter of Jersey jurisprudence, to decline to follow a decision of the Jersey Court of Appeal if there has been 'a compelling change of circumstances'[14] ; and short of that, it will be open to the Court of Appeal to depart from its own earlier decision. A case like Harcourt Developments should at least not be susceptible to being struck out as a matter of legal principle at an early stage.

When it comes to a trial, of course, proof on the evidence will be another matter. The facts in Harcourt Developments were never tested. A plaintiff must not only win the legal argument for the validity of the agreement in question; they must also win on the facts. The difficulties in establishing the other side's breach of an agreement to negotiate or lack of subjective good faith could be substantial. Bearing in mind the burden of proof, potential plaintiffs will be well advised to assess realistically and carefully the strength of evidence on which they seek to rely; but in our opinion, notwithstanding Harcourt Developments, the way is open in Jersey for a strong case to be won.

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Stephen has been involved in some of the largest and most complex trust proceedings, funds disputes and insolvencies in Jersey and the Cayman Islands, and has regularly appeared before courts in these jurisdictions.

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Stephen is the co-editor of the Jersey chapter of the current Chambers & Partners Global Insolvency Guide.

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Consultant

Andrew is a Consultant in Mourant's Jersey office. In his Knowledge Management role, he supports the litigation and disputes resolution team in Jersey. He also acts within the team in major litigation and arbitration proceedings.

He has for a number of years independently published the Weekly Digest of Jersey Law which, amongst other things, attempts to provide full summaries of all judgments issued by the superior courts of Jersey. Andrew also contributes case summaries to the Jersey and Guernsey Law Review, on whose Editorial Board he has served.

14 State of Qatar v Al Thani 1999 JLR 118; quite what 'changes in circumstance' are relevant is not cleat but on the face of it the Royal Court has considerable scope to follow other jurisdictions which have departed from Walford v Miles. The Privy Council, on appeal from Jamaica, in National Transport Co-operative Society v The Attorney General [2009] UKPC 48 has also stated that 'the principle that an alleged contract is ineffective or unenforceable in law because it is too vague, or because it constitutes an agreement to agree, or an agreement to negotiate, is well-established.' The case concerned an agreement to agree, rather than an agreement to negotiate; and thus, although the dictum above extends to agreements to negotiate, the case is not directly in point. Furthermore, being an appeal from another jurisdiction, the Board's opinion is not binding in Jersey: see also State of Qatar v Al Thani 1999 JLR 118.


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THE HEAT IS ON

FOR INSOLVENCY PROFESSIONALS IN CRYPTO WINTER

Authored by: Dani Haston - Chainalysis

On 3 January 2009 the first block on the Bitcoin Blockchain was mined. This was shortly after the start of the Great Recession. That is no coincidence; confidence in centralised financial systems had plummeted.

Satoshi Nakamoto encoded that first block of Bitcoin mined with the immutable message taken from the newspaper that day: "The Times 03/Jan/2009 Chancellor on brink of second bailout for banks."

Crypto was seen as the answer to the centralized financial system crisis in the eyes of Nakamoto and the early Bitcoin adopters. It is highly doubtful that they anticipated the vast re-centralisation of crypto. Users are now doing exactly the opposite to what the whitepaper envisaged by handing control of their finances over to third parties that are in large part regulated by the same systems as those very banks.

The first line of the Bitcoin white paper reads, "A purely peer-to-peer version of electronic cash would allow online payments to be sent directly from one party to another without going through a financial institution." In a whitepaper that was so articulately put that it changed the world in just 9 pages, the inclusion of the word "purely" must have been deliberate.

Not so Nakamoto, not so. Re-centralisation followed as more and more people wanted to enter the world of crypto but were not ready to do that which was intended, to actually take responsibility for their own digital money. The idea of being the master of your empire seems liberating until you realize you forgot your access credentials, no one has a password reset button and you've lost access to all your money. And so a whole generation of crypto native businesses, exchanges, hosted wallets and more nefarious custodians were born to do this for them.

But if you thought a recession when the banks had the money was bad, well, let's explore the alternative we now face. Banks rarely end up in insolvency

thanks to government backing. When they do, most of us have a guaranteed amount of protection against our finances via regulators/governments, and there are limitless highly skilled insolvency experts who can jump in with decades of experience in traditional financial markets to manage the process and investigate. But this time it's "normal corporate businesses" (read: businesses whose account holders' funds are not guaranteed protection) that will fall into insolvency far more often (because no one is propping them up) holding millions if not billions of pounds, euros, dollars and so forth of customers' assets (both in crypto and fiat).

It has already begun. Voyager, Three Arrows and Celsius all entered insolvency processes thanks to external threat and market forces. People leverage algorithms that break causing prices to crash, external threat actors breach security systems and steal funds, and even Joe Public will take advantage of a smart contract vulnerability to siphon out funds (and then send it back because they realize the blockchain's inherent transparency means they'd easily be tracked, identified and caught). Chainalysis estimates that $2 billion in cryptocurrency has been stolen from cross-chain bridges alone across 13 separate hacks, most of which occurred this year, demonstrating how fast these emerging threat classes are moving.

The biggest threat is perhaps yet to come: the internal threat. Let's set that scene.

2009 was not just the launch of Bitcoin, it was also the year in which the Association of Certified Fraud Examiners (ACFE) published a survey of more than 500 experts titled "Occupational Fraud: A Study of the Impact of an Economic Recession." One conclusion may seem obvious: in times of intense financial pressure, there is an increase in fraud. But noteworthy was the conclusion that not only is it the employees of entities that pose the greatest fraud risk, but that the gaps in workforce caused by layoffs meant there were holes in internal control systems.

Whether or not you believe a recession is imminent, it is a fact that crypto prices have plummeted and many crypto firms have responded to the changing market conditions with layoffs. As Crypto Winter and perhaps the next global recession unfolds, how many crypto businesses will find they have gaps in their internal control systems that leave them open to internal threat? In a world where even the US Secret Service had agents run off with ill-gotten crypto this is a real and current risk for crypto businesses. This risk also applies to any business holding crypto on its balance sheets or any business operating in fiat in which someone (whether a director anticipating insolvency, or a disgruntled accountant) decides to convert fiat into crypto thinking they can run off with it undetected. In other words, this may apply to any business. This is likely to lead to an increase in demand for crypto literate advisory professionals in compliance, audit, restructuring, internal investigations and of course insolvency and asset recovery.

The good news – because there is some (hurrah!) – is that we are seeing the first few lawyers and accountants firms taking genuine steps to equip themselves at scale with the tools, data and staff who know the right questions to ask, are trained in tracing cryptocurrency, know how to graph out crypto frauds, and are familiar with the case law around freezing and recovering crypto assets. But to meet current demand and the increase that is inevitably coming, scaling crypto asset investigation and recovery expertise is time critical.

Every law firm and every accountancy practice should have someone who knows enough to update their questionnaires and procedures to at least detect when crypto may be in play.

But anyone who is responsible for asset preservation and recovery is going to need to be skilled to respond urgently when the situation arises. Few assets are more liquid and dissipated than crypto, although on the plus side (another one!) few are less immutably traceable for recovery.

For those of you who are not corporate insolvency professionals and are enjoying watching your corporate colleagues or competitors squirm at this point, I have one final note. Based on research undertaken by the FCA and Gemini this year, the percentage of UK adults who own crypto could be anywhere between 4.4% and 18%. Either way, that's millions of people who are holding assets that could and should be realized for creditors. Everyone needs to ask the questions and understand the implications. It may only be 4 or 5 figures in value now, but we have seen that crypto assets recovered while the value of crypto assets are low – as they arguably are now in crypto winter – can transform insolvency to solvency, as we've seen in the Mt Gox case. So there's an opportunity for you too.

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"LOCK-ED" OUT:

COURT OF APPEAL DEMONSTRATES ITS RELUCTANCE TO SET ASIDE ASSIGNMENTS

Authored by: Philip Henderson and Bela Viramgama - Henderson & Jones

The Court of Appeal decision in Lock v Stanley (Re Edengate) [2022] EWCA Civ 626 makes it clear that defendants to assigned claims will face significant hurdles if they try to challenge the office-holders decision to assign.

Background

In insolvencies, assignment of claims is an increasingly popular way for office holders to realise value from legal claims. The claims are transferred to a third party (typically a litigation funder) who steps into the shoes of the company and runs the litigation in its own name using its own resources. This minimises the risk and expenses incurred by the company and its office holders, but allows them to realise a price and/or a share in the upside if the claim is successful.

Some defendants have tried to capitalise on the fact they are also (or claim to be) creditors of the company to mount opportunistic challenges to the assignment, and thereby defeat the claim.

Section 168(5) of the Insolvency Act 1986 provides that "if any person is aggrieved by an act or decision of the liquidator, that person may apply to the court; and the court may confirm, reverse or modify the act or decision complained of, and make such order in the case as it thinks just."

In Re Edengate, Mrs Lock, a creditor and former director of Edengate Homes (Butley Hall) Ltd (In Liquidation) (the "Company"), applied to set aside a decision made by the Company's liquidator to assign claims against her and her family to a third party litigation funder. Mrs Lock argued that the liquidator's decision had deprived her and her family of the opportunity to purchase the claim and thereby bring it to an end.

The High Court had concluded that Mrs Lock did not have standing to bring the application. It also held that, even if she did have standing, the liquidator's decision had not been perverse i.e. utterly unreasonable. Mrs Lock appealed on both issues.

Legal analysis

In relation to standing, the Court of Appeal agreed with the High Court. It is not sufficient to show that a "person is aggrieved" simply by virtue of being a creditor. A person must also show that they have a legitimate interest in the relief sought. In the context of assignment, "an applicant will have a legitimate interest if it is acting in the interests of creditors generally". On the facts, the Court of Appeal held that Mrs Lock's real interests were as a defendant in the litigation, and this was not aligned with the creditor class generally and as a whole. Accordingly, Mrs Lock did not have standing to bring the application.

The Court of Appeal went on to consider perversity as a distinct legal principle, saying that the correct test for perversity (excluding instances of fraud and bad faith) was best summarised in Re Edennote:

"the court will only interfere with the act of a liquidator if he has done something so utterly unreasonable and absurd that no reasonable man would have done it".

Therefore, whilst it may be good practice to give a defendant the opportunity to acquire (i.e. settle) a claim before assigning it to a litigation funder, there is no obligation on the liquidator to do so. Even if the reasons given for a liquidator's decision to assign a claim are unsatisfactory, this alone is not enough to automatically meet the perversity threshold.

Finally, it is clear that the court will not exercise its discretion under section 168(5) if doing so is not in the best interests of a company's creditors.

Commentary

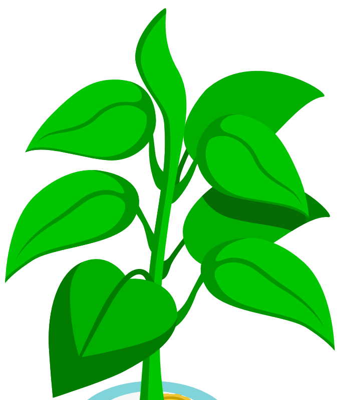
An office holder is appointed to realise value for company assets.

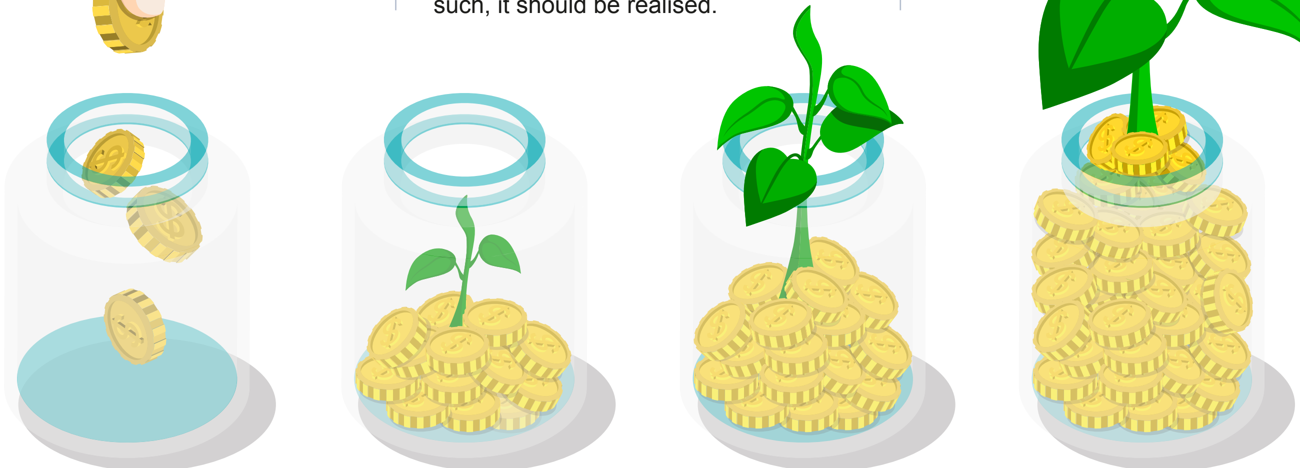
Claims requiring litigation are often difficult assets to deal with, but there is a growing and active market of companies willing to purchase these claims. This case is a further example of the Court encouraging and facilitating this market, thereby increasing options for insolvency practitioners.

In fact, office holders are more likely to find themselves being criticised (and potentially in breach of their duties) if they do not take steps to obtain value for claims, even if there are no funds in the estate. In the case of LF2 v Supperstone [2018] EWHC 1776 (Ch), the court made it clear that if an office holder "has no funds to investigate a possible claim against a third party and he receives an offer from a potential assignee of the claim to pay for an assignment, that offer will potentially constitute an asset of the company."As such, it should be realised.

In Re Edengate, the liquidator was able to overcome the challenge to the assignment by demonstrating that he had taken reasonable steps to realise the value of the litigation. For example, he had investigated funding possibilities with an alternative creditor and looked at entering into a conditional fee arrangement combined with ATE insurance, before assigning the claim to a litigation funder. There was nothing on the facts to show that he would have been able to obtain an equal or better offer for the assignment from Mrs Lock. In practice, defendants will be unable to show that better value could have been achieved unless they are willing to settle the claim with the assignee - which is what they are trying to avoid!

This case is a good reminder that, when assigning claims, office holders should bear in mind the same good practice as when realising any asset - they should consider the various options available to them and, of those, which is likely to result in the best outcome for the company's creditors.





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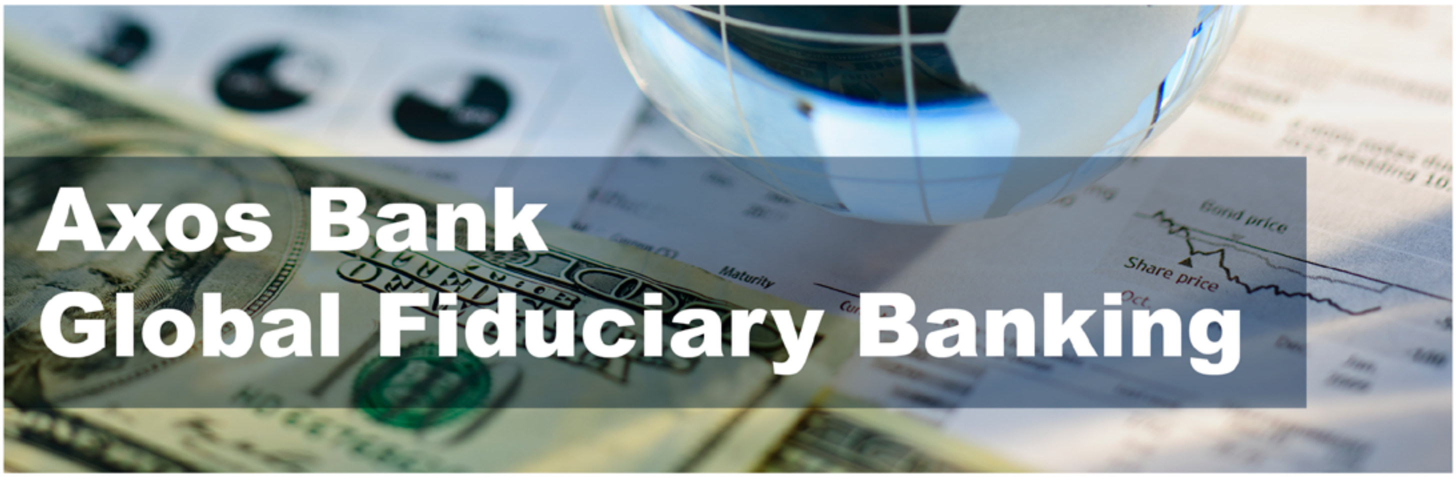

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CHALLENGING OFFICE-HOLDER DECISIONS AFTER BAGLAN OPERATIONS LIMITED [2022] EWHC 647 (CH)

Authored by: Thomas Robinson, Daniel Scott and Daniel Petrides - Wilberforce Chambers

Introduction

1 The purpose of this article is to consider two key issues that arise in connection with applications brought to challenge the decisions of office-holders in the course of their conduct of an insolvency. There have been recent decisions on this topic under s.168(5) of the Insolvency Act 1986 ("IA 86"), but the issues go wider than just liquidation and apply to administrators, trustees in bankruptcy and others. I propose to deal with them as follows:

- First, identifying which applicants a court will accept as having standing to challenge an office-holder's decision;
- Second, considering how the Court approaches such a challenge. What test does it apply to decide whether to modify the decision in question?

s.168(5)

2 Section 168(5) of IA 86 provides as follows:

"If any person is aggrieved by an act or decision of the liquidator, that person may apply to the court; and the court may confirm, reverse or modify the act or decision complained of, and make such order in the case as it thinks just".

Standing

3 In Mahomed v Morris [2001] BCC 233 Peter Gibson LJ noted at [24] that while the words "person aggrieved" in s.168(5) "are very wide at first sight and are not on their face limited to creditors and contributories", there was (at that time) only one reported decision in which a person not being a creditor or contributory had been allowed to apply under the section. Further, in Re Edennote Ltd [1996] BCC 718 at 721 Nourse LJ suggested that "an outsider" to the liquidation would not normally have standing to apply.

4 The one reported decision he referred to was Re Hans Place Ltd [1992] BCC 737 in which a landlord was permitted to challenge a decision by a liquidator to disclaim a lease despite not being a creditor.

5 In Brakes v Lowes [2020] EWCA Civ 1491; [2021] Bus LR 577 Asplin LJ explained the reasoning in Hans Place and Mahomed at [82] on the basis that:

> "The ability to disclaim onerous property under section 178 of the Insolvency Act 1986 is specific to a liquidator and arises in the liquidation. It is not surprising, therefore, that the decision to disclaim should be challenged in the liquidation itself. As Peter Gibson LJ put it in the Mahomed case [2000] 2 BCLC 536, the landlord was directly affected by the exercise of a power granted to the liquidator which he would not have been able to challenge otherwise.".

6 Even creditors will not constitute 'persons aggrieved' if their challenge is not in the interests of the class of creditors as a whole:

a. In Walker Morris v Khalastchi [2001] 1 BCLC, a law firm which was a creditor of the insolvent company in the sum of £237 was seeking to prevent the liquidator from handing over documents relating to the company's tax affairs to the Inland Revenue so as to protect its other clients from possible proceedings by the company. The firm was held not to have standing because it was seeking to advance the interests of possible debtors rather than creditors.

b. In Re Edengate Homes (Butley Hall) Ltd [2022] EWCA Civ 626 the Court of Appeal held that a creditor who sought to challenge the assignment to a litigation funder of possible claims which the insolvent company had against her and her family was seeking to advance her personal interests rather than that of the creditors generally, and accordingly did not have standing.

7 It thus appears that there are three elements to the question of whether an applicant has standing:

a. First, they must be directly affected by the proposed exercise of the power. This is a necessary, but not sufficient, ingredient; the courts are astute to protect liquidators from collateral attacks from an infinite array of third parties. The impact on the applicant does not have to be purely financial (Brake at [84]).

b. Secondly, the power that the applicant challenges must be a power given to the liquidator as part of the liquidation.

c. Finally, the challenge must be consistent with furthering the interests of the liquidation as a whole.

8 In the recent case of Baglan Operations Limited [2022] EWHC 647 (Ch) customers of an insolvent power company who were not creditors challenged the decision of the Official Receiver (as liquidator) not to continue supplying power due to the extent of his vires under IA 86. In his judgment at [40] Norris J recognised that the applicants came "within the narrow class of persons directly affected by the exercise of a power given to the Official Receiver who would not otherwise have the right to challenge their exercise".

The Correct Test

9 It is easy to find commentators that describe the test for a challenge under s.168(5) IA86 as akin to perversity. That is usually based on a statement in In Re Edennote Ltd [1996] BCC 718 at 722, as follows:

> "[…] (fraud and bad faith apart) the court would only interfere with the act of a liquidator if he has done something so utterly unreasonable and absurd that no reasonable man would have done it."

10 However that test applies to what may be called "commercial" decisions by office-holders, but it is not a complete statement of the position. Indeed the wording of s.168(5) allows the court a wide discretion to modify a decision of an officeholder and "make such order in the case as it thinks just".

11 It is thus not surprising that issues of fairness between affected persons can also prompt the court to modify a decision. In Hellard v Michael [2010] BPIR 418 at [8]-[9] Sales J noted (in a case dealing with the near equivalent power in s.303(1) IA 86 in relation to bankruptcy proceedings):[1]

> "In my view, however, the test in In re Edennote Ltd does not exhaustively state the grounds for intervention by the court. As is clear from the provisions of the Insolvency Act 1986, the court retains a general supervisory jurisdiction in respect of trustees in bankruptcy to ensure they behave properly and fairly as between persons affected by their decisions"

12 The touchstone for identifying when a court should apply the test in In re Edennote Ltd and when it should apply a different test is the nature of the decision under challenge. As noted above, a "commercial" decision will attract a high threshold for challenge. But where a decision is not simply a commercial one, different considerations will apply.

13 Thus in Re Buckingham International plc [1998] BCC 943 the Court of Appeal considered a challenge under s.168(5) IA86 to a liquidator's decision to apply to a US court under the US Bankruptcy Code to restrain steps by certain creditors of the company in liquidation that sought to gain precedence over other creditors in the liquidation by using "garnishment" proceedings in the USA.

14 At first instance Harman J had accepted the liquidators' submission that they were seeking to give effect to an overriding principle of pari passu distribution of assets among creditors of the same class. He rejected the challenge to the liquidators' decision, relying on Re Edennote Ltd [1996] BCC 718 at 722 in describing his jurisdiction under s.168(5) IA86.[2]

15 The Court of Appeal considered this reliance to be misplaced, as the nature of the decision complained of was not a "commercial one". Instead it concerned whether competing creditors could jump the queue in priority to general unsecured creditors. That was "eminently a matter for the Companies Court" and not one for the liquidator's discretion in the way realising assets requires the liquidator's discretion. In essence, it concerned how properly to enforce the statutory scheme for insolvencies under IA86.

16 In Baglan, the decision complained of was a decision by the liquidator that he had no vires under IA 86 to continue trading the business of the company in liquidation. The Court agreed this was a matter of law, under Schedule 4 to IA86, and not one for the Edennote test.

17 The question then becomes where to draw the line between (i) a decision that is one for liquidators in their discretion, applying commercial judgment, and (ii) a decision where the underlying dispute is one of law or where the liquidator may be said to be (wrongly) implementing the statutory scheme? If the latter, the applicant should get away from the high bar of a perversity test. Those acting for and against office-holders will need to think carefully about the nature of the decision that may be challenged.

1 Which provides that the court may give directions or make such other order as it thinks "fit", rather than "just" as in s.168(5).

2 At 953.

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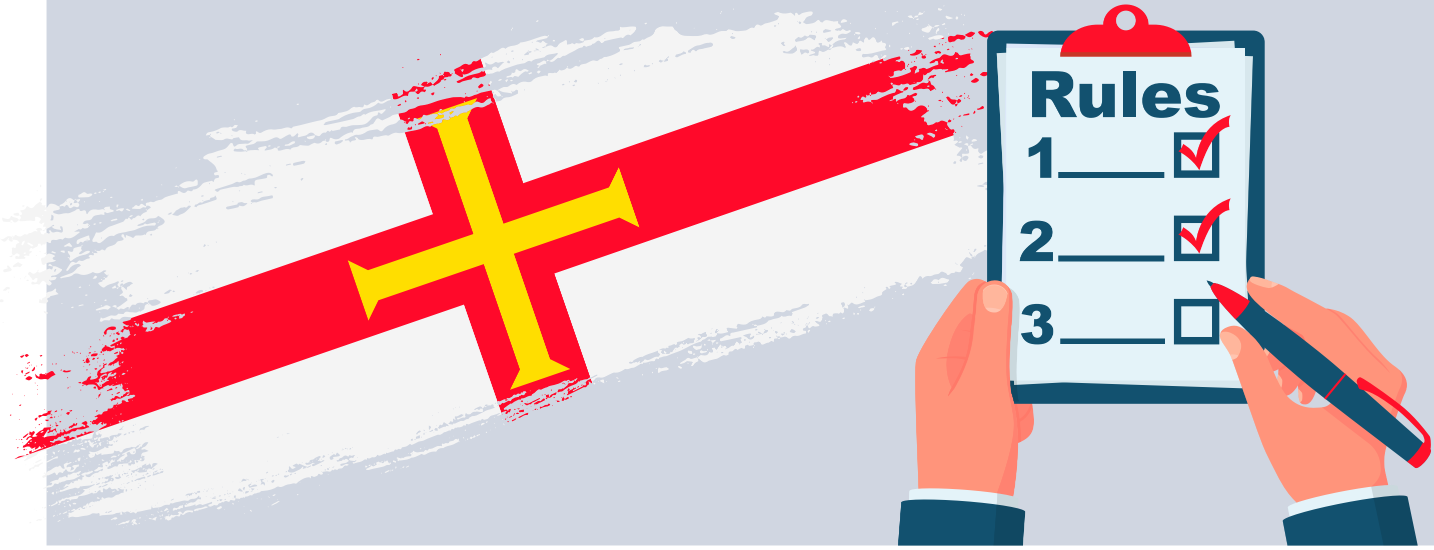
NEW DEVELOPMENTS IN GUERNSEY INSOLVENCY: THE GUERNSEY INSOLVENCY RULES



Authored by: Alex Horsbrugh-Porter and Michael Rogers - Ogier

Historically, Guernsey's insolvency law had limited operational provisions (compared to English law) and was largely developed by a bespoke and flexible application of common and customary law principles by the Royal Court. The old regime will now be updated and revised by the Companies (Guernsey) Law, 2008 (Insolvency) (Amendment) Ordinance 2020 (Ordinance) which was passed on 15 January 2020. Although it does not yet have force of law it is anticipated to become law in the latter part of this year. Ogier's briefing regarding the Ordinance is available here.

The Insolvency Rules have been developed by the Insolvency Rules Committee (IRC) to supplement and to provide helpful additional background and context to the changes which will be implemented by the Ordinance and to provide insolvency practitioners and industry related parties with further guidance on their practical application. The Rules have been drafted by the IRC which includes Alex Horsbrugh-Porter, and is based upon input and feedback from insolvency practitioners and lawyers in Guernsey.

It was considered that there were (among others) the following deficiencies in the existing corporate insolvency regime:

1. A lack of independence for liquidators of insolvent companies
2. During the course of an insolvent liquidation there was minimal requirement to consult with creditors
3. There is no positive obligation on liquidators and administrators to report director misconduct to the Guernsey Company Registry and/or the Guernsey Financial Services Commission where appropriate
4. There are insufficient powers for liquidators or administrators to obtain information from directors and officers; and
5. There is no proof of debt procedure

The initial Insolvency Rules have been prepared with these issues in mind and will address the following topics:

1. Meetings of creditors and shareholders
2. A duty to report delinquent officers
3. A requirement for a declaration of solvency; and
4. The power to disclaim assets

We examine below the applicable amendment which will be implemented by the Ordinance and thereafter a brief analysis of the proposed content of the applicable Insolvency Rule.

1. Meetings of creditors and shareholders

Ordinance

Meetings of creditors and shareholders will now be governed by the Ordinance. Section 386A of the Ordinance details the applicable provisions relating to meetings of creditors and shareholders and will require liquidators to call an initial meeting of creditors and to send an explanation to creditors of the aims and likely process of the administration. The Ordinance specifically gives the IRC the power to make regulations in respect of these meetings.

During the course of a winding up, where a liquidator becomes aware that despite a declaration of solvency having been made the company does not in fact satisfy the solvency test, then pursuant to section 398A of the Ordinance, the liquidator will be required to convene a meeting of creditors.

Section 398B addresses the scenario where a declaration of solvency has not been made and a liquidator is required to convene a meeting of creditors, unless he is satisfied that there will be no distribution to creditors.

The Ordinance also inserts provisions relating to circumstances prior to dissolution of a company where a final meeting of shareholders is called, but no quorum is present.

Draft Insolvency Rule

The draft Insolvency Rule covers the following:

- The requirement for a meeting to be held and the specific circumstances when the requirement can be dispensed
- Convening meetings of creditors and general meetings including the required timeframes for each
- Notice of creditor meetings and content of notices
- Location of creditor meetings
- Quorum at creditor meetings
- Chair of creditor meetings
- Voting at creditor meetings
- Suspension and adjournment of creditor meetings
- Proxies (including a standard form)
- Minutes
- Electronic communication regarding creditor meetings

2. Reporting delinquent officers

Ordinance

There is currently no positive obligation upon liquidators or administrators to report delinquent officers. Under the Ordinance (Sections 387A and 421E), administrators and liquidators will now have a duty to report to the Guernsey Registry and, in the case of regulated entities, to the Guernsey Financial Services Commission, if it is considered that there may be grounds for a disqualification order.

Draft Insolvency Rule

The draft Insolvency Rule will provide full information on the detail on the format of the report as well as introducing standard form reports, which will create a welcome standard from a reporting perspective.

3. Declaration of solvency

Ordinance

In order to distinguish whether a voluntary liquidation is solvent or insolvent, section 391A of the Ordinance requires directors to make a declaration of solvency. If a declaration of solvency is not made, the Ordinance requires that an independent liquidator is appointed (for example, a person that is not a director or former director of that company) and the liquidator will be required (subject to certain exceptions) to report to creditors and hold a meeting of creditors.

These amendments have been created in order to ensure that liquidators of insolvent companies are independent and will be required to investigate the cause(s) of insolvency, together with the actions of officers of the company and to ensure that liquidators of an insolvent company communicate adequately with creditors.

Draft Insolvency Rule

The draft Insolvency Rule will cover the format of the declaration of solvency in standard form. It is also proposed that the definition of 'solvency' is consistent with section 527 of The Companies (Guernsey) Law, 2008 (the Law).

4: Disclaiming onerous property

Ordinance

New provisions within the Ordinance provide the power to liquidators to disclaim onerous property, even though (as a function of their office) he or she may have exercised rights of ownership over the property (for instance by taking possession or endeavouring to sell it).

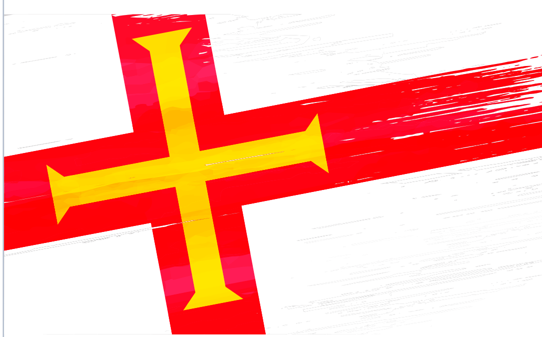
The amendments proposed by the IRC preserve existing contractual rights relating to (i) close out netting (ii) set-off or (iii) compensation and in addition any rights of enforcement and also unaffected.

Draft Insolvency Rule

The draft Insolvency Rule will address (i) the terms of the notice of disclaimer (ii) details of a non-effective notice of disclaimer to interested persons for information and (iii) those circumstances when a notice of disclaimer is presumed valid and effective.

Conclusion

The proposed Insolvency Rules will be a welcome addition to the operation of the corporate insolvency regime in Guernsey, by assisting Insolvency Practitioners and lawyers by creating certainty and predictability within the existing framework. These additions will also work to the benefit of creditors and stakeholders, to reduce costs which should assist with increasing returns for creditors.



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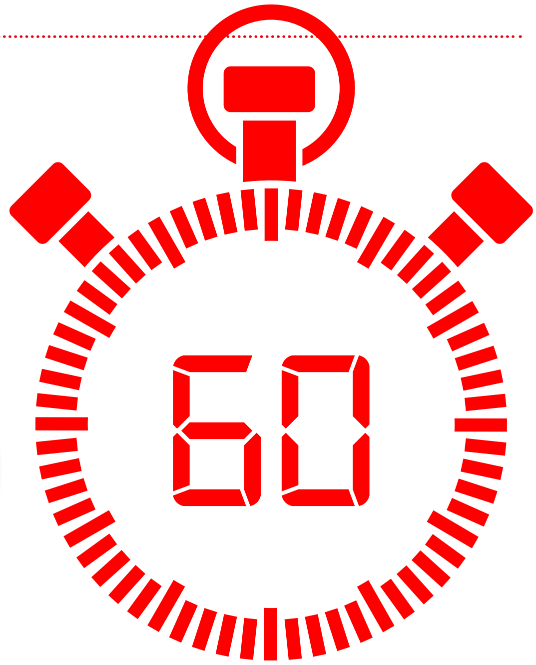

JENNIFER CRAVEN
LEGAL DIRECTOR
PINSENT MASONS

Q What do you like most about your job?

A Litigators tend to like winning: that's what I enjoy the most!

Q What would you be doing if you weren't in this profession?

A When I was at school, I ran cross-country and wanted to be like Liz McColgan! When I saw her daughter, Eilish, win a gold medal at the Commonwealth Games recently, it brought back memories of how I had once wanted to be a pro-athlete. Sadly, I think that ship has sailed!

Q What's the strangest, most exciting thing you have done in your career?

A As part of a huge investigation, I travelled into the desert to interview witnesses. The excitement wore off pretty quickly when the air-con failed!

Q What is one of your greatest work-related achievements?

A Receiving kind feedback from my clients and peers.

Q If you could give one piece of advice to aspiring lawyers, what would it be?

A Don't sit in the comfort zone! Do something that challenges you regularly: it will make you a better lawyer.

Q What do you see as the most significant trend in your practice in a year's time?

A Most likely an increase in APP fraud / Quincecare related litigation, complex class actions, and London will see more crypto related international arbitration.

Q What personality trait do you most attribute to your success?

A I would have been a good CEO as I'm organised and can multitask well (so long as I have regular cups of tea!).

Q Who has been your biggest role model in the industry?

A There are just too many to name one person so I'll say all of the clever, interesting and fabulous individuals who work in the civil fraud team at PM!

Q What is something you think everyone should do at least once in their lives?

A Visit Anfield when a Champions League match is being played!

Q You've been granted a one-way ticket to another country of your choice. Where are you going?

Barbados!

Q What is a book you think everyone should read and why?

A I'm into apocalyptic survival horrors (I like to be prepared for the worst!), so I will say Domain by James Herbert.

Q If you had to sing karaoke right now, which song would you pick?

A Toss up between "Give It Up" by KC and The Sunshine Band and "Hey Jude". I warn you though, I do sing with conviction…..and my husband says I'm tone deaf!

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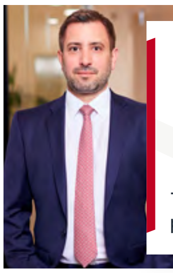

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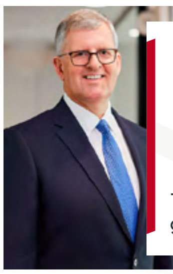

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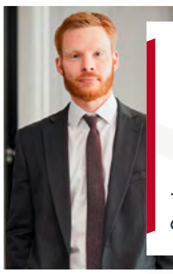

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LITIGATION COSTS

...AN INJUSTICE FOR ALL?

Authored by: David Hinrichsen - FRP Advisory

Creditors and insolvency practitioners continue to suffer from an inherently imbalanced and unfair costs regime in insolvency litigation giving an unfair advantage to respondents who have benefitted from misconduct.

Imagine this: An insolvency practitioner is appointed as trustee of a bankrupt, with creditors totalling £1m and a residual cash balance of £50k but no other assets of any meaningful value. On investigation, it becomes apparent that essentially all of the insolvent's other assets were transferred to two family members and another family member's company prior to bankruptcy, with the three recipients receiving a total of £500k each. So far, so familiar in any modestly contentious insolvency scenario, corporate or personal. To the IP, a clear transaction at undervalue (and misfeasance if this was a liquidation), capable of being reversed. To the creditors, an outrageous insult, facing an effective zero return while the insolvent (through his associates) merrily continues to benefit from the transferred assets.

So the IP, using the remaining cash, instructs a solicitor to issue letters before action to the recipients, seeking the appropriate remedies for the benefit of the estate's creditors. All three respondents instruct different (but expensive) firms of solicitors, claiming to have nothing to do with each other, but each seeks to assert that all transfers were legitimate and for value (if indeed there was any value to the assets, or any loss caused, which of course will need to be subject to expensive expert evidence). All respondents naturally promise to vehemently defend any claims against them. Still familiar?

The IP now faces a stark choice. By now the IP's costs are £20,000 and his solicitor is owed £15,000, leaving £15,000 in the estate. Creditors are seething about the shameless rip-off by the insolvent and want justice.

One option is to assign the £1.5m of claims to a claims purchaser, who has offered 40% of any net recovery. Another is to issue proceedings as trustee, but for that the IP will need to budget for an expert (say £100k), counsel to trial (say £250k – there are after all 3 sets of defendants) and ATE insurance (with 3 separately represented respondents, the cover limit will need to be say £1m, which comes at an upfront cost of £100k and a deferred element on success of £350k). Solicitors estimate their costs at £200k and have confirmed that they will act on a 75% CFA. The IP, wishing to act in the best interests of the estate, has persuaded his firm to allow him to work entirely contingently on this case at an anticipated future cost of £200k. A funder is prepared to lend the required £450k of hard costs to cover counsel, upfront ATE and experts for 100% return on success.

A quick projection to trial therefore shows the following calculation for a successful outcome:

	£ ('000)	£ ('000)
Claim value	1,500	
Cost recovery (say 70% plus all experts)	415	
Total recovery		**1,915**
Less		
Deferred ATE premium	(350)	
Funder return	(900)	
Solicitors' costs including uplift	(350)	
IP's fees	(200)	
Total costs		**(1,800)**
Anticipated net recovery		**115**

Clearly, no one in their right mind would deem a 6% recovery rate a commercially sensible outcome or a safe bet as far as litigation outcomes are concerned. One could of course hope for an early settlement which could produce a more beneficial return to the estate, but to embark on fully-fledged legal proceedings without an eye on the final outcome would be madness.

And this calculation is unsurprisingly wildly unrealistic. The IP shouldn't have to agree to act fully on risk without any upside, a 75% CFA is perhaps optimistic and only a 1x multiple at trial for a commercial funder is the stuff of sparkly unicorns and rainbows when in reality it is entirely possible that a funder may not even consider funding a case with such a projected outcome. The assignment option therefore looks quite attractive – once a well-funded assignee gets involved, the respondents may ultimately be persuaded to settle, but at this point, the estate will have already given up its right to 60% of any net recovery, still resulting in only a fractional return.

And before anyone raises their hand to point out that the costs are too high for this clear-cut scenario: this is an entirely made-up example with fairly arbitrary numbers. However, the correlation between recovery and cost values is probably not too far from reality in many corporate and personal insolvency contexts, which may often produce similarly uncommercial outcomes.

Armed with such commercial experience, any smart respondent will simply adopt the dual strategy of 1) waiting to see if the claim is issued and 2) making the IP incur as much cost as quickly as possible. Being a commercial beast by definition, no IP will be able to justify taking this claim very far. (I hope I haven't given away the holy grail of defending insolvency claims here but suspect I have not…)

The truth is that the Legal Aid, Sentencing and Punishment of Offenders Act 2012 has taken away any commercial edge IPs used to have, especially in any remotely complex litigation with values in anything below the tens of millions. Prior to the end of the insolvency claims exemptions from LASPO in 2016, the respondents in this scenario would have faced a much greater adverse costs exposure, including £450k of ATE premiums and the solicitor's CFA uplift, resulting in an improvement to the estate's projected net recovery of more than £550k.

That improved return and potential damage would have respectively incentivised the IP to bring proceedings for the benefit of creditors, and the respondents to sensibly engage with the process, without the need to involve a claims purchaser.

None of this is meant as a criticism to the claims purchasing market, which is of course a valuable tool for de-risking litigation by taking on claims that IPs are unable to bring, or creditors are unwilling to fund.

But in a world where IPs are increasingly expected by regulators and creditors to be aggressive and litigious to achieve recoveries, they need to be equipped with the right armoury to not be outgunned by well-funded (often through the very act that gives rise to the claim) and litigation-smart respondents.

LASPO's insolvency exemptions urgently need to be reversed, and in my humble opinion ought to go further. The IP essentially acts for the victims of a wrongful act in the context of insolvency. Those victims are bound through the collective nature of insolvency and have little way to seek redress other than through the IP who has the legal standing to bring claims and make recoveries on their behalf. To have those recoveries diluted by the cost of achieving them goes wholly against the underlying principles of justice. All costs associated with claims by an insolvent estate ought to be recoverable, especially where "claw-back" insolvency claims are concerned. That should include at least the IP's own costs in investigating and prosecuting such claims. Similarly, where an estate has lost assets that require an IP to issue claims to bring them back (or seek a contribution) into the estate, any cost of funding that the IP might reasonably require should be capable of being recovered in order to get proper justice for creditors.

When the Court has the power to award payment out of central funds in private prosecution cases to compensate a prosecuting victim for costs incurred, then should provision not be made for officeholders and their stakeholders to have similar recourse, say to allow for funding of court fees or other necessary hard costs to prosecute misconduct in insolvency for commercial restitution on behalf of creditors?

The urgent need for change has rarely been clearer than in the current climate.

With £5bn of bounce-back loans lost to fraud (and it's unclear whether that figure includes bounce back loans "improperly" used in the 106,000 legitimate companies that have already fallen behind with repayments), and an average loan size of only £31k, it is clear that a change to the cost regime in insolvency litigation is now urgently required if officeholders are to be properly equipped to attempt recovery in low to mid-size misconduct claims.

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WHAT TO DO WHEN CIVIL AND INSOLVENCY PROCEDURES CROSS OVER IN RELATION TO INVESTMENT SCAMS

Authored by: Gemma Kaplan and Andrew Barns-Graham - Pinsent Masons

Investment fraud has never been more prevalent than it is now and the victims of fraud are increasingly looking to solutions away from the criminal justice system. Once victims/creditors are faced with the realisation that the investment which seemed "too good to be true" actually was, they then have to decide what legal action to take to recover or mitigate their losses.

The victims are then often faced with a choice between appointing (or support the appointment of) insolvency practitioners in their capacity as creditors of the scheme or bringing their own civil claims in their capacity as the victims of fraud.

The pros and cons of each route will be well known to most of FIRE's members but, very briefly:

- Insolvency practitioners have extensive investigatory powers which allow them to obtain information about the fraud from third parties – including under compulsion from the court, where necessary. There are also Insolvency Act claims which only insolvency practitioners can bring, e.g. claims for transactions at an undervalue and preferences. In cross-border cases (as many investment frauds are), the scope for the international recognition of English insolvencies is another significant advantage.

- The main advantages of the civil litigation route, on the other hand, is that it gives victims the benefit of having lawyers who act in their sole interests, not those of the wider creditor group, along with control over the litigation process (including settlement negotiations). One of the practical consequences of this is that the first step that victims often take in a civil fraud action is to seek proprietary injunctions in respect of the particular assets which represent the proceed of the fraud on them.

The two options are of course not mutually exclusive, but it is often not justifiable on a cost-benefit analysis to go down both tracks in parallel. In our experience, though, making the right choice usually has less to do with weighing up the pros and cons of each route than it has to do with timing.

Insolvency is usually the best option in a case involving an investment scheme where extensive evidence of fraud has entered the public domain, and where the fraudsters have already gone into hiding and dissipated their assets. Additionally, there will be instances where the vehicle used to carry out the fraud might have been a regulated entity, or even worse an entity that extracted money from elderly or vulnerable individuals and where regulation is urgently needed to protect these investors. Insolvency practitioners have a wealth of experience liaising with and obtaining the relevant permissions and authorisations from regulators in these instances and can put in suitable protections for victims and client account monies.

Civil claims, on the other hand, are well worth considering at an earlier stage of the fraud's 'life cycle', in situation where there are red flags of fraud, but the scheme is still operational (save for perhaps a few early defaults), the fraudsters are still active and communicating with investors, and there are reasons to be confident that sufficient assets could be identified against which an English civil judgment could be enforced.

In the latter scenario, the scheme might be insolvent, but this is not usually the time for appointing insolvency practitioners to interview the fraudsters and witnesses or otherwise to create 'noise' around the scheme. The top priority is to locate and freeze the assets before the fraudsters realise that the game is up and start an asset dissipation process. Insolvency processes can then be used later in the asset recovery process once the assets are frozen to best utilise the skillset and powers an insolvency practitioner has available to them.

In other words, this is usually the time for the victims to take matters into their own hands and to deploy the classic civil fraud litigation playbook of Norwich Pharmacal / Bankers Trust orders and gagging orders against any third parties holding financial information, followed by ex parte applications for freezing and proprietary injunctions.

Despite this, investment fraud claims by victim groups in the English courts are still a relatively uncommon occurrence, at least compared with the frequency with which large-scale frauds are committed. Most fraudulent investment schemes still seem destined for insolvency, rather than civil action.

Why is this? To be frank, in our view it is partly because investment fraud group actions are extremely difficult. Building a group action is difficult enough in any case. Doing so whilst at the same time keeping the process confidential from the fraudsters is uniquely challenging.

On top of this, you of course need a claim with good merits, a jurisdictional nexus, a sound enforcement strategy, a galvanised claimant group, and most of the time you need a committed litigation funder, which in turn means you need a very large claim in order for the funding model to be economically viable.

And crucially, as noted above, the timing needs to be just right. You need to bring the claim late enough that there is good evidence of fraud, but early enough to protect the assets before the scheme collapses. In many cases this window is brief.

There are, however, four trends which we predict will lead to a gradual increase in the coming years in the frequency of investment fraud group actions: (1) the ongoing growth of the litigation funding industry, (2) the judiciary's gradually increasing willingness, in the absence of opt-out procedures, to be flexible in its use of procedures and remedies, (3) technological developments in the areas of fraud detection, bookbuilding and claims portals, and (4) the increasing familiarity of lawyers and other stakeholders with this technology.

We do not expect any radical change overnight, though. Insolvency proceedings will remain the norm for the foreseeable future. And even in those occasional cases where the stars align and a civil action is brought before the collapse of the scheme, insolvency practitioners and receivers will play a vital role in the asset preservation and enforcement processes.

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ENFORCING SECURITY OVER MORTGAGED ASSETS IN THE BRITISH VIRGIN ISLANDS: THE EMERGING BATTLE GROUNDS

Authored by: Christopher Pease and Megan Elms - Harneys

There has been a significant increase in the number of lenders enforcing against secured assets in the BVI, which has entailed an uptick in the appointment of out of court receivers. As heavily leveraged businesses approach a global recession, this trend is likely to continue. In this article, Christopher Pease and Megan Elms highlight the types of disputes that are arising out of such appointments.

Appointment

As many offshore companies operate as holding vehicles, security is often granted by way of share mortgage. The BVI Business Companies Act, 2004 (the BCA), provides a mortgagee with security over shares in a BVI company a statutory right to appoint receivers over those shares. That right is typically mirrored in the underlying security instrument.

The process for appointing receivers in the BVI is set out in the BVI Insolvency Act, 2003 (the Insolvency Act).

Powers and duties

Once appointed, out-of-court receivers act as agent for the mortgagor unless the instrument pursuant to which they are appointed provides otherwise. While receivers are generally personally liable for their actions, this agency affords them a degree of protection as they act in the name of and on behalf of the mortgagor.

BVI legislation is relatively light-touch on the powers granted to a receiver, generally deferring to what has been agreed and set out within the instrument pursuant to which the receiver is appointed. In the case of security over shares, the receiver will generally have the power to (i) sell the shares, (ii) vote the shares and (iii) take such other steps as they consider necessary or desirable to protect, improve or realise the shares.

According to the Insolvency Act, receivers are subject to a primary duty to exercise their powers (i) in good faith and for a proper purpose and (ii) in a manner in which they believe (on reasonable grounds) to be in the best interests of the person on whose behalf they are appointed. To the extent consistent with these primary duties, a receiver has a secondary duty to have reasonable regard to the interests of certain interested parties, such as creditors and those with an interest in any equity of redemption.

Disputes relating to the appointment of receivers

As the number of receiverships rise, so does the range of issues being disputed by mortgagors, often in seeking to prevent the appointed receivers from exercising their powers. The following trends are beginning to emerge:

1. **Challenges to appointment:** a mortgagor seeking to resist having their security enforced will often start by challenging the validity of the receiver's appointment by reference to the security documents. The relevant documents must have been properly executed and valid, the right to appoint receivers must have accrued (usually contingent upon a default) and the necessary processes carried out to notify the mortgagor of the default and give effect to the receiver's appointment.

2. **Extent to which the Insolvency Act applies to receiverships over shares in BVI companies owned by an individual or entity located elsewhere:** the Insolvency Act has an entire part that governs the appointment of receivers. However, there is ambiguity as to whether several key provisions, such as those setting out the duties of a receiver, apply to all receivers appointed in relation to assets in the BVI.

   Various provisions apply specifically to a receiver of a 'company', a company being defined as a company in respect of whose assets a receiver is appointed, unless the context requires otherwise. The overarching definition of a 'company' in the Insolvency Act is restricted to BVI registered companies. Arguably, therefore, where a receiver is appointed over shares in a BVI company, but not the assets of a BVI company, these provisions do not apply.

   This ambiguity can lead to disagreements over what steps should or should not be taken by receivers and provides fertile grounds for legal disputes.

3. **Balancing duties:** the tripartite nature of receiverships (between mortgagee, mortgagor and receiver) has given rise to extensive authority on how receivers ought to balance the various duties that arise. But there is no one-size-fits all solution: a receiver must evaluate the competing interests according to the circumstances of their appointment. They cannot solely protect the interests of their appointer, particularly if there is likely to be substantial excess value in the secured assets after the debt has been repaid.

4. **Internal conflicts:** a receiver appointed over shares may not have a readily saleable asset, as a share sale is often found not be a commercially viable option. As a result, receivers commonly look to obtain control of asset holding companies as soon as possible by exercising a shareholder's voting power to reconstitute the board (and those of any subsidiaries). Receivers therefore often simultaneously hold office as receiver and director.

As director, a receiver will owe further duties; to whom will depend on the company's solvency. While insolvency may be assumed in a receivership scenario, where appointments are taken at different levels within a group, or where there is likely to be significant equity after repayment of the secured debt, this may not be the case.

A receiver who is also a director must be mindful as to how the arising duties interact. Where there is likely to be residual value in a company, a director may need to act in the interests of the company and/or its other creditors despite the purpose of their appointment as receiver being to repay the secured debt. If it occurs to the receiver/director that the company is insolvent, then a decision would need to be taken as to whether the company should be placed into liquidation. While this may appear absurd in the context of fixed charge receiverships, the bespoke issues created by offshore security structures means these are issues that receivers are increasingly having to grapple with.

As the number of receiverships, and by extension the numbers of such disputes, increase, it is only a matter of time before the BVI courts render a judgment that will provide guidance and shape how future BVI receiverships are to be approached.

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SAMUEL OURIACH ASSOCIATE DIRECTOR GRANT THORNTON

Q What do you like most about your job?

A Banking the cash!
It's a great feeling when you have spent years researching, analysing and building a claim or tracing assets to eventually see a successful outcome.

Q What would you be doing if you weren't in this profession?

A I initially was meant to do aeronautical engineering at university… but I can't see myself there now.
I would have loved to be a musician or in a band. Unfortunately, it was always going to be difficult when I lacked the fundamental skills to play an instrument.

Q What's the strangest, most exciting thing you have done in your career?

A I used to work in Grant Thornton's BVI office. In my first week my boss told me that we had to go to Bogota to wind up a local company. I thought he was having me on, as a trip to the world's most dangerous city didn't fill me with enthusiasm.
However, I was so glad I had the opportunity to go as it was a fantastic place to visit.

Q What is one of your greatest work-related achievements?

A It will hopefully be happening in the next few months, so keep your ears to the ground!

Q If you could give one piece of advice to aspiring insolvency professionals lawyers, what would it be?

A Stick with it, it can be a very tough job sometimes but the hard work pays off when you get a great result.

Q What do you see as the most significant trend in your practice in a year's time?

A The last financial crisis we had insolvencies of large organisations such as Lehmans, in addition there were lots of investment scams uncovered as investors scrambled around to withdraw non-existent funds and access returns.
We look to be entering a similar cycle now, however I fear that it will be much worse combined with the cost of living crisis, magnifying the effect.
You can see the early signs of this with the recent Crypto-based insolvencies.

Q What personality trait do you most attribute to your success?

A A mix of resilience and commerciality.

Q Who has been your biggest role model in the industry?

A An old boss of mine used to say that you need to enjoy what you do, if you don't do something different.
He always had a smile on his face when he came into the office!

Q What is something you think everyone should do at least once in their lives?

A Something that you think is beyond the limits of your ability. Stretch yourself, you'll be amazed at what you can do if you put your mind to it.

Q You've been granted a one-way ticket to another country of your choice. Where are you going?

A A few bintangs in Bali would be great thank you very much.

Q What is a book you think everyone should read and why?

A I love John Le Carre books, but for something transformational you should read 'Quiet Leadership' by David Rock. It will fundamentally change the way you manage people and think about your leadership style.

Q If you had to sing karaoke right now, which song would you pick?

A Firestarter, Prodigy…

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S423 INSOLVENCY ACT 1986: OPPORTUNITIES FOR VICTIMS

Authored by: Natalie Todd and Jon Felce - Cooke, Young & Keidan

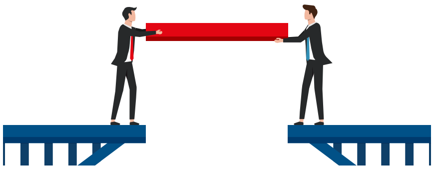
The powerful relief available under section 423 Insolvency Act 1986 (s423) is not just available to insolvency practitioners but to victims of transactions defrauding creditors too. It is increasingly being used by fraud and asset recovery practitioners, and we outline some key features below.

1. What is s423?

In brief, s423 concerns transactions at an undervalue for the purpose of putting assets beyond the reach of potential or actual creditors, or otherwise prejudicing the interests of such a person in relation to a claim which they are making or may make. Relief can include restoring the position to what it would have been had the transaction not been entered into, and protecting the interests of persons who are victims of the transaction.

2. Extra-territorial reach of s423

The court can grant permission for a claim to be served out of the jurisdiction if that claim is made under an enactment which allows proceedings to be brought and those proceedings are not covered by any of the other grounds in CPR Practice Direction 6B. Given that it was not otherwise covered by PD 6B, the question of whether s423 fell within this gateway was finally resolved in the Court of Appeal in Orexim Trading Ltd v Mahavir Port and Terminal Private Ltd[1]. Accordingly, s423 has extra-territorial effect, and can be used in relation to both evasive fraudsters and assets overseas. However, this is subject to demonstrating sufficient connection with the jurisdiction[2].



3. Is there a sufficient connection to the jurisdiction?

Whether or not there was a sufficient connection to England and Wales was one of the questions considered in Akhmedova v. Akhmedov[3], where a former husband set up a series of schemes designed to put his assets out beyond his ex-wife's reach following a divorce award, including by setting up Liechtenstein trustee companies. The former wife, Ms Akhmedova, sought to have certain transactions set aside using s423.

The respondent trustee companies denied that there was sufficient connection, relying upon SAS Institute v World Programming[4], in which the Court of Appeal had stressed the importance of not making orders with exorbitant extraterritorial effect in respect of property located abroad. The trustees argued that any order under s423 would have exorbitant extraterritorial effect, and they would be subject to a real risk of prosecution in Liechtenstein if they complied. Knowles J had little difficultly in distinguishing the SAS Institute case. The transfers made to the trusts by Mr Akhmedov or at his direction were put into effect in order to evade an English claim brought by Ms Akhmedova, an English resident. There was therefore a sufficient connection.

4. Wide ambit of 'victims' under s423

Helpfully for claimants in fraud cases, it is apparent that a wide ambit of victims have standing to bring a claim under s423.

1 [2018] EWCA Civ 1660
2 Re Paramount Airways [1992] Ch 223
3 [2021] EWHC 545 (Fam)
4 [2020] EWCA Civ 599

In Akhmedova, the Liechtenstein trustees submitted that Ms Akhmedova had no standing as a "victim" under s423. The assets in question had been held previously in Switzerland and she had not been able to enforce her order there. Following the transfer of the assets to Liechtenstein, the trustees argued that Ms Akhmedova did not and could not suffer any prejudice upon such transfer. However, the Judge held that Ms Akhmedova was a "victim" under s423 as she was a person capable of being prejudiced by the transaction, the transaction having converted the respondent from an entity at least capable of paying its liabilities to an empty shell which was hopelessly insolvent. The transactions were made with the prohibited purpose, and it was not therefore necessary to prove that enforcement had become more difficult.

5. Identity of the party to the transaction / beneficial ownership

Just as 'victims' are construed widely, there is scope to apply s423 even when the debtor is not party to the transaction complained about. This issue recently arose in Invest Bank v El-Husseini & others[5]. Here the majority of the transferred assets were held not by the individual judgment debtor, but by a company said to have been wholly owned or controlled by him. When the company then disposed of assets, did that constitute an entry by the company's owner/controller into a transaction (whether that transaction was with his company, the transferee of the assets or both)?

The court found that, without more, the company's disposal of assets could not be a transaction entered into by the debtor under s423, in light of ordinary principles of company law and the separate legal personalities involved. Nevertheless, the judge did find that such a transaction could fall within s423 if the debtor was to go beyond the steps taken by his company, for instance, if he acted on his own behalf rather than the company's. In particular, a "transaction" can extend to an agreed plan pursuant to which an asset will come to be transferred, and is not limited to the action or actions by which the transfer is made.

6. Does the asset need to be beneficially owned by the debtor?

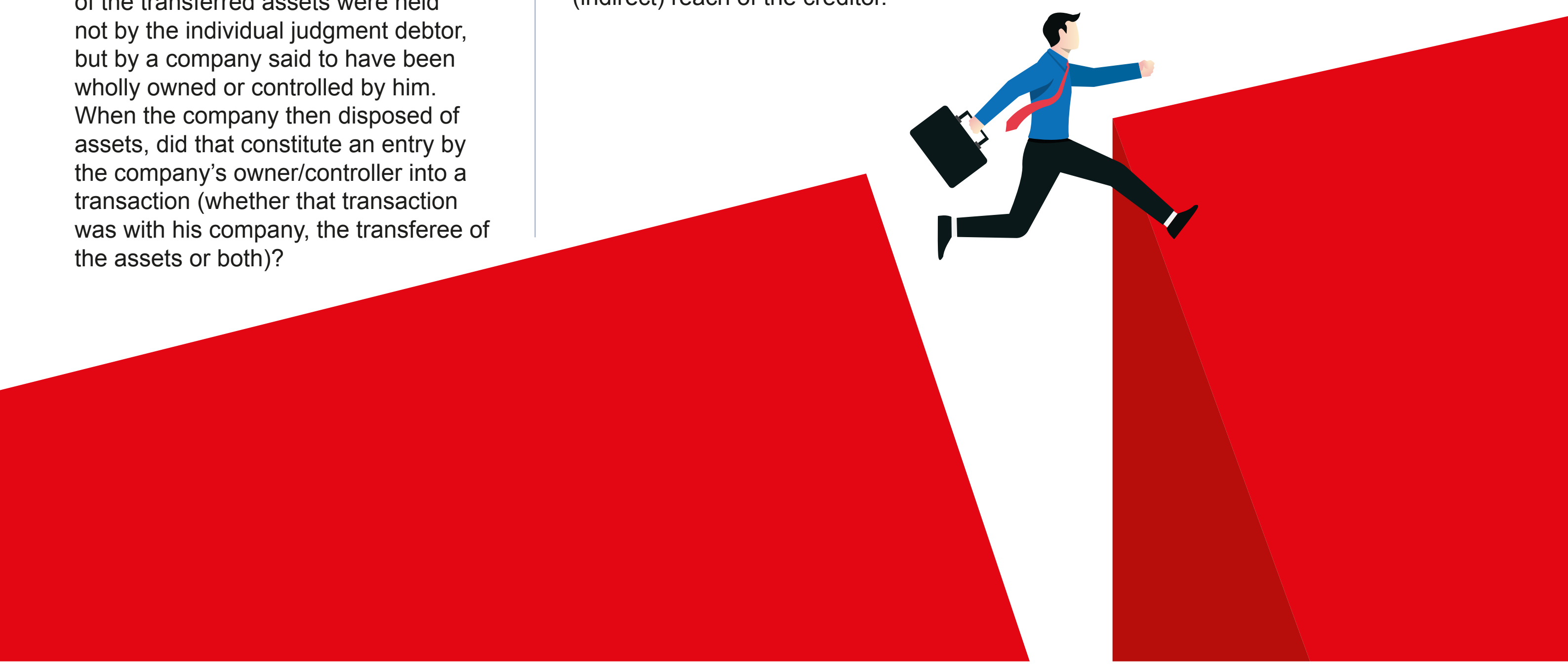
This question arose in Invest Bank. The court found that s423 claims did not contain such a stipulation. There was no such limit in the definition of "transaction" in s436 or in the definition of the impugned purpose in s423(3). Therefore, s423 could extend to an arrangement whereby a transferee acquired at an undervalue an asset owned by a debtor's company, with a view to putting that asset beyond the (indirect) reach of the creditor.

7. Does the debtor need to have insufficient assets following the transaction to satisfy its liabilities to the creditor?

This novel question was raised by the Akhmedov respondents, who argued that s423 contained a "gateway" condition before any transaction could be set aside. However, this was not within the plain wording of the statute and was rejected by the court. Imposing such a condition would unduly prejudice creditors' interests.

8. Conclusion

These cases demonstrate that s423 is a wide-ranging and flexible means of recovery for victims of fraud, and one that should be in every FIRE practitioner's toolbox.



5 [2022] EWHC 894 (Comm)

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THE CONTINUING EXPANSE OF CRYPTO LAWS

SERVICE BY NFT AIRDROP AND CONSTRUCTIVE TRUST CLAIMS AGAINST CRYPTO EXCHANGES

Authored by: Simon Jerrum and Tom Serafin - HFW

The English Court has recently, for the first time, allowed a claimant to serve proceedings out of the jurisdiction by "airdropping" a non-fungible token (NFT) on the blockchain.[1] The Court also held that the claimant had a good arguable case for a claim in constructive trust against the crypto exchanges that held or controlled the digital wallets into which the misappropriated cryptocurrency was transferred.

D'Aloia v Persons Unknown & Ors

Fabrizio D'Aloia, a successful gaming application developer, was induced into transferring 2.1 million USDT and 230,000 USDC to persons unknown operating a sham online brokerage platform, believing it to be genuine. The cryptocurrency was transferred to two digital wallets over the course of five months. However, when Mr D'Aloia submitted a withdrawal request, his account was blocked. He then exchanged communications with a certain email address to seek to unblock his account, but the result of these communications was that Mr D'Aloia was again induced into making further deposits to the wallets. Some months later, with his account recording a value of zero, it became apparent to Mr D'Aloia that he had been a victim of fraud. He therefore engaged experts to trace his misappropriated cryptocurrency, who established that some of the cryptocurrency had been transferred to several private wallets controlled by various crypto asset exchanges.

The Issues

Mr D'Aloia issued an ex parte application for urgent interim injunctive relief, disclosure and ancillary orders against both the persons unknown (to whom the cryptocurrency was initially transferred) and also the exchanges in control of the digital wallets to which his cryptocurrency was subsequently transferred.

The claim against persons unknown was founded on fraudulent misrepresentation and deceit, unlawful means conspiracy, unjust enrichment and constructive trust. The claim against the exchanges was premised on constructive trust (i.e. that the exchanges held the assets in the digital wallets on behalf of Mr D'Aloia as beneficiary).

Mr D'Aloia, having no knowledge as to the real identities or whereabouts of the alleged fraudsters, sought to have the proceedings served on the persons unknown by email and also by NFT airdrop into the digital wallets into which he had initially transferred his cryptocurrency. Mr D'Aloia also sought to have the exchanges served by email.

Decision

Mr Justice Trower held that the causes of action advanced by the claimant against persons unknown gave rise to a "serious issue to be tried" so as to permit service out of the jurisdiction. The learned Judge also highlighted that the misrepresentations made to Mr D'Aloia were made in England (where he resided) and there was a good arguable case that the misappropriated cryptocurrency was an English asset

1 D'Aloia v Persons Unknown & Ors [2022] EWHC 1723 (Ch).

because of previous authority to the effect that the lex situs of a crypto asset is the place where the person who owns it is domiciled.[2] The court was also satisfied that there was a sufficient connection with England and that there were applicable gateways under Practice Direction 6B of the Civil Procedure Rules to justify the granting of permission to serve out of the jurisdiction.

The Court therefore permitted service to be effected out of the jurisdiction. The Court granted permission for the claimant to serve the claim both by email and, in the case of persons unknown, also by way of an NFT "airdrop" into the digital wallets concerned. This is the first time such a form of alternative service was permitted by the English Court, although it has previously been permitted in the United States.

Trower J also held there was a good arguable case that the exchanges in control of the digital wallets to which Mr D'Aloia's cryptocurrency was transferred held those assets as constructive trustees for and on behalf of Mr D'Aloia.

As to the question of whether the Court should grant the injunctive relief sought (i.e. a freezing injunction in respect of crypto assets held in the wallets) Trower J considered that damages would not be an adequate remedy. He had already held that there was a serious issue to be tried, and the balance of convenience was held to fall firmly in favour of Mr D'Aloia obtaining the relief sought.

The Court also granted the disclosure orders sought pursuant to the Bankers Trust jurisdiction on the basis there were good grounds that the cryptocurrency held in the relevant wallets belonged to Mr D'Aloia and there was a real prospect the information sought would lead to the identification of the persons unknown. The relief sought was no wider than necessary, and the balance of interests between Mr D'Aloia and the exchanges fell in favour of Mr D'Aloia in circumstances where he would pay the exchanges' reasonable costs that would be incurred in their providing the information sought. The balance was in favour of Mr D'Aloia notwithstanding the duties of confidentiality that may be owed to third parties by the exchanges.

Key Takeaways

Whilst the judgment in this case followed an ex parte hearing, the decision is significant for several reasons.

First, it illustrates the English Courts' increased willingness to adapt the existing law to achieve practical solutions for claimants facing service out issues.

However, it should be noted that Trower J also ordered service by email, and indicated he would have been unwilling to order service by NFT alone. It remains to be seen whether this will be permitted in future where no email address is available. It may be that this is also restricted to cases concerning crypto assets, unless it can be shown that service in this way would bring the claim to the attention of the applicable defendant.

Second, it gives judicial support to a constructive trust claim against the crypto exchanges themselves (in a similar way to a claim against a bank which might hold misappropriated funds on constructive trust).

For exchanges this means taking information requests seriously and putting in place mechanisms to ring-fence misappropriated assets to avoid dissipation and the risk of being found liable for breach of trust. It also means that exchanges are far more likely to respond to requests by potential claimants for assistance in providing information about accounts involved in potential frauds.

Finally, it illustrates the importance of acting quickly.

The Court relied heavily on Mr D'Aloia's expert report to satisfy itself that his cryptocurrency was capable of being traced and that the exchanges had control over the digital wallets containing it. By acting quickly, Mr D'Aloia was also more likely to be able to trace the currency and determine where it was being held, and therefore obtain tangible relief in the form of a freezing order over the relevant cryptocurrency.

2 Following Ion Science Limited & Duncan John v Persons Unknown, Binance Holdings Limited, Payment Ventures Limited (unreported) [2020] (Comm).

ADMINISTRATORS' APPOINTMENTS – VOID OR DEFECTIVE - LIGHT AT THE END OF THE TUNNEL

Authored by: Rachael Earle - Wilberforce Chambers

The problem with the requirements in respect of out of Court appointments, as set out in Schedule B1, is that they do not specify the consequence of a failure to comply and this has led to uncertainty.

In Re Tokenhouse [2020] EWHC 003171 (Ch), ICC Judge Jones was concerned with a failure to comply with paragraph 26(1) of Schedule B1. He noted that:

> [31] … the underlying problem is the tension between: (i) the normal meaning of the words used within those provisions strongly suggesting that non-compliance with their out-of-court procedural requirements should prevent an appointment being effective; and (ii) the fact that this may have a disproportionate result when compared with the prejudice caused by breach and, even more importantly, may adversely affect a company's ability to achieve the purposes it would have been likely to achieve had the appointment been valid.
>
> …
>
> [35] The tension has resulted in … "conflict of judicial opinion" in cases which have considered (in the context of the application of principles of statutory interpretation) whether there was power to make an appointment or if an appointment was made and, to the extent that there was an appointment: (i) whether the provisions requiring notice provide for the consequences of breach; or, if not, (ii) the plain meaning overrides any contrary purpose arguments; or (iii) insofar as purpose is relevant, whether non-compliance with the notification requirement(s) must be a fundamental breach because the absence of notice cannot be cured and, certainly in the case of a chargeholder, the rights lost cannot be revived; or (iv) whether the breach is not fundamental taking into consideration it is procedural and/or the overriding purpose of achieving the aims of an administration.

This has caused the editors of Sealy and Milman (25th Ed) to note in the commentary to paragraph 26 that:

> The question whether the failure to comply with the notice requirements of para.26 inevitably invalidates the appointment of the administrator has been much debated in recent cases at first instance, and remains the subject of controversy. Only a ruling of a higher court can resolve the current impasse (without legislative amendment).

A tour of the conflicting authorities would take this article beyond the prescribed word count and well beyond the reader's patience (but for those interested – see the reviews contained in Re ARG Mansfield Limited [2020] EWHC 1133 (Ch) and Re Tokenhouse VB Limited [2020] EWHC 003171 (Ch)). What can be seen from those authorities, however, is that despite conflicting decisions in the past, a consistent line has recently emerged to the effect that:

1. There is now a consensus that the answer to the question whether non-compliance results in invalidity depends on whether Parliament intended that outcome – a question to be answered by first identifying the purpose of the requirement breached and then by identifying the consequences of non-compliance. This follows the approach to statutory interpretation in R v Soneji [2005] UKHL 49 ('the Soneji Approach'). See Re Ceart Risk Services Ltd, Re Assured Logistics Solutions Limited [2011] EWHC 3029 (Ch), Re BXL Services [2012] EWHC 1877, Re Eiffel Tower Steelworks [2015] EWHC 511 (Ch)).

2. Schedule B1 contains a mixture of provisions some of which are naturally read as defining the circumstances in which the appointment arises (paragraphs 22-25) and some of which are naturally read as prescribing procedural requirements that must be fulfilled before the appointment is properly made (paragraphs 26-32). Failure to comply with the former generally renders the appointment void, failure to comply with the latter generally renders the appointment defective. See Re Euromaster Limited, Re Melodius Corporation [2015] EWHC 621 (Ch), Re Spaces London Bridge Limited [2018] EWHC 3099 (Ch), Re Arlington Infrastructure Limited [2020] EWHC 3123 (Ch)).

This approach is consistent with the persuasive decision of ICC Judge Jones in Re Tokenhouse VB Limited [2020] EWHC 3171 (Ch) on the specific issue of a failure to comply with paragraph 26(1). ICC Judge Jones conducted a thorough review of the conflicting authorities and, applying the Soneji Approach, he concluded that a breach of paragraph 26(1) was a breach of a procedural requirement which renders the appointment defective but not void.

This approach was also confirmed in Re Zoom UK Distribution Ltd [2021] EWHC 800 (Ch) where Stuart Isaacs KC (sitting as a Deputy High Court Judge) accepted the submissions made on behalf of the Joint Administrators that, despite the conflicting authorities in this area (none of which are binding on a High Court Judge), a consistent line has emerged in recent cases to the effect that the Court should apply the "Soneji Approach" to statutory construction pursuant to which the Court should first identify the purpose of the requirement in question and then identify the consequences of non-compliance by considering whether Parliament intended the outcome of a failure to comply to be total invalidity.

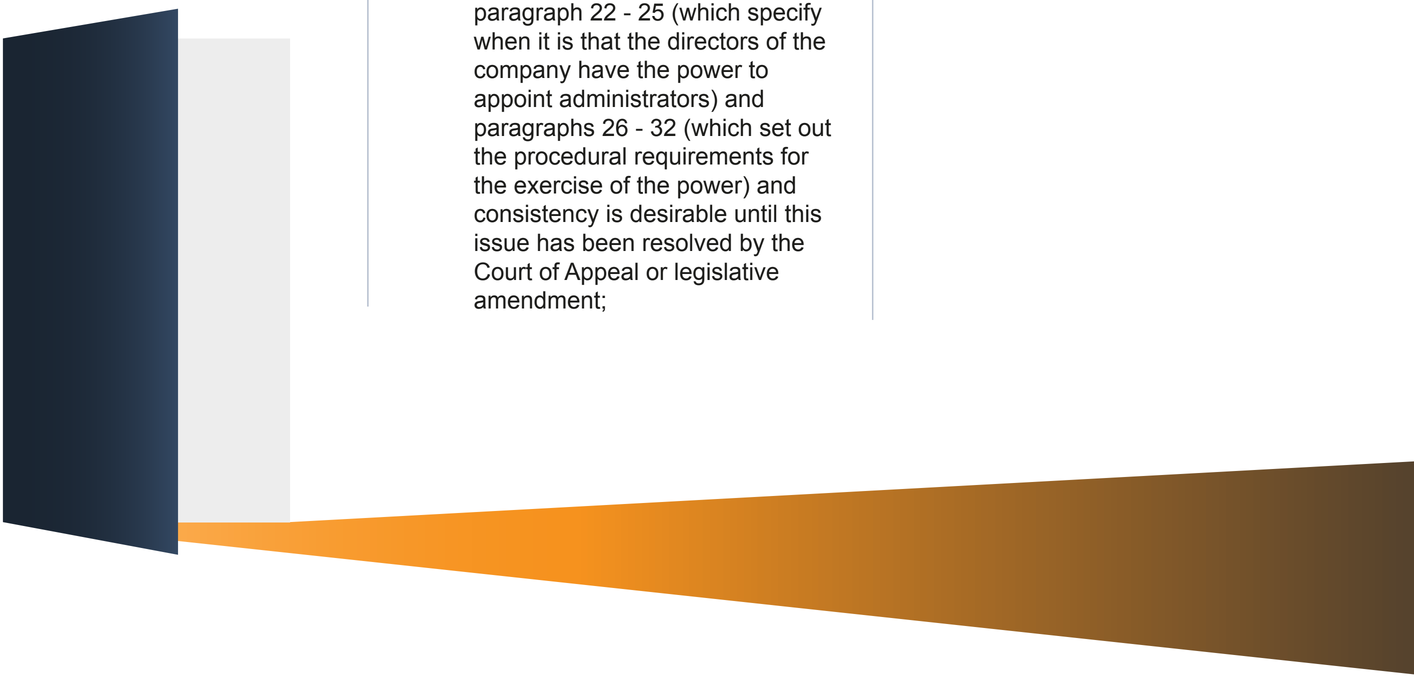
The Court in Re Zoom adopted the reasoning of ICC Judge Jones in Re Tokenhouse and concluded that a breach of paragraph 26(1)(b) of Schedule B1 renders the Administrators' appointment defective only. This is a welcome result for administrators because:

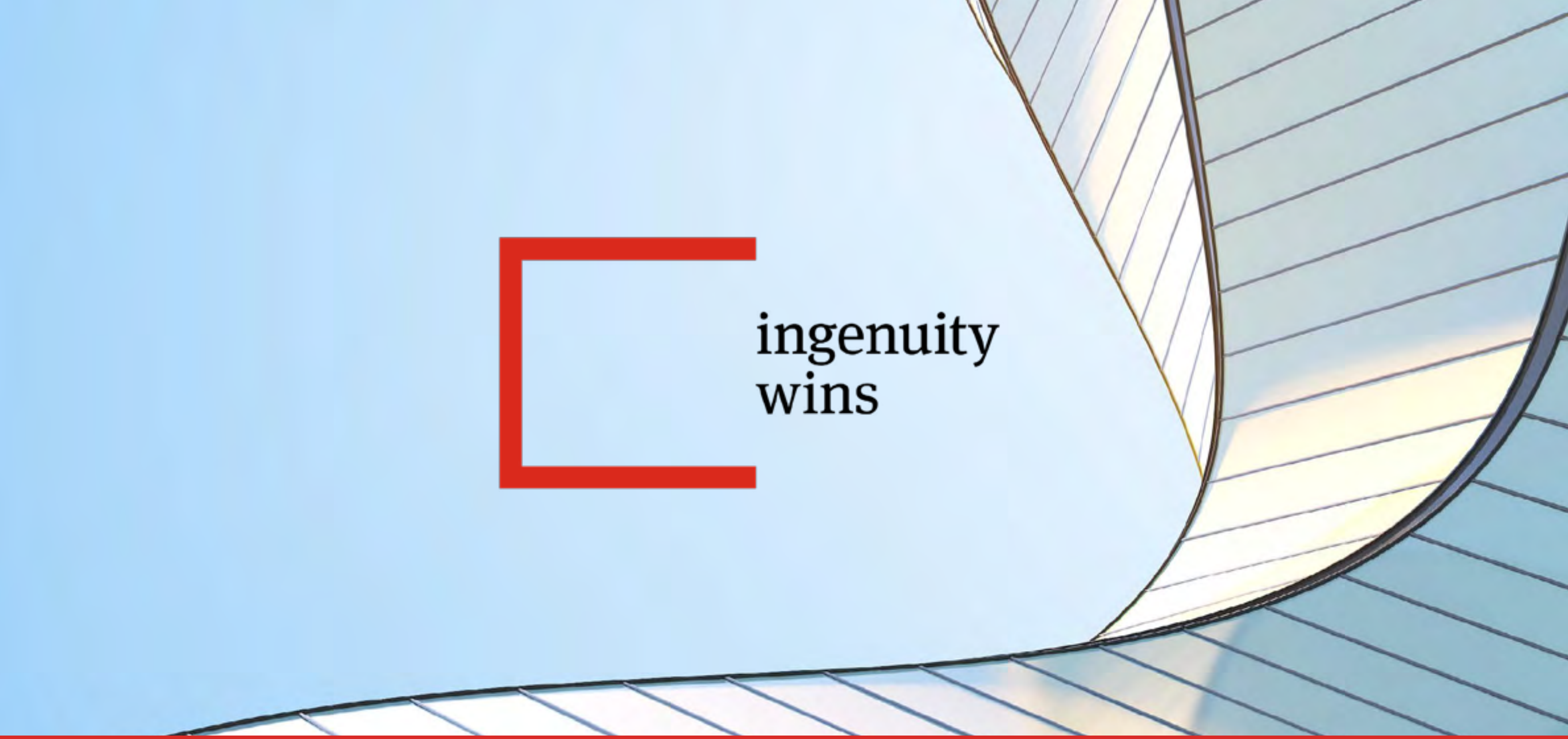
1. the Court's decision is consistent with Euromaster Ltd and the distinction that made between paragraph 22 - 25 (which specify when it is that the directors of the company have the power to appoint administrators) and paragraphs 26 - 32 (which set out the procedural requirements for the exercise of the power) and consistency is desirable until this issue has been resolved by the Court of Appeal or legislative amendment;

2. the consequence of the breach is proportionate: a qualifying floating charge holder who is not given the requisite notice is still be able to apply to the Court for the defect to be cured and have an administrator of its choice put in place but the key consideration is for there to be an administration in the first place; and

3. such a conclusion removes the need for the parties to resort to unattractive applications for retrospective appointments in the event that the purported original appointment was held to be invalid, see Tokenhouse at [39], citing Re Elgin Legal Data Ltd [2016] EWHC 2523 (Ch) and Pettit v Bradford Bulls (Northern) Ltd (in administration) [2016] EWHC 3557 (Ch).

There does therefore appear to be a glimmer of light at the end of the tunnel for administrators, but the current state of the law is still less than ideal and further clarity is needed (whether from the Court of Appeal or by legislative amendment) particularly in relation to which provisions are, properly construed, merely procedural requirements.





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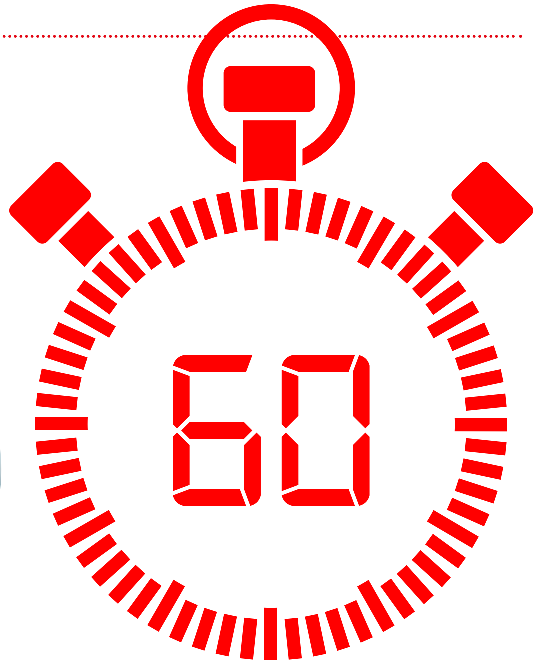


MOLLY SANDQUEST
SENIOR MANAGER
FRP ADVISORY

Q What do you like most about your job?

A The variety; every day is different and each involves an eclectic mix of individuals, companies, industries and issues.

Q What would you be doing if you weren't in this profession?

A Perhaps a psychologist, understanding and helping others overcome their problems. Part of my role involves examining the individuals behind the numbers and their behaviour and actions, which is fascinating.

Q What's the strangest, most exciting thing you have done in your career?

A Joint administrators at FRP were simultaneously appointed over a group of 12 companies. I was onsite on day one to secure and collect information with the regional teams that were deployed to each trading site. It was a hostile appointment that involved a police presence, sniffer dogs, 24-hour security, hidden recording devices, drugs and guns!

Q What is one of your greatest work-related achievements?

A Helping grow, shape and develop the FRP Forensic Services team over the past six years since its inception has been a unique opportunity and accomplishment.

Q If you could give one piece of advice to aspiring lawyers, what would it be?

A Find an area you are truly passionate about, and I look forward to hopefully working with you in the future.

Q What do you see as the most significant trend in your practice in a year's time?

A I anticipate there will be an increase in matters involving cryptocurrency, both directly and indirectly, additional investment scams, and as the economic situation deteriorates and the fall-out from the pandemic hits, we will see a lot more fraud coming to the fore.

Q What personality trait do you most attribute to your success?

A Enthusiasm and my passion for forensic accounting and investigations.

Q Who has been your biggest role model in the industry?

A Where possible I try to learn something from each and every person I work with.

Q What is something you think everyone should do at least once in their lives?

A Freefall from an airplane or a helicopter, and preferably for charity.

Q You've been granted a one-way ticket to another country of your choice. Where are you going?

A New Zealand. To clarify, it is not because it is the furthest place away from the UK!

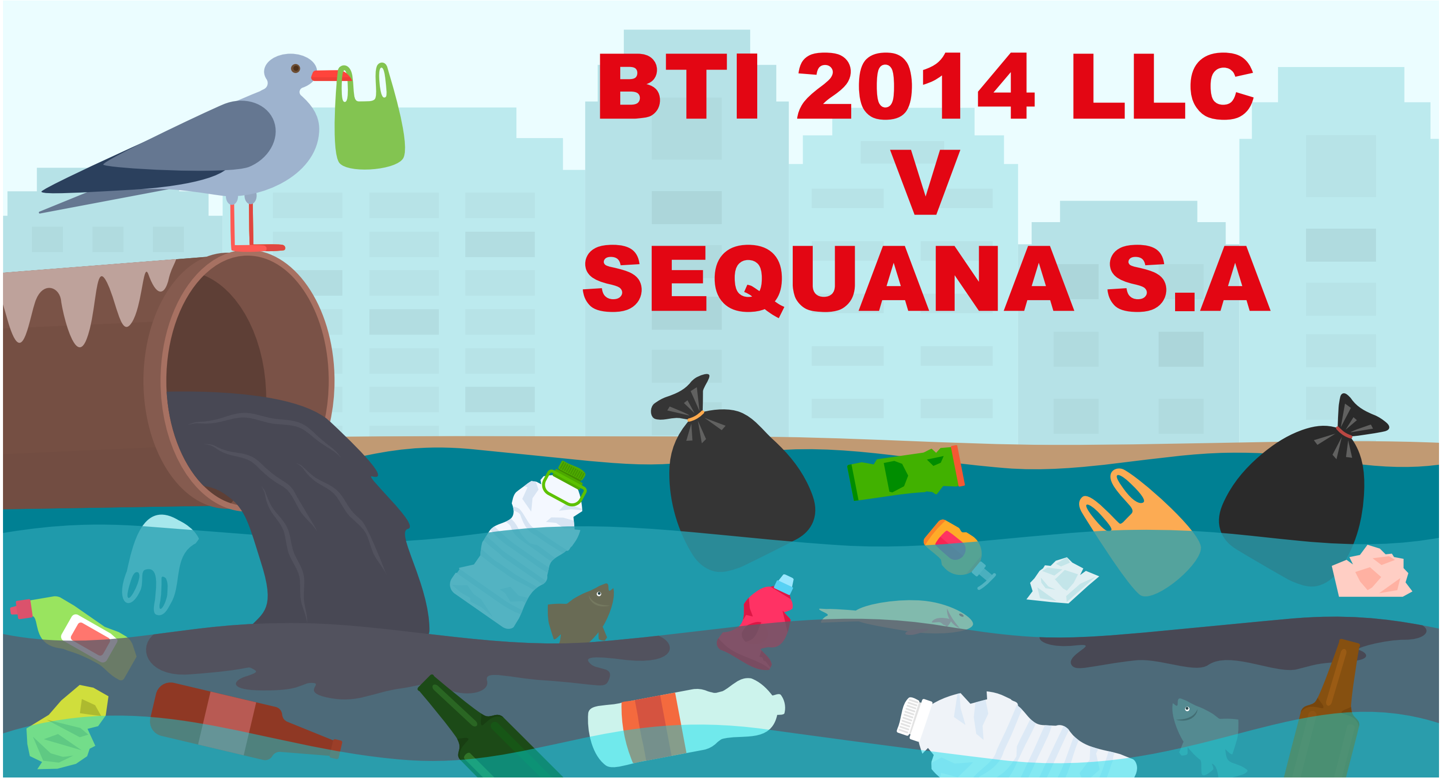
Q What is a book you think everyone should read and why?

A Flying with Condors. It is Judy Leden's incredible autobiography telling her story from absolute beginner to world champion in hang gliding. Her zest for life, determination and courage are truly admirable.

Q If you had to sing karaoke right now, which song would you pick?

A No one should be subjected to my singing, but if I had to, then it would probably be Moving on up by M People, or maybe Eminem's Lose yourself, depending on the crowd…

BTI 2014 LLC V SEQUANA S.A



Authored by: Oliver Hyams - Gatehouse Chambers

The facts

Arjo Wiggins Appleton Limited (AWA) paid two dividends to its parent company, Sequana S.A. (Sequana). The first, of €443m, was paid in December 2008 (the December dividend) and the second, of €135m, was paid in May 2009 (the May dividend).

The dividends were paid at a time when AWA had ceased to trade but remained subject to contingent indemnity liabilities, including in respect of clean-up costs and damages claims arising out of river pollution in Wisconsin, USA. BAT Industries plc (BAT) was liable to pay for part of that clean up and AWA was liable to indemnify BAT for part of the monies BAT had to pay out.

AWA's assets were an investment contract with a value of up to $250m, historic insurance policies with an expected recovery, subject to litigation, of US$100m, and an inter-company debt of €585m owed by Sequana to AWA (the Sequana debt).

The dividends were paid by way of set-off against the Sequana debt.

The effect of the dividends was that Sequana could no longer, in broad terms, be called upon to repay the Sequana debt in order to assist AWA with meeting its contingent liabilities. It therefore almost eliminated Sequana's exposure to the pollution issue. The dividends also created the possibility that AWA's assets would be insufficient to meet the contingent liabilities to BAT.

The High Court

Both dividends were challenged, in each case on the bases that (i) they were not lawfully paid in accordance with the provisions of Part 23 of the Companies Act (CA) 2006 (ii) alternatively, they were paid in breach of the duty of the directors of AWA to have regard to the interests of its creditors under section 172(3) of the CA 2006 (the creditor duty), and (iii) in any event, the payment of the dividends fell within the scope of section 423 of the Insolvency Act (IA) 1986.

AWA assigned its claims, including those arising out of the payment of the May dividend, to BTI 2014 LLC (BTI). BTI was a corporate vehicle set up by BAT. BAT, in turn, brought the claim under section 423 in its own capacity as a potential creditor of AWA and thus, to use the statutory term, as a "victim" of the payment of the dividends.

At first instance, Rose J (as she then was) dismissed all the claims as they related to the December dividend and there was no appeal against that part of her decision. As regards the May dividend, Rose J gave judgment against Sequana under section 423, but otherwise dismissed the claims.

The Court of Appeal

With permission granted by the Judge, Sequana appealed against the judgment under section 423, and BTI appealed against the dismissal of the claim for breach of the creditor duty.

The Court of Appeal, aside from one minor issue concerning the calculation of interest, dismissed the appeal and the cross-appeal.

David Richards LJ, giving the leading judgment, determined that the creditor duty is triggered where the directors know or should know that the company is actually insolvent or likely to become insolvent (more than 50%), meaning either balance sheet or cash flow insolvent. The Court of Appeal did not, however, identify the content of the duty, other than to suggest (without deciding) that creditors' interests must be given paramount importance (i.e. they override shareholders' interests) in a situation of actual insolvency.

The Court of Appeal's decision did not, therefore, resolve the uncertainty as to the content of the creditor duty, particularly in situations short of actual insolvency. It remains unclear whether creditors' interests trump shareholder interests, or whether they only have to be considered alongside shareholder interests, but without overriding them.

The Supreme Court

BTI appealed to the Supreme Court, which heard its appeal over 2 days in May 2021. The appeal focused on the existence, trigger, and content of the creditor duty. Both sides argued that the Court of Appeal's decision was wrong.

BTI maintained that the creditor duty is triggered where there is a real risk of insolvency. Prior to actual insolvency, the duty requires creditors' interests to be taken into account alongside members' interests. Once the company is actually insolvent, the creditor duty becomes paramount. This 'two stage' trigger, BTI argued, would provide additional protection for creditors, without causing directors to become overly cautious.

Sequana and AWA's former directors contended, amongst other things, that the creditor duty does not exist at all, and the law has taken a wrong turn. The creditor duty, they argued, cuts across other common law and statutory rules, including the ratification principle and section 214 of the IA 1986. Alternatively, if the duty does exist, it cannot be triggered before the point of actual insolvency, because it is only at that point that creditors become prospectively entitled, through the medium of liquidation, to the company's assets.

Awaiting the outcome

The Supreme Court has yet to deliver its decision some 16 months later.

It is unlikely that the Supreme Court will do away with the creditor duty altogether. The duty has been well-established in English law since the decision of the Court of Appeal in West Mercia Safetywear Ltd v Dodd [1988] BCLC 250 and serves an important function in discouraging risk-taking behaviour by directors. Moreover, the wording of section 172(3) appears to recognise the existence of such a duty.

On the other hand, if the creditor duty is triggered too early, it will, in practice, have a chilling effect on entrepreneurial activity.

This policy issue was recognised by David Richards LJ in the Court of Appeal and was a focus of argument before the Supreme Court.

As to the content of the duty, it is hoped that the Supreme Court will bring some clarity, defining if, and when, creditors' interests become paramount.

Until the Supreme Court delivers judgment, the law remains as stated by the Court of Appeal. The creditor duty arises where the directors know or should know that the company is actually insolvent or likely to become insolvent, and in a situation of actual insolvency, creditors' interests are probably to be regarded as paramount.

FEDERAL REPUBLIC OF NIGERIA V JP MORGAN:

WHEN A WHIF ISN'T ENOUGH

Authored by: Kit Smith - Keidan Harrison

The High Court has recently handed down the much awaited judgment in the case of Federal Republic of Nigeria ("FRN") v JP Morgan[1]. Having lain dormant for a number of years following the seminal decision in Barclays v Quincecare[2], there has been a renaissance of these claims, starting with the Singularis decision in 2017.

More recently the duty has undergone a period of clarification, expansion and then refinement. The recent decision from the Court of Appeal in Philipp v Barclays[3] has confirmed that the duty can apply to individuals dealing with their own funds, although the facts of that case remain to be tested at trial. Previously, it had been understood (owing perhaps largely to how the cases had been interpreted) that the duty could only apply to corporate clients acting by their agents. Further the duty was confirmed, by the Privy Council in RBS v JP SPC[4] to only be applicable to a bank's client and not to third parties, including those with a beneficial interest in funds fraudulently paid away.

To-date the duty has only been found, following full trial, to have been breached on one occasion in this jurisdiction[5] (Singularis). Following the decision in FRN the banks are back to level pegging with the claimants.

Executive Summary

FRN's claim against JP Morgan failed in the first instance, as it was held by Cockerill J that the existence of a fraud against FRN in 2011 had not been proven. Cockerill J went further in her judgment, noting that even if fraud had been proven to have occurred in 2011, JP Morgan did not act in a grossly negligent manner by making the payment in 2011 or a later payment in 2013.

The relevant test for negligence in this case was gross negligence, since the parties had agreed that the terms of JP Morgan's depository agreement applied. Those terms excluded any obligation on the part of JP Morgan to investigate or check the veracity of instructions provided to them. As such FRN were required to show that JP Morgan was grossly negligent in processing the payments in 2011 and 2013. Gross negligence has always been an exceptionally difficult and nebulous hurdle to clear and on this occasion it was a hurdle that was too great to overcome on the facts of the case.

The Quincecare Duty

The Quincecare duty was established in the 1992. At that time it was regarded as an extension of the duty of care that banks are said to owe to their customers (including compliance with their instructions), which was established in the preceding case of Lipkin Gorman v Karpnale. In the Quincecare case, Mr Justice Steyn (as he then was) described the duty as one whereby:

1 The Federal Republic of Nigeria v JP Morgan Chase NA [2022] EWHC 1788 (Comm)
2 Barclays Bank v Quincecare [1992] 4 All ER 363
3 Fiona Lorraine Philipp v Barclays Bank UK PLC [2022] EWCA Civ 318
4 Royal Bank of Scotland International Ltd v JP SPC 4 and Anor [2022] UKPC 18
5 The other instance, of which the author is aware, in which the duty has been found to have been breached following a full trial of fact is in the DIFC in Aegis Resources DMCC v Union Bank Of India (DIFC) Branch [2020] DIFC CFI 004

"a banker must refrain from executing an order if and for as long as the banker is 'put on inquiry' in the sense that he has reasonable grounds (although not necessarily proof) for believing that the order is an attempt to misappropriate the funds of the company."

Background

FRN's claim concerned payments made by JP Morgan on its behalf in 2011 and 2013. FRN had opened the account in question with JP Morgan for the specific purpose of holding a payment for a settlement agreement in respect of the ownership of a very valuable oil field (known as "OPL 245") which had been the subject of extensive litigation.

The position of the Nigerian government in 2011 was to settle all litigation in respect of OPL 245 and to make a payment to settle all claims in connection with the same. The account with JP Morgan was to receive the settlement sum which was paid out to an offshore entity known as Malabu Oil and Gas Limited, which was said to be under control of the disgraced former oil minister of Nigeria, Mr Dan Etete. A new government came into power and claimed that the entire settlement was procured via corruption and that Malabu, as the recipient of funds, was not truly entitled to them. The payment of the settlement sum (some USD$875m) was said to be part of systemic corruption within the 2011 government.

FRN brought a claim against JP Morgan averring that it had been in breach of its Quincecare duty in making the payments in 2011 and 2013 given what, it said, was apparent corruption that should have put the bank on notice of a fraud against its client.

The Decision

The judgment of Cockerill J rejected FRN's claim on two principal bases. Firstly, FRN failed to show that a fraud had been perpetrated. This is a key pre-requisite to launching a Quincecare claim. In all previous cases, including Singularis, there was a proven fraud which the bank should have been on notice of before processing the payments in question. The claim fell at this first hurdle.

Despite the fact that the claim fell at this hurdle, Cockerill J went on to examine the question of whether JP Morgan was grossly negligent in transacting the payments to Malabu.

The bank may have been on notice, but its breach of its duty did not reach the required threshold of "gross" negligence. To constitute an actual "Quincecare" trigger, the court suggested that the specific payment instruction would need to give a clear steer towards a fraud by, for example, being a payment instruction to a local casino or to the 'Adoke Holiday Fund Limited' (Mr Adoke being one of the alleged fraudsters).

Comment

The decision in FRN will no doubt be warmly welcomed by banks at a time when the duty is being expanded so as to be applicable to individual customers and to customers dealing with their own funds as part of a fraud.

This expansion of the duty, coupled with the recent rise in authorised push payment fraud, will place an enhanced burden on the role banks play in the fight against fraud.

In particular, the acceptance of the parties that JP Morgan's terms and conditions were applicable, such that no obligation existed upon them to investigate the veracity of payment instructions, will be a source of assurance to banks and may lead to systemic change in standard banking terms. However, banks will need to have very clear language if they want to exclude the possibility of a Quincecare claim, since general language will not suffice. This may now precipitate an industry-wide movement of banks to incorporate terms limiting their liability to gross negligence – something that insolvency practitioners and claims purchasers alike should be alive to when considering launching a claim against a bank in future.

The rarity of final judgments is perhaps largely due to banks seeking settlement of cases before trial so as not to develop the case law to be used against them. Where such considerable sums are in dispute as they were in Singularis and FRN, it is perhaps unsurprising that these cases found their way to full trial. However, the judgment is clear that the successful claimant will need to show a genuine nexus between the instructions (which ought to have put the bank on notice) and a proven fraud. It will not be enough for a claimant to point to a generalised suspicion of fraud involving the bank.

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FORTIFICATION FOR DAMAGES IN FREEZING INJUNCTIONS: RESTORATION OF THE STATUS QUO?

Authored by: Siân Mirchandani KC and Hannah Daly - 4 New Square

Since writing on the recent High Court decision: Claimants Listed in Schedule 1 v Spence [2021] EWHC 925 (Comm) ("the High Court Decision") in our previous article titled "Fortification for damages in freezing injunctions: Out with the old, in with the new?" (FIRE Magazine Issue 9), the Court of Appeal has heard and handed down judgment on the appeal. In short, the status quo has been restored, with the original principles for fortification applications being applied. The decision resolves any doubt that was cast by the High Court Decision, particularly in relation to the need for "real evidence" of harm to be shown.

In our earlier article, we discussed the concept of fortification and the principles applicable to an application for fortification. Put briefly, and as many commercial practitioners know, freezing orders are part and parcel of the Commercial Court's business, particularly where it is alleged that the respondent has committed a fraud. For an applicant to obtain the freezing order, they will have to provide a cross-undertaking in damages to the court, which provides protection to the respondent to a freezing order, from the harm it may suffer because of the restrictions imposed.

This need to provide an undertaking in damages as a pre-condition to obtaining a freezing order can cause problems particularly for an applicant that is an international entity which may struggle to show it has sufficient assets within the jurisdiction to give its cross undertaking in damages any real value. It is at this point that a respondent to the freezing order will make a cross-application for fortification of the undertaking in damages proffered by the applicant. The court will then assess what harm may be suffered by the respondent and examine whether fortification of the damages could resolve any lingering risk of harm that may be suffered by the respondent.

As highlighted in our earlier article, the law regarding fortification for damages in freezing orders was, prior to the High Court Decision, in a fairly settled state. There had to be a good arguable case that there was a sufficient risk of loss to the respondent due to the freezing order being granted, and there would need to be sufficient evidence to allow an intelligent estimate of the quantum of the losses to be made.

However, the High Court Decision of Moulder J appeared to depart from this formerly consistent approach and risked bizarre and far reaching consequences for applicants to freezing orders. One of the key issues in the High Court Decision was that no real or documentary evidence was adduced to support the respondent's application for fortification.

The Judge herself remarked that there was an "absence of evidence" in the case. Neither was there an estimate of loss which could be considered to be informed, intelligent or realistic.

The High Court Decision was appealed and heard in April 2022 in: Claimants Listed in Schedule 1 v Spence [2022] EWCA Civ 500. The primary respondent to the appeal was Mr Spence.

The relevant principles confirmed

The Court of Appeal noted at para [17] that there was no dispute as to the principles to be applied when deciding whether to order fortification of an undertaking in damages, and also noted that Moulder J had correctly identified those legal principles. These principles were summarised by Popplewell J in Phoenix Group Foundation v Cochrane [2018] EWHC 2179 as follows:

i) First, that the court can make an intelligent estimate which is informed and realistic, although not necessarily entirely scientific, of the likely amount of any loss which might be suffered by the applicant by reason of the freezing order.

ii) Secondly, that the applicant has shown a sufficient level of risk of loss to require fortification, that is to say, has shown a good arguable case to that effect.

iii) Thirdly, that the making of the interim order is or was a cause without which the relevant loss would not be, or would not have been, suffered.

One of the appellants' grounds of appeal was that an application for fortification could not be based on an assertion or supposition, but required an evidential foundation. The Court of Appeal highlighted that this is not a separate requirement when granting an application for fortification. It was simply an obvious aspect of the need for the applicant to demonstrate a good arguable case – and it would be impossible to show there was a good arguable case without a proper evidential basis.

Further, the appellants submitted that for an application for fortification the applicant needed to show that the losses would result because of the injunction being granted by the court, rather than due to the underlying proceedings: see Harley Street Capital Limited v Tchigirinski [2005] EWHC 2471 (Ch). Moreover, it was important to recognise that it may be difficult to disentangle the prospect of damage caused by the mere existence of the litigation from the making of the freezing order. The Court of Appeal once again considered this was simply another aspect of the causation element of the applicable requirements for an application for fortification.

Had the respondent shown an arguable case that he would suffer loss?

In the High Court Decision, the Judge's main focus was on Mr Spence's financial arrangements. Mr Spence had a US dollar loan with Coutts of c.$9 million, which he had used to buy US assets, and which was secured by a sterling deposit of c.£8.8 million. Although he was incurring interest on the dollar loan, his evidence was that he intended to redeem the loan once sterling had appreciated to the rate of $1.55 to £1. He complained that there was a risk that Coutts would call in his dollar loan and that he would be forced to discharge the sterling deposit to redeem the US dollar loan at a rate over which he had no control and which would be lower than the exchange rate at which he intended to exchange currency to redeem the US dollar loan. As such, the early and forced realisation of his sterling deposit risked causing him harm and loss. The measure of that loss was, he contended, the difference between the rate at which he might be forced to realise the sterling deposit and the rate at which he intended to convert it.

The Court of Appeal found that this approach was "too narrow", failing to reflect Mr Spence's overall financial planning and arrangements. The Court observed that Mr Spence had put in place these arrangements to provide an effective hedge. By maintaining a sterling fund which would match the dollar assets (standing as security for the loan that was used to purchase them), he had effectively protected himself from the risk of depreciation of the dollar against sterling. The realisation of the sterling deposit would not therefore cause Mr Spence any loss. The real loss was the loss of his protection (i.e. his hedging arrangements) – and the measure of that loss was the cost of putting in place an alternative hedging arrangement.

The Court of Appeal considered that there were potentially a number of ways in which Mr Spence could replace his existing currency protection. He could simply replicate the hedge – by re-mortgaging his US assets and converting the proceeds to sterling. Alternatively, he could enter into forward currency trades or purchase suitable options or swaps. The Court of Appeal raised this as an issue in advance of the appeal and invited the parties to respond. Mr Spence did not adduce any evidence about the availability or cost of these replacement options, and simply invited the Court of Appeal to assess his loss in the full amount that would occur in the worst-case scenario i.e. that sterling reached $1.55 at some point after he had been forced to convert the sterling deposit at a much lower rate. He also argued that he could not reasonably be expected to put alternative arrangements in place because of the complexity of doing so and his inability to prove their cost without actually having to enter into them.

The Court of Appeal rejected his arguments. It found that Mr Spence could reasonably have been expected to obtain evidence about whether alternative financial arrangements were available. Moreover, it said that adducing such evidence was a pre-requisite of inviting the judge at first instance to embark on the assessment of speculative future losses based on currency movements.

It was therefore held that Mr Spence had failed to show a good arguable case that he would suffer loss as a result of the worldwide freezing order and the judge at first instance was wrong to have found that he had.

It was not strictly necessary, given that finding, for the Court of Appeal to go on to consider the basis of the appellants' appeal. However, it proceeded to do so and thereby provided some important indicators for the proper approach to applications for fortification.

Was there sufficient evidence?

The first question was whether Moulder J had been wrong to accept Mr Spence's assertion that he intended to retain the sterling deposit until the dollar exchange rate hit $1.55, without any supporting documentary evidence.

The Court of Appeal agreed with the appellants to the extent that the arrangements Mr Spence had made with Coutts were questionable commercially. The arrangements were in place and only made sense if Mr Spence was anticipating a steep rise in sterling in the short-to-medium term. As such, and notwithstanding the lack of evidence, the judge was entitled to accept his evidence as to the exchange rate at which he planned to unwind the arrangement as the basis of the assessment of loss.

Was there a sufficient risk that Coutts would make a demand?

The next ground of appeal was whether Moulder J had been entitled to find that there was a sufficient risk (as contended by Mr Spence) that Coutts would make a demand on the dollar loan. The Court of Appeal noted and agreed with Moulder J's observation that under the terms of the loan, Coutts was able to make such a demand at any time without giving warning to Mr Spence, regardless of whether there was a worldwide freezing order present or not. However, the question was whether it was arguable that the freezing order (as distinct from the allegations in the claim more generally) would cause Coutts to make such a demand.

In this regard, the Court noted that Coutts was substantially over-secured by cash for the loans. It continued to benefit from substantial interest payments on the loan. It had no financial reason to terminate the arrangement which had already been in place for some years. Furthermore, and importantly, Coutts had had notice of the freezing order for several weeks and had not given any indication that it would seek to call in the loan. That was a clear indication that it was not sufficiently concerned by the freezing order to terminate its arrangements with Mr Spence.

Accordingly, the Court found that the judge at first instance was wrong to find that there was a real, as opposed to a fanciful, risk that Coutts would call in the loan.

Was there an intelligent estimate of loss?

Finally, the Court of Appeal considered whether there had been an intelligent estimate of the loss. Moulder J had found that the likely loss was in the region of £800,000, but had failed to explain her reasoning for this, and in particular, had not explained what values she was ascribing to various factors which had been identified as relevant to estimating the loss.

The Court of Appeal noted that this was not surprising since the estimation of loss based on exchange rate movements was "notoriously difficult" and, by definition, was "entirely speculative". In those circumstances, however, the unexplained number arrived at by the judge was "intelligent guesswork", but not an intelligent estimation of loss.

Accordingly, the Court held that Mr Spence's losses were inherently speculative and incapable of intelligent estimation.

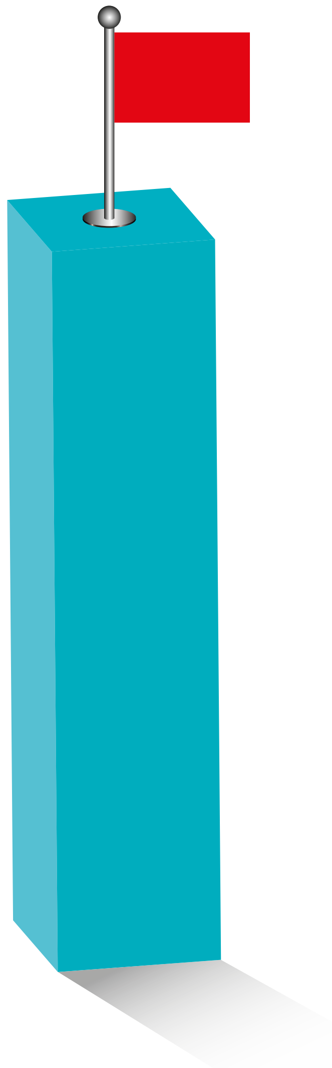
So what does the Court of Appeal decision highlight?

Firstly, the decision highlights the importance of correctly characterising and identifying the loss which a freezing order might cause to materialise.

Secondly, even though the test on an application for fortification is merely that there must be a good arguable case of a risk of loss, it is not permissible to gloss over the causation element. The risk of loss must be specifically linked to the injunction rather than the substantive allegations in the litigation.

Thirdly, when assessing loss, it is crucial that the court makes an informed, realistic and intelligent estimate of the proposed loss. It cannot simply be the product of intelligent guesswork based on entirely speculative foundations.

From now on, as confirmed by the Court of Appeal in this decision it appears to be the case that no detailed evidence = no fortification.



LIMITATION AND QUINCECARE CLAIMS

Authored by: David Johnson - PCB Byrne

Introduction

It seems that barely a month goes by without the Courts further clarifying the nature and scope of the Quincecare duty. However, this growing body of case law is silent on limitation issues arising from such claims.

That is surprising given the viability of such claims will often turn on a limitation issue. The following example will be familiar to many practitioners:

(a) The claimant company (C) has been defrauded by its director (D) in circumstances in which the defendant bank (B) may have breached the Quincecare duty.

(b) A liquidator is then appointed to the company, which has by that point been denuded of its assets.

(c) However, the payments were made over six years before the liquidation date.

Whilst the Quincecare claim would of course be time barred if the usual six-year limitation period applied,[1] the authorities referred to below clearly suggest that the clock may not run until the liquidator is in office and has had a chance to identify the claims.

Section 32

When considering the above claims, practitioners may instinctively turn to section 32 of the 1980 Act, given that provision often saves the day when liquidators seek to bring claims which are prima facie time barred.

That section (so far as relevant to this article) extends the limitation period in claims where: (i) the action is based on the fraud of the defendant or his agent or anyone through whom he claims (the fraud exception), or (ii) the defendant has concealed facts relevant to the claim from the claimant (the concealment exception).[2]

Whilst Quincecare claims invariably involve fraud, they are not based on the fraud of the defendant bank, so the fraud exception is inapplicable. Any extension under section 32 must then arise from the concealment exception.

At first blush, the concealment exception could seem only to arise where the bank has actively concealed the fraud from the company (which would in practice require fraud to be pleaded against the bank). However, the exception is engaged in a wide range of circumstances where a defendant has breached a duty to the claimant, or has simply failed to disclose relevant facts:[3]

1 Section 2 of the 1980 Act
2 "Defendant" for these purposes includes any agent of the defendant
3 Canada Square Operations Limited v Potter [2021] EWCA Civ 339

- Firstly, if a defendant intentionally or recklessly commits a breach of duty in circumstances where the breach is unlikely to be discovered for some time, they are taken to have concealed facts relating to the breach.
- Also, if a defendant is under a duty to disclose a relevant fact to the claimant, but (either intentionally or recklessly) fails to do so, they are taken to have concealed that fact. For these purposes, "duty" is defined broadly to include situations where the defendant, although not under a legal duty to disclose, should have disclosed the fact as a matter of "utility and morality".

On this basis, claimants in Quincecare claims may look to overcome a limitation defence by demonstrating that the bank has recklessly failed to comply with its Quincecare duty, or has subsequently recklessly failed to disclose relevant facts (for example, failures in its own internal procedures) to the claimant.

However, whilst "recklessness" may seem a low threshold for practitioners used to pleading fraud, it can only be proved with detailed pleadings, supported by cogent evidence, which specify exactly how section 32 is said to be engaged. This may prove an insurmountable task to a liquidator with limited documents and no cash to obtain disclosure orders.

As detailed below, an alternative (or additional) argument to defeat a limitation defence may be available which does not give rise to such complications.

Attribution

Pursuant to section 14A of the 1980 Act, the limitation period in Quincecare claims doesn't begin running until the claimant is aware of the facts underpinning the claim.

As Lord Hoffman set out in Meridian,[4] companies can only think and act through their human agents. A company can only know relevant facts if a real person knew those facts, and their knowledge is imputed to the company under the doctrine of attribution.

In the above scenario, B would likely submit that C is imputed with D's knowledge of the fraud, so limitation runs from the moment the payments were made. That may well be true if general principles of corporate attribution and agency were applied.

However, C would have a strong counterargument that it should not be imputed with D's knowledge:

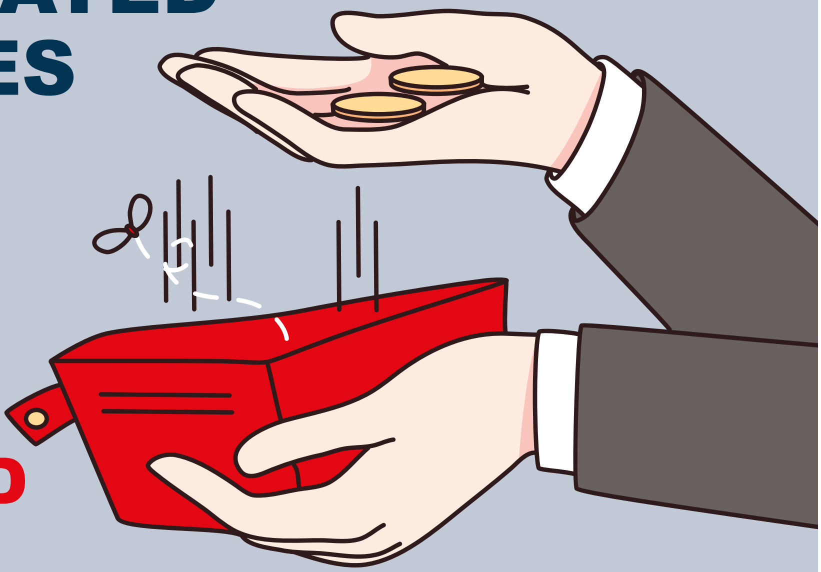
- The Court does not determine questions of attribution by mechanistically applying principles of corporate law and agency. Rather, "the answer to the question of whether to attribute the knowledge of the fraudulent director to the company is always to be found in consideration of the context and the purpose for which the attribution is sought".[5] If the application of general principles would defeat the purpose of the underlying rules, the court will likely refuse to attribute the director's knowledge to the company.[6]
- The purpose of the extension in section 14A is to prevent claims being time-barred before the claimant has "discovered" the underlying damage, so that claimants at least (subject to a 15-year longstop) have a chance to bring their claims.[7] If D's knowledge was attributed to C in the above example, C's claims might be time barred, despite there being no prospect of them being brought whilst it remained under D's control.
- Also, if the limitation period was not extended under section 14A in the above circumstances, this would denude the Quincecare duty of any value wherever a delinquent director manages to delay the company's liquidation for six years following the impugned payments. This weighs heavily in favour of the limitation period being extended.
- Finally, the Supreme Court in Singularis held that a bank cannot raise an illegality defence to a Quincecare claim by imputing the director's knowledge to the company. If it is wrong in principle to allow an illegality defence in those circumstances, it would be perverse to apply the doctrine of attribution so as to time-bar a Quincecare claim before there is any prospect of it being brought.

If the above analysis is correct, this could give a neat answer to most limitation defences to Quincecare claims. Given the current dearth of authority as to how limitation issues apply in this context, it is hoped that these issues will come before the Courts in the near future, in order to clarify this important aspect of the law surrounding Quincecare claims.

4 Meridian Global Fund Management v The Securities Commission [1995] UKPC 5
5 Singularis Holdings Limited v Daiwa [2019] UKSC 50 at [34]
6 Singularis at [35] and Meridian at [12]
7 See the 24th Report of the Law Reform Committee (Cmnd. 9390)

LIFTING THE VEIL ON CONSOLIDATED BANKRUPTCIES

UPDATE ON THE RECOGNITION OF FOREIGN BANKRUPTCIES IN SWITZERLAND



Authored by: Edouard Kaiflin and Natalia Hidalgo - Monfrini Bitton Klein

On 14 July 2021, the Geneva Court of First Instance granted an application for the recognition of consolidated bankruptcies of Brazilian entities. For the first time, to our knowledge, consolidated bankruptcies (i.e., the combining of two or more bankruptcy proceedings into one) were recognised in Switzerland[1].

Since Swiss law does not provide for consolidated bankruptcies, how can we explain the recognition of such proceedings in this case? By the application of a principle well known in numerous jurisdictions: the piercing of the corporate veil.

This recent decision of the Geneva Court is an opportunity to give an update on the recognition of foreign bankruptcies in Switzerland by answering five questions frequently asked in practice.

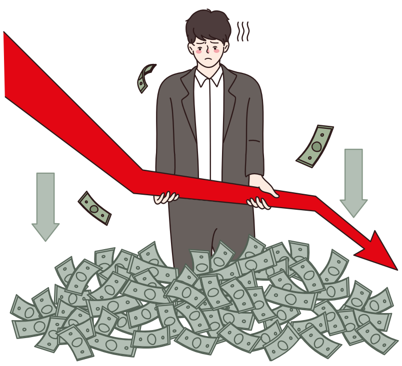
1. Why is the recognition of a foreign bankruptcy necessary?

In accordance with the principle of territoriality, foreign bankruptcies have in principle no effect in Switzerland. Access to the debtor's assets located in Switzerland is only possible once the foreign bankruptcy has been recognised.

Violations of the principle of territoriality may have criminal consequences. A foreign bankruptcy administrator acting as such in Switzerland – without the foreign bankruptcy having been recognised – may be subject to criminal prosecution under Article 271 of the Swiss Criminal Code, which punishes acts performed for a foreign state without authorisation[2].

1 Decision of the Geneva Court of First Instance of 14 July 2021, JTPI/9640/2021.

2 Pursuant to Article 271 (1) of the Swiss Criminal Code, any person who carries out activities on behalf of a foreign state on Swiss territory without lawful authority, where such activities are the responsibility of a public authority or public official, shall be liable to a custodial sentence not exceeding three years or to a monetary penalty, or in serious cases to a custodial sentence of not less than one year.



2. What does foreign bankruptcy mean?

Under Swiss law, foreign bankruptcy encompasses all proceedings that share the main characteristics of a Swiss bankruptcy, namely proceedings:

- caused by the debtor's insolvency;
- supervised by a state body;
- leading to the debtor's incapacity to dispose of his assets; and
- resulting in the liquidation of the debtor's assets and their distribution among creditors.

The cause and effects of the foreign proceedings are therefore decisive.

By way of example, winding-up proceeding under English law may have similar consequences as a Swiss bankruptcy, in particular the liquidation and the distribution of assets. However, they cannot be qualified as a foreign bankruptcy if they have been opened for a reason which is not related to the debtor's insolvency[3].

3. What is the legislative framework for recognition of a foreign bankruptcy?

The recognition of foreign bankruptcies in Switzerland is governed by Articles 166 et seq. of the Federal Act on Private International Law of 18 December 1987 (PILA). The competent authorities are the cantonal courts at the location of the foreign bankruptcy's assets.

If the debtor is comparable to a financial institution subject to regulation in Switzerland, (e.g., banks, insurance institutions, investments funds, etc.), the recognition is governed by the Federal Act on Banks and Saving Banks. The competent authority is the Financial Market Supervisory Authority (FINMA).

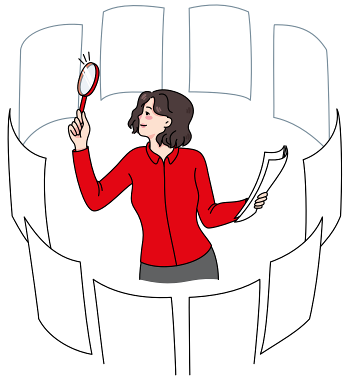
4. What are the main conditions to recognize a foreign bankruptcy?

On 1 January 2019, legislative changes entered into force to facilitate and simplify the recognition of foreign bankruptcies and to improve coordination with foreign proceedings.

Pursuant to Article 166 (1) PILA, the current conditions to recognize a foreign bankruptcy are the followings:

- the request for recognition is filed by the bankruptcy administrator, the debtor or a creditor;
- the bankruptcy decision is enforceable in the state where it was issued;
- the decision was issued in the debtor's state of domicile, or in the state of the centre of the debtor's main interests (COMI), provided the debtor was not domiciled in Switzerland when the foreign proceedings were opened;
- there are no grounds for non-recognition (e.g., imcompatibility with Swiss public policy, violation of fundamental procedural rights, lis pendens, res judicata).

The conditions mentioned in Article 166 (1) PILA also apply to the recognition of foreign bankruptcies falling within FINMA's competence.



5. What are the effects of the recognition of a foreign bankruptcy?

Once the foreign bankruptcy is recognised, Swiss law provides for two options.

Option 1: ancillary bankruptcy proceedings

The recognition of a foreign bankruptcy decision leads to the opening of ancillary bankruptcy proceedings in Switzerland, usually conducted by a local Bankruptcy Office, which will liquidate Swiss assets and claims of the foreign bankruptcy. This mutual assistance procedure makes it possible to assist the foreign authority conducting the main proceedings, while guaranteeing priority payment of certain Swiss privileged creditors: their claims are satisfied first from assets located in Switzerland. The remaining balance is transferred abroad after the foreign schedule of claims has been recognized in Switzerland.

Option 2: waiver of the ancillary bankruptcy proceedings

At the request of the foreign bankruptcy administrator, the Swiss court or FINMA may agree to waive the ancillary bankruptcy proceedings if no Swiss-based privileged creditors exist and if Swiss creditors' claims are adequately taken into account in the foreign proceedings.

In such case, the foreign bankruptcy administrators may exercise in Switzerland all powers to which they are entitled under the law of the state in which the bankruptcy proceedings were opened, with the exception of coercive powers.

3 Decision of the Swiss Federal Court of 25 July 2014, 5A_952/2013.

Case study: the recognition of Brazilian consolidated bankruptcies

The Brazilian proceedings

The Probank Group was a corporate group mainly composed of companies based in Brazil that provided telecommunication services, including electronic voting services to the Brazilian government.

Between 2004 and 2006, due to mounting debts, the Probank Group allegedly restructured its shareholding to conceal the assets of its ultimate beneficial owners.

As of September 2013, the Brazilian courts opened bankruptcy proceedings against several Probank Group companies. The proceedings were subsequently consolidated to ensure equality between the various creditors of the Probank Group.

In addition, the Brazilian courts also extended, on the basis of Article 50 of the Brazilian Civil Code, the effects of the bankruptcy proceedings to fourteen – national and foreign – individuals and companies related to the Probank Group because of their involvement in acts of fraud against the bankrupt entities with the purpose to conceal their assets.

The extension of the bankruptcy proceedings to those third parties was based on a principle similar to the piercing of the corporate veil.

The recognition in Switzerland

On 14 July 2021, the Geneva Court of First Instance recognized the Brazilian consolidated bankruptcies.

In the context of the Swiss ancillary bankruptcy, the Geneva Bankruptcy Office also recognized the extension of the effects of the Brazilian bankruptcy proceedings to BVI companies by sending freezing and productions orders to the various Swiss banks where they held their accounts.

Under Swiss bankruptcy law, the atomistic principle is the rule: each independent legal subject must be the subject of an independent bankruptcy proceedings.

Thus, how can the position of the Geneva Court and Bankruptcy Office be explained?

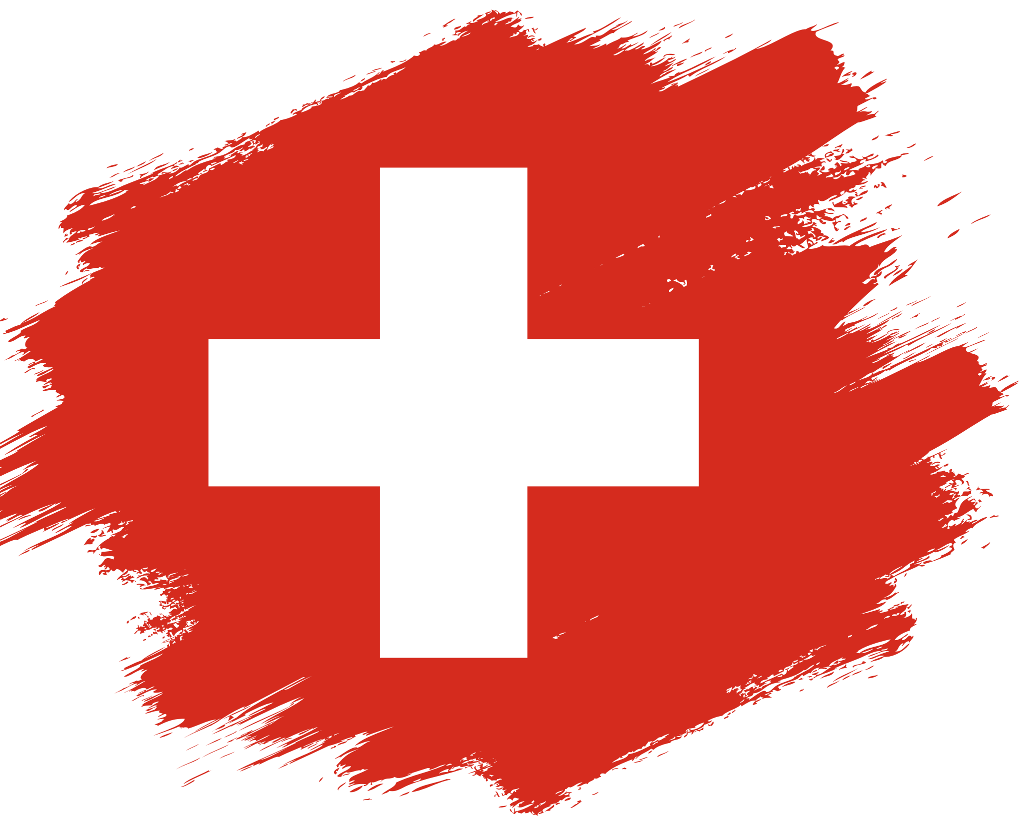
The principle of piercing the corporate veil also exists in Swiss law (Durchgfriff). It is derived from Article 2 (2) of the Swiss Civil Code, according to which the manifest abuse of a right is not protected by law. It allows creditors of a company to reach the assets of another company or individual in case of abuse of the company structure.

Although the consolidation of bankruptcies does not exist under Swiss law, the Swiss government contemplated it in 2002 following the bankruptcy of Swissair. In this context, the expert group in charge of amending the Swiss Debt Enforcement and Bankruptcy Act debated the opportunity to introduce this concept in the new provisions of said Act. Most of the experts considered that the consolidation of bankruptcy proceedings could be justified in exceptional cases, based in particular on the principle of piercing the corporate veil. Even though the experts decided eventually against the explicit mention of this concept in the revised Act, this evidenced that the recognition of consolidated foreign bankruptcies would not breach Swiss public policy.

For the same reason, the extension of the effect of the Brazilian bankruptcies to third parties based on their fraudulent act did not breach Swiss public policy.

The consolidation of the Brazilian bankruptcies and the extension of their effects pursued objectives that were in line with Swiss law, namely the protection of creditors' interests and the prohibition of the misuse of entities. Under these circumstances, there were no grounds to refuse the recognition of these foreign bankruptcy proceedings.

This case illustrates the pragmatic attitude of Swiss courts and authorities towards the recognition of foreign bankruptcies and enforcement of their claims.



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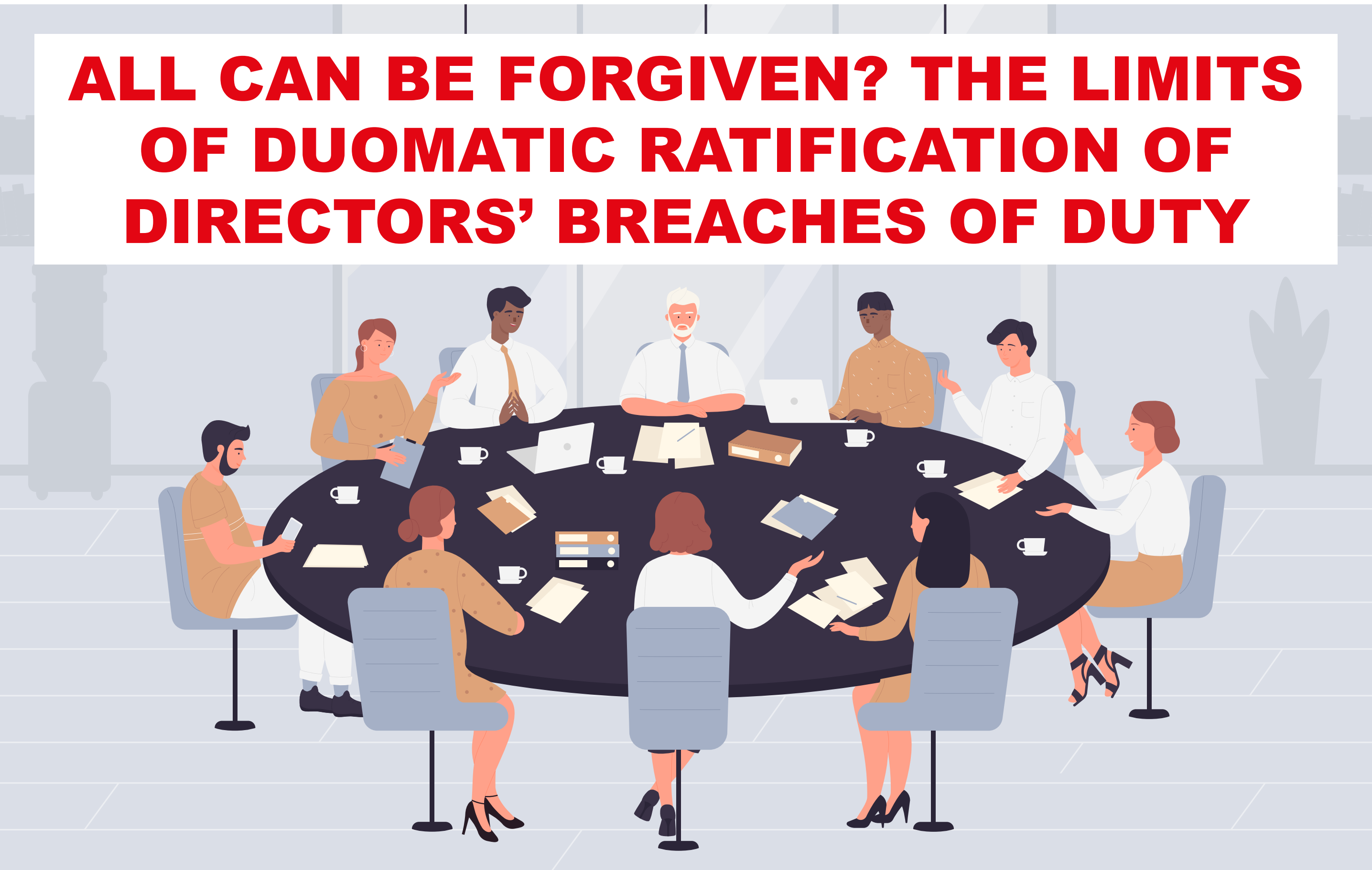

ALL CAN BE FORGIVEN? THE LIMITS OF DUOMATIC RATIFICATION OF DIRECTORS' BREACHES OF DUTY

Authored by: Tony Beswetherick KC - Twenty Essex

Following a company's entry into an insolvency process, one of the most common avenues of recovery for the officeholder (whether liquidator or administrator) is the pursuit of a claim against the company's former directors for acting in breach of the duties they owed to the company whilst it was under their stewardship.

In such cases, directors often raise ratification as a defence to the claim. Conduct that may otherwise amount to a breach of duty might potentially be ratified by its members by formal shareholder approval (whether a written resolution of members or a resolution passed at a meeting) or by the members' informal unanimous asset (also known as the Duomatic principle). Consequently, defendants will often argue that any claim against them is precluded because their conduct was ratified by the company prior to its demise.

In private companies where there is an identity between the directors and its shareholders (or those who own/control the shareholders), it is frequently contended that the conduct complained of was approved informally by the shareholders of the company.

The focus of this article is upon informal ratification under the Duomatic principle. Although long pre-dating it, the principle derives its name from the decision In re Duomatic Ltd [1969] 2 Ch 365. The essence of the principle is that anything that the members of a company can do by formal resolution in a general meeting, can also be done informally where all of them assent to it.

There are certain well-established limitations upon the ability of shareholders to ratify misconduct. These include:

- Where the act in question was ultra vires (i.e. beyond the corporate capacity of the company). For example, where directors act in breach of duty in procuring the company to make an unlawful return of capital, its shareholders cannot ratify such an ultra vires act as they cannot do informally that which they have no power to do formally.

- Where the company's financial position is such that the directors were under a duty to give primacy to the interests of its creditors as body. That duty arises when the directors know or should know the company is or is likely to become insolvent. Whilst the interests of a company are normally identified with those of its members, in a situation where the company is facing financial difficulties, the interests of its creditors intrude and the company's shareholders lose the power informally to ratify breaches of duty.

In an insolvency context, it is the second of those exceptions that has most often been relied upon to overcome a Duomatic defence. However, in BTI 2014 LLC v Sequana S.A. [2019] EWCA Civ 112, the Court of Appeal held that in the context of considering whether the company is or is likely to become insolvent, "likely" means "probable", thereby setting the threshold at a higher level than many had previously understood. Pending any review of this issue in the long-awaited decision of the Supreme Court in Sequana, insolvency lawyers and practitioners may need to look elsewhere to overcome a Duomatic defence.

In that regard, whilst there remains some uncertainty as to its precise ambit, it is clear that there is also an exception which precludes ratification of breaches of duty in cases of "relevant dishonesty" (that, is where the dishonesty is directed towards the company).

Several first instance decisions touched upon this exception:

- In Bowthorpe Holdings Ltd v Hills [2002] EWHC 2331 (Ch), it was said, with reference to a number of authorities (mostly from the early 20th century) that to be capable of ratification, the transaction "must be bona fide or honest".
- In Madoff Securities International Ltd v Raven [2011] EWHC 3012 (Comm), the limited question was whether there was a serious issue to be tried that the dishonesty exception applied. The argument advanced was that the Duomatic principle would not apply where the shareholders were acting dishonestly or using the company as a vehicle for fraud or wrongdoing. Flaux J expressed the view that a number of cases, including Bowthorpe, "recognise the existence of a wider exception to the effect that a transaction can be impugned by the company if it is not honest, bona fide and in the best interests of the company". The Judge tentatively suggested that one explanation may be that "public policy demands that a transaction which is not honest, bona fide and in the best interests of the company is not binding on the company".
- In Auden McKenzie (Pharma Division) Ltd v Patel [2019] EWHC 1257 (Comm), Robin Knowles J rejected a defence based on Duomatic ratification where directors had procured a company to make payments into accounts they owned or controlled against invoices which falsely described the sums as being due in respect of research and development. The Judge held that the payments were procured dishonestly ("they were said to be for research and development when they were not; they were for the Defendants to have for themselves and to have in a way that dishonestly evaded the tax consequences") and concluded that: "Whatever else may be the precise compass of the Re Duomatic principle, as a principle developed to save conduct it has not been developed to save conduct of this nature. The company … could not do lawfully what was done and the assent of all its members could not alter that."[1]
- In Tonstate Group Ltd v Wojakovski [2019] EWHC 3363 (Ch), Zacaroli J noted the discussion of the breadth of the exception in Madoff but did not regard it as necessary to consider "the precise limits of an exception to the Duomatic principle based upon dishonesty", since whatever those limits, he was satisfied by reference to Auden, that Duomatic ratification "cannot apply to conduct which the company could not lawfully carry out itself".

Auden and Tonstate stand as authority for the proposition that shareholders cannot informally ratify conduct which the company could not lawfully carry out. The question they left open, but which seemingly found traction in Madoff, is whether the exception extends beyond this to prevent ratification wherever there is dishonesty.

It is hard to see the justification for such an expansive exception. The suggestion in Madoff was that it might be justified on public policy grounds, but the general law does not adopt such a stringent approach to any transaction tainted by dishonesty. It is far from obvious why shareholders should be unable to ratify conduct by a director (which is an internal company matter) whenever there is dishonesty in a general sense.

Some further clarity has since been provided by appellate courts. In Ciban Management Corporation v Citco (BVI) Limited [2020] UKPC 21, the Privy Council confirmed that the Duomatic principle cannot be relied upon where there is "relevant dishonesty" and, in Satyam Enterprises Ltd v Burton [2021] EWCA Civ 287, the Court of Appeal accepted the submission that "relevant dishonesty" in this context connotes dishonesty or bad faith towards the company. It was said that:

".. if the members[2] are not acting dishonestly towards the company, we have been shown no authority that the fact the transaction was intended to be used subsequently as an instrument to defraud someone else precludes the application of the Duomatic principle. Nor would there seem to be any good reason in principle why it should: this restriction on the application of the Duomatic principle would appear to be for the protection of the company and its creditors, not the Court's response to fraud more generally."

It followed that, whilst the company's director and sole shareholder in Satyam had been "undoubtedly dishonest" in executing a document transferring a property which contained a deliberately inflated price so as to enable a fraud to be committed on a future lender, that was not relevant dishonesty such as to prevent the application of the Duomatic principle.

Whilst it is not therefore possible to exclude Duomatic ratification just because some aspect of a director's conduct (or the members' approval of that conduct) is dishonest vis-à-vis an outsider to the company, where that dishonesty is towards the company itself, the ratification defence may be excluded.

The interesting question of what conduct comes within the ambit of dishonesty "towards the company" is an area that will no doubt be explored in future decisions.

1 The decision was overturned on appeal but not in relation to this issue.

2 Whilst the the Court referred to "members" acting dishonestly, this appears to be because it was considering a position where the members are also the directors.

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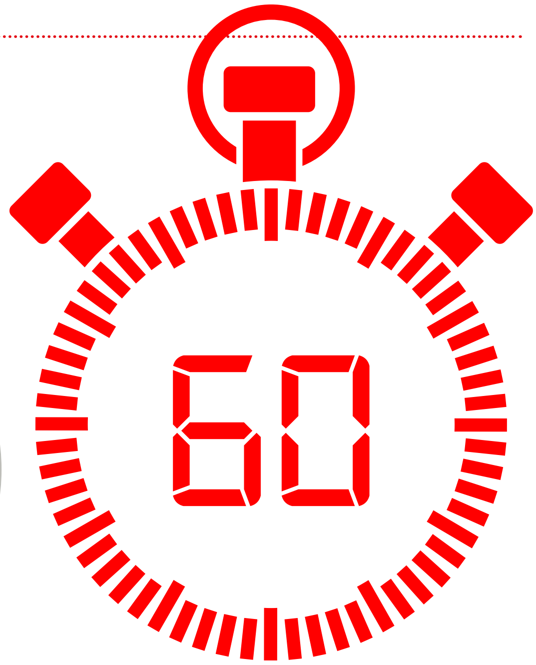
BARRISTER
GATEHOUSE CHAMBERS



Q What do you like most about your job?

A The people you meet and deal with. Lay clients, solicitors, colleagues, opponents and judges.

Q What would you be doing if you weren't in this profession?

A I would have loved to be a professional cricketer but was nowhere near good enough sadly.

Q What's the strangest, most exciting thing you have done in your career?

A A couple of trips to the Privy Council on matters of constitutional law in Trinidad and Tobago. Quite far removed from my usual diet but fascinating and exciting.

Q What is one of your greatest work-related achievements?

A When I see the calibre of applicants today, I think getting pupillage at all was a huge achievement.

Q If you could give one piece of advice to aspiring lawyers, what would it be?

A Advice which was given to me by my colleague Sarah McCann – never lose sleep wishing the facts of your cases were better/different.

Q What do you see as the most significant trend in your practice in a year's time?

A A surge in corporate insolvencies seems inevitable given the economic news. Likely to bring an increase in civil fraud and asset recovery claims as well.

Q What personality trait do you most attribute to your success?

A I'm fairly calm and not easily flustered. It helps during the busy spells and when cases take an unexpected turn.

Q Who has been your biggest role model in the industry?

A No one individual and too many to name but I've been very lucky to be surrounded by senior barristers who have set fantastic examples and given me endless guidance throughout my practice.

Q What is something you think everyone should do at least once in their lives?

A Rescue a dog. They give so much back even if their behaviour is terrible.

Q You've been granted a one-way ticket to another country of your choice. Where are you going?

A My wife is South African and we might retire there. Might be a bit early to accept the ticket though.

Q What is a book you think everyone should read and why?

A The Dishoom cookbook. The recipes all take an absurd amount of time but it's incredibly addictive.

Q If you had to sing karaoke right now, which song would you pick?

A I would never inflict this on anyone. I think if I started singing Sweet Caroline enough people would join in to drown me out though.

A GUIDE TO CYPRUS EXAMINERSHIP REGIME

Authored by: Antonia Argyrou - N. Pirilides & Associates

Introduction

Since 2013, new mechanisms for the protection of businesses facing financial difficulties by the appointment of an examiner have been introduced in Cyprus by the amendment of the Cyprus Company Law, Cap.113.

Who can apply for the appointment of an examiner?

A petition for the appointment of an examiner under Cyprus Company Law, Cap.113, may be filed by the company in question, a creditor of the company, member(s) of the company holding more than 10% of the share capital of the company, or a guarantor of the company.

Under which circumstances will the Court decide for the appointment of an examiner?

The Court may proceed to the appointment of an examiner for the purpose of examining the state of the company's affairs and performing such functions in relation to the company as may be conferred by Cyprus Company Law, only if satisfied that there is a reasonable prospect of survival of both the company and the whole or any part of the company's undertaking as going concern and such appointment may be extended to any related (subsidiary or holding) company of the company in question.

Period of Protection

Upon the appointment of an examiner by the Court, the company is under protection from its creditors for a period of 4 months from the date of filing of the petition requesting the appointment of an examiner.

During the aforesaid period of protection:

- No winding-up proceedings may be commenced against the company, nor any resolution for the winding-up of the company may be passed.
- No receiver may be appointed over any part of the property or undertaking of the company.
- No attachment, sequestration, distress or execution shall be put into force against the property or effects of the company, except with the consent of the examiner.

- Where any claim against the company is secured by a charge on the whole or any part of the property, effects or income of the company, no action may be taken to realise the whole or any part of such security, except with the consent of the examiner.
- No steps may be taken to repossess goods in the company's possession under any hire-purchase agreement, except with the consent of the examiner.
- Where, under the provisions of any legislation, regulation or otherwise, any person other than the company is liable to pay all or any part of the debts of the company, (i) no attachment, sequestration, distress or execution shall be put into force against the property or effects of such person in respect of the debts of the company, (ii) no proceedings of any sort may be commenced against such person in respect of the debts of the company, and (iii) where any claim against any such person is secured by mortgage, encumbrance or otherwise, which affects all or part of the property of the company, no action may be taken for the realisation of the whole or any part of such security, except with the consent of the examiner.

Proposals for a Compromise or Scheme of Arrangement

One of the main functions of an examiner is to formulate proposals for a compromise or scheme of arrangement regarding the restructuring of the debt obligations of the company in question, as soon as practicable after he or she is appointed; such proposals or scheme are presented to the members and creditors of the company in question in a series of meetings.

Proposals shall be deemed to have been accepted by a meeting of creditors or of a class of creditors when a majority in number representing a majority in value of the claims represented at that meeting have voted, either in person or by proxy, in favour of the resolution for the proposals.

Upon the acceptance of such proposals or scheme, the examiner files a report with the Court, including the aforesaid proposals or scheme, in order for the Court to confirm the latter.

Confirmation of the Proposals or Scheme

The Court shall not confirm any proposals unless at least one class of creditors whose interests or claims would be impaired by the implementation of the proposals has accepted the proposals, and the court is satisfied that the proposals are fair and equitable in relation to any class of members or creditors that has not accepted the proposals and whose interests or claims would be impaired by the implementation, and the proposals are not unfairly prejudicial to the interests of any interested party.

During the Court hearing in relation to the confirmation, or not, of the proposals, a member or creditor whose interest or claim would be impaired by the proposals may object to their confirmation on any of the following grounds:

- that there was some material irregularity at or in relation to a meeting that was called for the examination of the proposals for compromise or scheme of arrangement;
- that acceptance of the proposals by the meeting was obtained by improper means;
- that the proposals were put forward for an improper purpose;
- that the proposals unfairly prejudice the interests of the one who objects.

If the Court refuses to confirm the proposals, or there has not been possible to reach any agreement on a compromise or scheme of arrangement, following the aforesaid meetings of creditors, the Court may, if it considers it just and equitable to do so, to issue an order for the winding up of the company.

Conclusion

In light of the extraordinary pressure that has been put on many previously healthy companies due to the pandemic, the process of examinership may be proved to be a saviour for such companies, able to provide breathing space for the company to operate without pressure from its creditors whereas the control of the business will be retained by its management.

THE BOUNCE BACK LOANS SCHEME
WHAT IS BEING DONE TO RECOVER FUNDS MISAPPROPRIATED BY FRAUDSTERS?

Authored by: Barry Coffey and Elena Georgiou - Mishcon de Reya

Summary

The National Audit Office (NAO) has estimated that, of the £47 billion lent under Her Majesty's Government's (HMG's) Bounce Back Loan Scheme (BBLS), approximately £4.7 billion was obtained fraudulently.

HMG is now taking steps to prosecute wrongdoers. However, what is being done to recover funds misappropriated by fraudsters?

What was the Bounce Back Loan Scheme (the BBLS)?

The BBLS was designed to enable small and medium sized businesses to access finance quickly during the COVID-19 pandemic. In particular, it was designed to direct financial support to businesses that were losing revenue, and seeing their cashflow disrupted, as a result of the COVID-19 outbreak.

How was it administered?

The BBLS was administered as follows: (i) during 2020 and 2021, high street banks entered into approximately 1.5 million loans for sums up to £50,000 with SMEs around the UK; (ii) the BBLS was overseen by the British Business Bank (BBB); and (iii) all loans made were underwritten by the HMG[1].

Was the BBLS highjacked by fraudsters?

In its latest update report[2], the NAO has identified that:

- **£47 billion was advanced.**
- **£17 billion (37%) of loans are expected to not be recovered from borrowers.**
- **£4.9 billion (11%) of loans appear to have been obtained fraudulently.**
- **£32 million has been made available for counter fraud operations.**

1 https://www.british-business-bank.co.uk/ourpartners/coronavirus-business-interruption-loan-schemes/bounce-back-loans/
2 https://www.nao.org.uk/wp-content/uploads/2021/12/The-Bounce-Back-Loan-Scheme-an-update-Summary.pdf

How did HMG end up in this position?

When the BBLS was launched in 2020, HMG made a policy decision to prioritise speed of payments to borrowers in order to ensure push money out into the wider economy. In order to achieve this policy goal, high street lenders were told to dispense with standard due diligence, applicant companies were required only to "self-certify" their financial position and the terms of the loans expressly stated that the borrower company (not the directors) would be liable upon any default of repayment.

It has now become apparent that entrepreneurial fraudsters exploited the scheme in some of the following ways:

- Making applications in their role as director on behalf of companies and then dissipating sums out of the company (and in many instances then applying to Companies House to have the borrower company voluntarily struck off the register).
- Making multiple applications to different high street banks on behalf of the same company and then dissipating sums into personal bank accounts.
- Incorporating new companies, applying for, and obtaining a loan, and immediately dissipating funds out of the company.

Is the State taking steps to prosecute fraudsters?

HMG has appointed The National Investigation Service ("NATIS") to investigate fraudulent activity relating to the BBLS. By August 2022, NATIS had identified 559 individuals suspected of defrauding the BBLS[3].

The Insolvency Service, meanwhile, has been making use of new powers under The Rating (Coronavirus) and Directors Disqualification (Dissolved Companies) Act 2021[4].

The Zagroba Case[5]

Mr Zagroba was the director of a limited company in Manchester in the business of making and delivering pizza. Mr Zagroba (on behalf of his company) applied for a bounce back loan of £20,000 two weeks after applying to voluntarily dissolve the company.

The terms of the Bounce Back Loan clearly stated that borrowed funds could only be used for business purposes and not personal use. However, Zagroba admitted that the funds were not used to support his company. Instead, he used the money to purchase a car for personal use and gift money to friends and family.

Mr Zagroba pleaded guilty to the charges brought against him under s1007 of the Companies Act 2006 and s2 of the Fraud Act 2006 and has been jailed for two years and disqualified from acting as a director for seven years.

What about asset recovery?

According to the NAO's report, suspect loans are being grouped as follows:

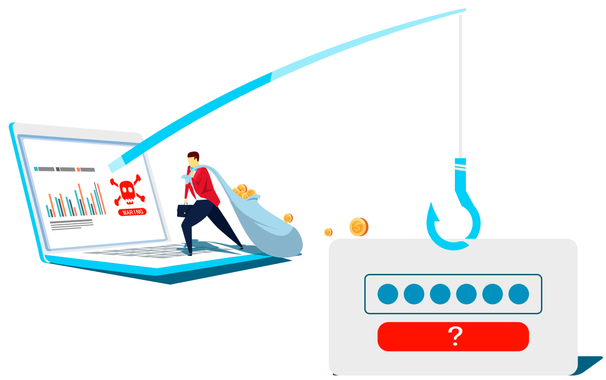
- Top-tier loans involving organised crime groups (OCGs) with sums of more than £100,000;
- Mid-tier loans where there is evidence that borrowers acted dishonestly but not on a large scale;
- Bottom-tier loans where individuals might have dishonestly received loans.

The job of recovering assets into HMG has to date sat on the shoulders of NATIS (however, as noted above it only has a limited budget and has been tasked with recovering just £6million over the next three years). The burden of recovering assets into HMG could soon be shared with the Insolvency Service, if it is empowered to pursue more prosecutions, like that pursued against Mr Zagroba and use its powers to make applications for compensation orders. It is currently not clear whether the Insolvency Service intends to make an application for a compensation order against Mr Zagroba.

However, the apparent scale of fraudulent activity is stark against the relatively limited resources available to the public sector and the expertise of the UK's asset recovery eco-system (forensic accountants, data analytics teams, insolvency practitioners and, dare we say, civil fraud lawyers). There must surely be a greater role that the private sector and the civil courts can play in recovering assets into HMG.

The losses arising out of a fraudulent loan application made by one company might not justify the use of the private sector. However, the role of OCGs has already been identified by the NAO's recent report. It seems likely that OCGs used mules to act as directors of companies that made fraudulent loan applications and then misappropriated sums from those companies (at the expense of the creditors of those companies – i.e. – the taxpayer). An obvious alternative route may therefore be for the relevant high street banks that administered loans to pool their intelligence and then take steps to wind up target companies and then appoint an insolvency practitioner who can engage asset recovery lawyers to pursue wrongdoers in the civil courts in England and Wales (and elsewhere).

If HMG is serious about prosecuting fraudsters and recovering assets, then perhaps we should allow state agencies to focus on protecting the public – by sending fraudsters to prison – and let the asset recovery specialists in the private sector do what they do best – recover assets.



3 https://www.bbc.co.uk/news/business-62338308

4 The Act has given the Insolvency Service new powers to prosecute directors who deliberately dissolve companies for the purposes of avoiding the payment of liabilities. These powers can be used retrospectively and up to three years after the dissolution of the company. Under the Act, the Insolvency Service can apply for disqualification orders against such directors of up to 15 years and/or for an order that the director is personally liable to compensate the company's creditors who have suffered losses due to their behaviour.

5 https://www.gov.uk/government/news/bounce-back-loan-fraudster-jailed

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