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FIRE MAGAZINE

Fraud • Insolvency • Recovery • Enforcement

ISSUE 14

FIRE CONTENTIOUS INSOLVENCY EDITION 2023

FUELING YOUR POST SUMMER SPARK

INTRODUCTION

"No one needs to light a fire under you when there's a fire in you."

Richie Norton

We are well and truly back from the summer break, so with that we are delighted to present Issue 14 of FIRE Magazine, our 'Contentious Insolvency' edition for 2023. Alongside a series of 60 seconds with interviews with some of our community partners, we hear from a number of authors discussing what is going on in their jurisdiction, from the UK to Singapore, BVI, Hong Kong, Switzerland and more. Our contributors provide a number of relevant updates including recent cases such as *Stephen Hunt v Jagtar Singh* and *Re Lam Kwok Hung Guy,* and other topics discussing crypto, litigation funding agreements, enforcement and more. This issue also features the winning essay for the International Law Book Facility (ILBF) essay competition, with a foreword from our community partner, and trustee of the ILBF, Jane Colston of Brown Rudnick.

Thank you to our community partners, contributors and members for their support, we look forward to staying in touch as we delve into a busy Q4 for all FIRE practitioners.

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CONTENTS

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FIRE®

Upcoming Events

International Arbitration and Enforcement: A Changing Landscape

4th October 2023 | Doubletree Tower of London, London

FIRE, Disputes & Investigations: Central Asia

5th October 2023 | Mandarin Oriental Bosphorus, Istanbul

FIRE Middle East

12th -14th November 2023 | Shangri-La Hotel, Dubai

KC Surgery: Asset Recovery

28th November 2023 | Radisson Blu Edwardian Bloomsbury Street Hotel, London

India Disputes Mumbai

1st - 2nd December 2023 | Sofitel Mumbai BKC, Mumbai

FIRE Starters Global Summit: Dublin

21st – 23rd February 2024 | Conrad Hotel, Dublin

FIRE International: Vilamoura

15th – 17th May 2024 | Anantara Hotel, Vilamoura

FIRE Americas: Cayman

5th - 7th June 2024 | The Westin, Grand Cayman

To register for the events and speaking opportunities contact:

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CRS CharlesRussell Speechlys

ThoughtLeaders FIRE

FIRE Starters Global Summit 2023: Dublin

22 - 24 February 2023, Conrad Hotel, Dublin Ireland

A Recap By: Abigail Rushton, Lucy Wicksteed, Joseph Evans, Hannah Edwards – Charles Russell Speechlys

The ThoughtLeaders4 FIRE Starters Global Summit in Dublin is a fantastic opportunity to connect with professionals with a similar level of experience across the fraud, insolvency and asset recovery space.

Key takeaways from the event

The Charles Russell Speechlys team found there to be lots of opportunity to meet and have interesting conversations with other delegates, and there was always plenty of cross over in terms of the work we were doing. It was pitched very well, with plenty of insights to take away!

A particular highlight this year was the collaboration between TL4 FIRE Starters and the Female Fraud Forum in hosting a post-conference dinner drinks event. Several of our colleagues at Charles Russell Speechlys are members and committee members of the Female Fraud Forum and likewise several of our colleagues are contributors to TL4 FIRE Starters events and literature.So, it was great to have these two networks come together.

Standout panel: Quincecare: Where are we where banks are concerned?

The Quincecare duty has been back in the spotlight in recent years with a key case where the scope of the banks' duties has been considered reaching the Supreme Court. Whether as a practitioner you are involved in acting for the banks or for claimants, it is an evolving area which will be of interest to FIRE practitioners. So, it was only right to find a lively discussion about the Quincecare duty on the agenda.

FRA

ThoughtLeaders FIRE

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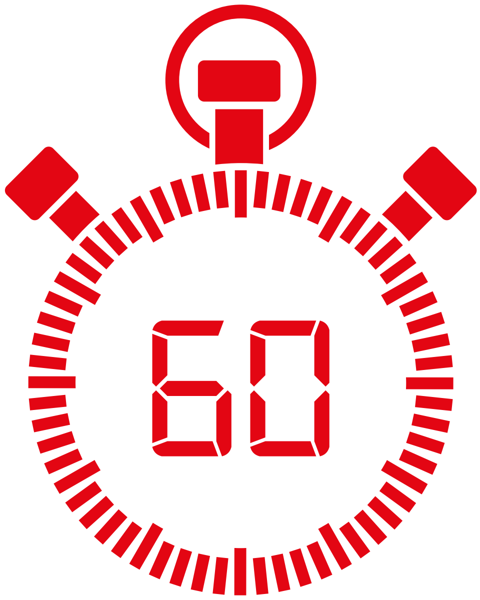
60-SECONDS WITH:



MEREDITH M. FITZPATRICK
DIRECTOR OF CRYPTOCURRENCY, INVESTIGATIONS AND COMPLIANCE
FORENSIC RISK ALLIANCE

Q Imagine you no longer have to work. How would you spend your weekdays?

A Exploring every playground in the area with my two sons! I also love running and my favorite way to explore a new city is by going on a long run. I'd travel and go on a long run in every city on my bucket list (probably followed by an equal amount of time checking out the local ice cream shops).

Q What do you see as the most important thing about your job?

A Clear communication. The crypto industry is sometimes filled with FUD and hype, which can drown out investigative facts and the potential of the technology. Whether it's a matter involving something technically sophisticated like Decentralized Finance (DeFi) or something more familiar such as bitcoin, if I am an effective communicator of the situation at hand I allow our clients to move forward from a position of strength.

Q What motivates you most about your work?

A Helping our clients harness the power of blockchain analytics to solve their investigative and compliance issues. With the open ledger of the blockchain, there's a powerful amount of information an investigator can learn about the source and destination of funds, and even more so when combined with open-source intelligence and unstructured data sets.

Q What is one work related goal you would like to achieve in the next five years?

A Conduct a major investigation in every continent. From my experiences as an FBI Special Agent and at FRA, the approach to crypto varies across the globe, often rooted in cultural differences and varying sensitivities to organized crime and corruption. This is often an overlooked but crucial perspective to have when conducting any crypto investigation. I hope to one day have supported our clients across each continent, and as a result experienced all the nuances associated with conducting an investigation in-country.

Q What has been the best piece of advice you have been given in your career?

A Fail in order to succeed. I am a perfectionist and early on in my career I struggled with not putting pen to paper until I thought something was perfectly organized in my head. An old Mathematics professor from College, Dr. Edward Burger, wrote a wonderful book with Michael Starbird called The 5 Elements of Effective Thinking. In the section on failure, they talk about treating every failed attempt or rough draft as forward progress towards becoming less wrong. I've come back to this book many times throughout my career - highly recommend!

Q What is the most significant trend in your practice today?

A Concerns over compliance in an uncertain regulatory environment. There's two different ways I'm seeing this come up with our clients. Crypto has been adopted all over the globe but there's a wide range of regulatory requirements across jurisdictions, especially in the US and Europe. Many companies are trying to do the right thing but struggling with how. There's also a heightened sensitivity to sanctions exposure as the prolificity of Russian and North Korean cybercrime continues.

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

A Laura Shin. I dove into her podcast, Unchained, when I first started investigating crypto matters in 2017. She does a phenomenal job of making the cryptocurrency space accessible and asks tough but fair questions to cut through sensationalism. I can't count how many times I've recommended her work to people dipping their toes into the space.

Q What is one important skill that you think everyone should have?

A How to evaluate sources of information. In the context of investigations, it's critical to consider veracity of the facts you're basing an opinion or assumption on, and how biases may affect someone's opinion, especially your own. The film "12 Angry Men" should be mandatory viewing for anyone working in the investigations space.

Q What cause are you passionate about?

A Mentoring and paying it forward to the next generation. Throughout my time as a Software Engineer, FBI Special Agent, and now as a Director at FRA, I have been extremely fortunate to have mentors who pass on their lessons learned to me and act as a sounding board whenever I encounter a challenge my career. I think everyone has a duty to help foster the next generation of practitioners. No one gets anywhere without support.

Q Where has been your favourite holiday destination and why?

A Salzburg, Austria. I went there on my honeymoon – it's an amazing combination of natural splendor and history. One day we started out with a bike ride with a view of the mountains, then walked around a fortress that dated back to the 1100s, went to a brewery in a monastery, and ended at a restaurant that's rumored to be the oldest operating restaurant in the world. Perfect day if you ask me!

Q Dead or alive, which famous person would you most like to have dinner with, and why?

A Alan Turing. I think it would be fascinating to hear what it was like working on an incredibly secretive and complex project during the height of WW2 when the stakes could not have been higher. He changed the world and fought through so much adversity while doing it.

The Singapore Court's Treatment of Foreign Solvent Liquidations

Under the UNCITRAL Model Law on Cross-Border Insolvency

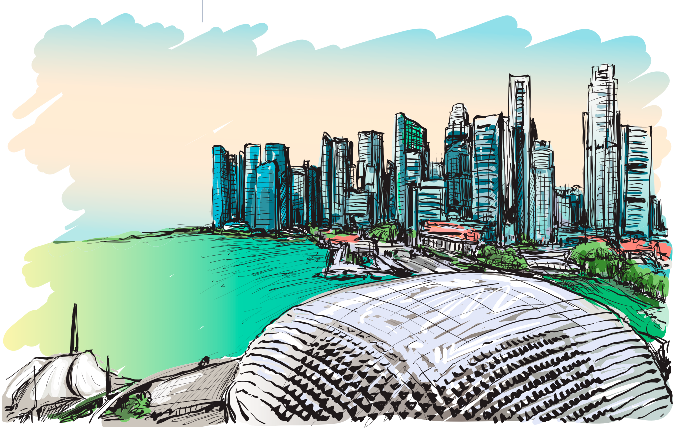
Authored by: Bethel Chan (Associate Director) and Lee Jin Loong (Associate) – Setia Law

Introduction

Whether foreign solvent liquidations are entitled to recognition and assistance under the UNCITRAL Model Law on Cross-border Insolvency is a question which has divided its enacting jurisdictions. The Singapore Court recently weighed in on this issue in Re Ascentra Holdings, Inc [2023] SGHC 82 ("Re Ascentra").

The Decision

Ascentra Holdings, Inc ("Ascentra") sold health and beauty products as well as computer communications software. Following disputes between its shareholders, the Company was placed in voluntary liquidation under the Cayman Islands Companies Act (2021 Revision) (the "Cayman Act"). Importantly, Ascentra was solvent. The Liquidators applied to the Singapore Court for recognition of the Cayman liquidation in Singapore as a "foreign main proceeding" under Article 2(f) of the Third Schedule to the Insolvency, Restructuring and Dissolution Act 2018. The Third Schedule is Singapore's enactment of the Model Law.



The Judge dismissed the application, holding as follows:

- Only a "foreign proceeding" within the meaning of Article 2(h) of the Third Schedule could be recognised under Article 17 of the Third Schedule. The Article 2(h) definition required that the foreign proceeding be "under a law relating to insolvency".
- The ordinary meaning of "a law relating to insolvency" was a body of rules which governs a company that is insolvent or in severe financial distress. It did not suffice that the body of rules under which the foreign proceeding was taking place happened to be located in a statute that also governed insolvency. So, it did not suffice that Ascentra's solvent liquidation was under the Cayman Act, which governed the liquidation of all Cayman companies both solvent and insolvent.
- The purpose of the Model Law was to enable national courts to put in place a global collective regime for the benefit of creditors as a class, to avoid creditors scrambling to seize the debtor's assets. These purposes were not engaged in the liquidation of a company which was solvent and whose assets were sufficient to pay all creditors in full. This understanding was confirmed by the preparatory records and documents of the Model Law, as well as the guides to enactment provided by UNCITRAL.

It is worth noting that the definition of "foreign proceeding" in Article 2(h) of Singapore's Third Schedule is different from the parallel Article 2(a) of the Model Law. Whereas the latter defines foreign proceeding as a proceeding "…pursuant to a law relating to insolvency…", Article 2(h) of the Third Schedule defines foreign proceeding as a proceeding "…pursuant to a law relating to insolvency or adjustment of debt…". As the Judge observed, the additional words "adjustment of debt" are taken from Section 101(23) of Chapter 15 of the US Bankruptcy Code.

However, the Judge rejected the suggestion that he should give any special weight to decisions of the US Bankruptcy Court in which recognition and assistance had been granted in support of foreign solvent liquidations on the basis that these were "foreign proceedings" within Chapter 15. Noting that these US decisions had been criticized, the Judge preferred the view of the English Court in Re Sturgeon Central Asia Balanced Fund (in liquidation) Carter v Bailey and another (as foreign representatives of Sturgeon Central Asia Balanced Fund Ltd) [2020] EWHC 123 (Ch) that it was contrary to the Model Law's purpose and object to enlarge its scope by interpreting "foreign proceeding" as including solvent companies and proceedings.

The decision in Re Ascentra is presently under appeal.

Potential Impact on Recognition of Foreign Solvent Liquidations Under the Common Law

While Re Ascentra was concerned with an application for recognition under the Model Law, the decision may

have implications for the recognition of foreign solvent liquidations under the common law. The decision suggests that modified universalism, the principle which the Model Law was conceived to advance, and which has also formed the basis of several Singapore decisions recognising foreign corporate insolvency and rehabilitation proceedings under the common law, is exclusively applicable to insolvency and financial distress situations.

It is in that unique context that global co-ordination and inter-jurisdictional co-operation are required to facilitate the fair and efficient administration of cross-border insolvencies or reorganisations, so as to preserve and maximise value for the general body of creditors and avoid a disorderly scramble for the debtor's assets across jurisdictions. It would appear that an application for recognition of a foreign solvent liquidation under the common law may be denied on broadly the same ground cited in Re Ascentra - that modified universalism is not engaged when the debtor is neither insolvent nor in financial distress.

Nevertheless, foreign officeholders may have other options, apart from applying for recognition, to be clothed with the requisite power and authority to take the necessary steps to investigate into the affairs of and/or take control of all assets and property of the distressed company. For instance, in the recent decision of Seahawk China Dynamic Fund [2022] HKFCI 1994 ("Seahawk"), while the Hong Kong Court found that the common law power to recognise and assist foreign officeholders does not extend to solvent liquidations, the court nonetheless granted declaratory relief confirming that the liquidators appointed by the Cayman Court over a solvent entity had powers to take control of assets in Hong Kong.

This was based on private international law principles applicable to corporations. So, too, in Re Ascentra, while recognition under the Model Law had been refused, the Judge observed that Singapore law recognises the Liquidators' power to cause Ascentra to take steps in Singapore, including gathering the evidence needed to frame causes of action, to identify defendants and to assess prospects of success in litigation.

Depending on the type of relief that is sought by foreign officeholders of foreign solvent liquidations in Singapore, an all-inclusive recognition application may no longer be the most appropriate means to further efforts in investigations or asset recovery. Instead, there may be an increase in practitioners applying for declaratory relief recognising their powers to take certain steps, as was the case in Seahawk, or employing other evidence gathering mechanisms such as third-party or non-party discovery.

THE RELEVANCE OF LOSS IN PREFERENCE TYPE MISFEASANCE CLAIMS – REVISITED

Authored by: James Morgan KC (Barrister) – Radcliffe Chambers

Introduction

An insolvent company (A) has assets of £1,000 in cash and creditors of £10,000. One of the creditors is a connected company (B) and is owed £1,000. In disregard of the interests of the unconnected creditors, the director (C) unlawfully causes A to pay B the cash of £1,000, thereby preventing a pari passu distribution. A goes into insolvent liquidation. Can the liquidator of A bring a misfeasance claim against C for recovery of the £1,000? Or can C defend the claim on the basis that A has suffered no loss?

In 'The relevance of loss in preference type misfeasance claims' (2014) CRI 7(3), 123-124, the writer considered GHLM Trading Ltd v Maroo [2012] EWHC 61 (Ch), Re HLC Environmental Projects Ltd [2013] EWHC 2876 (Ch) and Madoff Securities Int. v Raven [2013] EWHC 3147 (Comm), and reached the conclusion, at least in relation to an insolvent company and with the caveat that it must be restoration (not augmentation):

"In light of HLC and Madoff it is suggested that in GHLM, Newey J was incorrect to say that in a preference type misfeasance claim it is necessary to prove that the company has suffered loss by reference to its balance sheet. Whether or not the claim is brought under s. 212, the obligation on the director as quasi trustee is to restore the company's fund to what it should have been. The fact that the payment of an existing debt is balance sheet neutral is not relevant: the fund held by the company has been depleted and must be restored" (the "2014 conclusion").

Nearly 10 years on, it is timely to consider whether the 2014 conclusion remains sound. Considerations of space preclude discussion of alternative relief in the form of disgorgement of profits or avoidance of the transaction in question.

Restoration, compensation and AIB

Directors are treated as being in an equivalent position to trustees. The basic rule is that a trustee in breach of trust must restore or pay to the trust estate either the assets which have been lost to the estate by reason of the breach or compensation for such loss: Target Holdings Ltd v Redferns [1996] 1 AC 421, per Lord Browne-Wilkinson at 434C-D. Such a "substitutive" claim may be distinguished from a "reparative" claim to make good damage caused by a breach of trust.

This area was the subject of controversial attention by the Supreme Court in AIB Group (UK) plc v Mark Redler & Co Solicitors [2015] AC 1503 in which AIB's claim for restoration of funds paid away in breach of trust was limited to the (much lower) loss in fact suffered. Lord Toulson held (see at [36] and [66]) that the object of an equitable monetary remedy for breach of trust, whether it be classified as substitutive or reparative, is to make good a loss in fact suffered by the beneficiaries and which, using hindsight and common sense, can be seen to have been caused by the breach. Lord Reed concurred holding at [134] that:

"...the model of equitable compensation, where trust property has been misapplied, is to require the trustee to restore the trust fund to the position it would have been in if the trustee had performed his obligation."

The "compensatory focus" of AIB led some commentators (e.g. van Zwieten (2018) 38 OJLS 382, 403)) to doubt the validity of making any restorative order against directors for preference type claims by analogy with the accounting responsibility of a defaulting trustee in circumstances where the breach causes no loss to the company.

But, as is apparent from the quote from Lord Reed above, there is no suggestion in Target or AIB that the courts were departing from the rule that a trustee was required to restore the trust fund. As another commentator has pointed out (Worthington, [2020] CLJ 220-224), the rule was never invariably "to put back the value of what had been taken out": it was "to put back the value of what should have been there". That, like in Madoff - where the company had to give credit for a benefit received from the same transaction – was what the courts were doing.

Cases below the Supreme Court

Without making reference to AIB, Newey J (as he then was) returned to this issue in Northampton BC v Cardoza [2017] EWHC 504 (Ch) when he said at [32] that the authorities tend to suggest that:

"the remedies that should be granted where a director has acted in breach of duty by causing the company to prefer a particular creditor may be affected by, among other things, whether the company is in liquidation (as was the case in West Mercia and HLC, but not, much more unusually, GHLM), whether the preference consisted of the simple payment of a debt (again, West Mercia and HLC, but not GHLM), whether the creditor whose debt was to be discharged was the director himself (certain of the HLC payments)..."

Following trial in the same case, HHJ Simon Brown QC held ([2019] EWHC 26 (Ch)) at [188] that:

Returning to GHLM..., in the light of the above and to the observation that it may be impossible to show a loss where the balance sheet is unaffected, I do not understand Newey J to have meant that in all cases where the balance of assets net of liabilities remains unchanged by reversing a preference the company is unlikely to have suffered a loss. For example, the net assets figure may remain the same after restoration and a compensating adjustment to reinstate a liability to a director but the distribution of assets, notional or actual, to those entitled to receive them (creditors and contributories) may be very materially different... The remedy available to redress this 'loss' is restoration, which may be by compensation to restore the value of the assets to the trust estate."

It is suggested that both dicta provide support for the 2014 conclusion.

The effect of AIB on misfeasance claims generally was directly considered by the Court of Appeal in Auden McKenzie (Pharma Division) Ltd v Patel [2019] EWCA 2291 when allowing an appeal against an order for summary judgment awarding equitable compensation against a director. The relevant claim was for misappropriation of funds for no value. The defence was that, if the misappropriation had not occurred, the funds would have been lawfully transferred to the same persons for no value, so no loss had been incurred. This raised the issue of the relevance (if any) of counterfactual situations which the Court – perhaps somewhat reluctantly – concluded should be decided at trial following further argument.

Relevantly in the context of the present discussion, David Richards LJ (now Lord Richards) noted at [38] the importance of the decisions in Target Holdings and AIB, but said it was necessary to be clear as to the qualification established by those cases. After further analysis, he held at [49] that:

"While [those cases] establish that equitable compensation in respect of unauthorised payments is not invariably for a sum equal to the payments, the decisions in those cases provide no further direct assistance to Mr Patel's case. They are restricted to circumstances where the beneficiary obtained the full benefit for which it bargained or where, if the trustee had fully performed its obligations, the loss would have been less than the amount of the unauthorised payment made by the trustee. In each case, the reduced figure is the loss that flowed directly from the breach of trust."

Although Auden did not concern a preference type claim, it is apparent from the above (and the example given by the Judge at [53]) that he did not consider that Target Holdings and AIB precluded substitutive claims for misfeasance "measured by the amount misappropriated" in circumstances where hindsight and common sense showed the breach had caused the trust fund such a loss.

In Mitchell v Al Jabar [2023] EWHC 364 (Ch), Joanna Smith J confirmed at [561] that "The core message of the judgments in AIB...was that a trustee is required to restore the trust fund to the position it would have been in 'if the trustee had performed his obligations'" and at [563] that, on the facts before her, "...I can see no justification for a departure from the strict obligations of trustees and fiduciaries to restore the fund under their control, always assuming that the breach...can be seen with hindsight and common sense to have caused the loss".

In both cases the Judges were referring to a loss to the trust fund, not to loss and damage in a strict balance sheet sense, as would be the test in a purely reparative claim whether for breach of fiduciary duty, or in contract or tort.

Supreme Court Dicta

The facts and decision in BTI 2014 LLC v Sequana SA [2022] 3 WLR 709 are well known. But there has been limited focus on Lord Reed's discussion of s.239, IA 1986 and its relationship with misfeasance claims at [100]-[109]. As part of his reasoning on the existence of the West Mercia (or creditor) duty, he held at [109] that the existence of s.239 was not incompatible with it.

Although not directly arising for decision, Lord Reed also noted some of the issues that had arisen in the cases (including West Mercia itself, GHLM, Re HLC and Northampton BC) as regards the basis of relief in preference type misfeasance claims. At [104], he referred to the decision in West Mercia to order the director who had authorised a preference payment to a third party to repay the amount of the preference subject to inclusion of that debt in the amount of the company's liabilities with any dividend attributable to that debt being paid to the director (i.e. the West Mercia proviso). At [105] he said:

"My provisional view is that the court was correct in taking that approach to the question of relief. In order to obtain a pecuniary remedy, it was not necessary for the company to have suffered a loss in the conventional, balance sheet, sense. The funds available to the company to meet the claims of the general body of creditors were depleted as a result of the director's breach of his fiduciary duty. The court granted an equitable remedy, based on the restoration of the misapplied monies to the company so as to reconstitute its assets as they ought to have been. By doing so, and treating the debt as subsisting for the benefit of the director, the court achieved the equivalent, as nearly as possible, of the directors performance of his fiduciary duty to the company."

It is therefore clear that Lord Reed, who had himself given one of the two substantive judgments in AIB, did not regard that decision as any form of bar to substitutive relief arising from a preference type misfeasance claim by an insolvent company.

Shortly after Sequana, the Supreme Court handed down judgment in Stanford International Bank Ltd (in liquidation) v HSBC Bank Plc [2022] UKSC 34. The majority (Lord Sales dissenting) rejected SIB's tortious claim against HSBC for breach of the Quincecare duty on the basis that the £116m paid out as a result of breach, discharged debts owed to customers and hence there was no recoverable loss. It was not a claim for breach of fiduciary duty, but some obiter references were made to such claims and questions of remedy.

Lady Rose (with whom Lords Hodge and Kitchen agreed) distinguished the case before her with that in West Mercia. At [34] she accepted that:

"...there may well be situations, similar to West Mercia, where a director is properly regarded as

misfeasant and required to repay sums to the insolvent company even though those sums have been used to extinguish an existing liability...I do not accept that a decision that no recoverable loss is suffered by SIB in this case undermines the ability of the court of equity to identify a case of misfeasance and fashion an appropriate remedy, as the Court of Appeal did in West Mercia."

In his dissenting judgment at [122], Lord Sales described the approach in West Mercia as "sensible and justified" and said at [123] that the obligation of a fiduciary to make good the trust fund from which he has diverted money is to make good a loss "in the fund which has been created by the diversion of money from the proper use to which it should have been put".

Lord Leggatt took a different approach. After referring to West Mercia, Re HLC and AIB, he said at [75] that it was hard to see how, in the absence of loss to the company or gain to the director, a director who caused a preference type payment to be made "which does not meet the criteria for an unlawful preference" could properly be liable to repay the money. He suggested, without expressing any concluded view that:

"Requiring the director to repay the money in such a case would cut across the distribution of assets provided for by the insolvency regime. It would also impose on the director a liability for which he or she (despite not having personally received a benefit) would not even in principle be entitled to an indemnity from the person who received the money. That would not be just."

Although any dicta of a Justice of the Supreme Court merits careful attention, it is apparent that Lord Leggatt holds a minority (provisional) view amongst the Justices who have recently considered this point. Further:

- Lord Reed specifically rejected the argument that s.239 was incompatible with the creditor duty, a form of which was relied in West Mercia as giving rise to the preference type claim against the director.
- It is not at all clear why it would be unjust for a director to restore (subject to the West Mercia proviso) funds misapplied by a preference type payment to the detriment of other creditors, any more than it would be unjust for him or her to restore funds paid to a third party for no consideration.

- The legal existence of a claim under s.239 against the third party can surely not be determinative; if it is insolvent then the claim is of no practical relevance.

Conclusion

Whilst this area of law would benefit from detailed attention by the higher courts, it is suggested that the direction of travel remains firmly in favour of the 2014 conclusion.

In the example given above, if the director had performed his duty, the company would have retained the cash of £1,000 and the creditors would have received a pari passu distribution accordingly. The misappropriation of the £1,000 is properly to be regarded as "a loss to the trust fund which the trustee has brought about" (per Lord Toulson in AIB at [65]) and restoration is "likely to be the only way to put the beneficiaries [i.e. the creditors] in the same position as if the breach had not occurred" (ibid at [67]).

It is in accordance with principle and authority for the director to be required to restore the £1,000 to the estate, subject to the West Mercia proviso. Indeed, that should be the conclusion whether the recipient was the director himself, a connected third party or an unconnected third party, albeit the latter may raise more difficult questions on the facts as to breach of duty.

BRINGING ACTIONS AGAINST COURT-APPOINTED RECEIVERS: KEY CONSIDERATIONS

Authored by: Peter Ferrer (Partner) and Julia Iarmukhametova (Associate) - Harneys

Receivership, although not strictly considered a matter of insolvency law, commonly arises in the situation of financial distress, and in the BVI, it is primarily governed by Part IV of the Insolvency Act 2003 (the Act). Under the BVI law, a receiver can be appointed either as an equitable receiver, pursuant to an order of the court; or out of court, under a power arising under a security document.

This article explores some of the key considerations when bringing action against a court-appointed receiver, including the legal test for accessing receivers' conduct.

Court's permission

It is a well-established principle of BVI law that a receiver is considered an officer of the court, and, as a general rule, they are answerable to the court and not to the party who was instrumental in securing their appointment. [1]

In Kerr & Hunter [2], the authors note at 8-0 that "in appointing a receiver, the court appoints an officer of its own, to take possession of the property over which he or she is appointed". Accordingly, and as confirmed by case law, before pursuing legal action against a receiver in their official capacity, a party must first seek permission from the court that made the appointment.[3] In the circumstances where a party fails to obtain permission from the court to initiate legal action against the receiver, further prosecution of the case will be restrained. As stated above, the requirement for the court's permission is imposed by common law and failure to obtain permission is a tort and contempt of court.

Receivers' powers and duties

The scope of receivership is delineated by an order appointing the receiver and, therefore, can be crafted to various scenarios. The typical appointment order issued by the court will grant authority to the receiver to marshal and protect the assets of the estate and to engage in litigation in the discharge of his duties.

1 JT Trust Asia Pte ltd v Mitsuji Konoshita BVICMAP 2020/0022 (delivered 31 May 2021) per Blenman JA at [30]

2 Kerr & Hunter on Receivers and Administrators, 21st Ed.

3 Searle v Choat (1884) LR 25 Ch.D. 723

When exercising their powers, receivers are bound by specific duties outlined in the Act.

In particular, section 128 of the Insolvency Act provides that receivers must exercise them (i) in good faith and for a proper purpose and (b) in a manner that they believe to be in the best interests of the person for whom he was appointed.

To the extent consistent with that, receivers are also required to consider the interests of creditors, sureties and persons claiming through the company an interest in the assets over which he was appointed. Receivers must not conduct the receivership in a way which unfairly prejudices those persons or recklessly sacrifices their interests[4].

It should be noted that receivers can be held personally liable for any contracts they enter into for the performance of their functions[5].

Assessing Receivers' Conduct – Legal Test

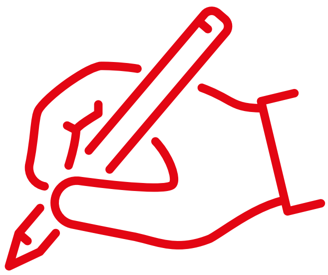
In accessing what test is to be applied if a receiver is sued, it is important to consider whether they acted in bad faith, as established, in particular, by the cases of Re Nortel Networks UK Ltd (Re Nortel)[6] and JTrust Asia PTE Ltd v Mitsuji Konoshita, A.P.F. Group Co Ltd, Showa Holdings Co Lts and others (the Showa case) [7].

In the Showa case, the appeal judge carefully analysed the application of the test laid out in Re Nortel as referred to by the first instance judge, citing his ex tempore judgment on this point:

"In essence it is that the Court must be concerned to ensure that: One, the proposed exercise is within the Receivers' power; Two, that the Receivers genuinely hold the view that what they propose to do will be for the benefit of the receivership and those who may benefit under it. And, thirdly, that the Receiver is acting rationally and without being affected by the conflict of interest in reaching that view.[8]"

The appeal judge also referenced the legal test for rationality, citing with approval the following quote from the judgment in Re Greenhaven Motors Limited (in liquidation) '… the court should not interfere in such a case unless the liquidator is acting mala fide or his decision is one which no reasonable liquidator could take'[9].

Importantly, the appeal judge agreed with the approach taken in the case of Re Hans Place, which requires demonstrating bad faith on the part of the receiver: "[t]he court would only interfere with the exercise of the liquidators' discretion where he acted in bad faith or his decision was perverse and since there were no allegations of this nature the court would not interfere"[10].



Remedies

Section 132 of the Act outlines available remedies that can be sought by, in particular, the person by whom or on whose behalf the receiver was appointed and individuals whose interests are being represented by the receiver. The Court has the authority, in relation to any issue pertaining to the receiver's duties, to issue one or more of the following orders:

- (a) An order giving appropriate directions as deemed suitable by the Court;
- (b) An order that declares the rights of the parties involved; and
- (c) Any other order that the Court deems just and equitable in the given circumstances.

Conclusion

In conclusion, when assessing the conduct of a court-appointed receiver, it is important to consider the test established in Re Nortel and evaluate whether there is evidence of the receiver acting in bad faith, which is a very high threshold to meet. It is important to note that failure to seek the court's permission prior to initiating actions against receivers is a tort and contempt of court.

4 Meretz Investments NV v ACP ltd [2006] EWHC 74 (Ch)
5 Section 130 (1) (a) of the Insolvency Act 2003
6 [2016] EWHC 2769 (Ch)
7 [BVIHCMAP 2020/0031]
8 [BVIHCMAP 2020/0031], [71]
9 [1999] BCC 463
10 [BVIHCMAP 2020/0031], [73]

"THE VULTURES ARE CIRCLING!"

COUNTERING THE DAMAGING PUBLICITY CREATED BY A WINDING-UP PETITION

Authored by Rabin Kok (Barrister) - South Square

And the vultures all start circling
They're whispering, you're out of time…
When you think the final nail is in, think again
Don't be surprised, I will still rise

Katy Perry, Rise (Power Hits 2016)

It is said that winding-up petitions are not meant to be used a debt collection device. The reality is that they often are. A creditor who is owed a debt above £750 will often issue a statutory demand and petition immediately, instead of first seeking a judgment upon the debt.

A winding up petition which becomes public can wreak havoc long before any winding-up order has been made. It is well known that most banks will freeze a company's bank accounts when a petition is advertised in the Gazette. However, a determined creditor can use the existence of the petition to exert enormous pressure in other ways. Such a creditor might, for example, attach copies of the petition or screenshots of the electronic court record (CE-file) to an email and send that email to a company's known trade suppliers. Other creditors might start seeking documents about the petition from the court file.

This short article discusses these issues. It suggests some ways in which solvent companies can protect themselves against the negative publicity that will inevitably result from an ill-advised petition.

Injunctions against presentation and advertisement

Before any petition is presented, a well-advised creditor will normally write to the debtor company and ask for payment. If negotiations break down, it is common to give the company informal notice (usually 5 to 7 days) that a petition will be presented at the end of that period.

When a company receives such notice, if the company has good grounds to do so it should immediately apply to the High Court for an injunction restraining presentation of a winding-up petition

The High Court will normally restrain the presentation of a winding-up petition if (i) the debt is disputed on genuine and substantial grounds, (ii) if there is a genuine and substantial cross-claim, or (iii) if the petition is otherwise an abuse of process.

A cross-claim that is used to resist a winding-up petition need not be one that could be raised as a set-off against the debt in Part 7/writ proceedings.

If a petition has been presented, the Company should immediately apply to restrain advertisement of the petition (nowadays called the 'giving of notice' of the petition in the Gazette). Rule 7.10(4)(b) of the Insolvency (England & Wales) Rules 2016 ("2016 Rules") provides that the petition should only be advertised 7 days after presentation. The purpose of this delay is to give the Company time to apply to restrain advertisement. The grounds on which a company can restrain advertisement are nearly identical to the grounds for restraint of presentation.

A hearing to restrain advertisement is invariably heard in private, to prevent third parties coming to know of a petition that may turn out to have no merit. The hearing will be displayed on the public-facing screens in the Court as "Re a company", therefore anonymising the Company's name. All court orders relating to the hearing should also have the name of the debtor company replaced with "a company".

At the first hearing of an application to restrain advertisement, the Court will normally grant an interim injunction against advertisement of the petition until such the final hearing of the application. Often, the petitioner will undertake by its solicitors not to present a petition until the final hearing of the restraint application. If it does so, the Court will accept the undertaking instead of ordering an injunction.

Publicity other than notice in the Gazette

A determined petitioner may yet seek to use the existence of a petition to exert the maximum pressure possible. For example, (i) a petitioner may – before the end of the seven days between presentation and advertisement prescribed by the 2016 Rules – immediately write to a company's other known creditors to inform them of the petition. In addition, (ii) there is usually a delay of several months between the grant of an interim order restraining advertisement, and the final hearing of a restraint application. Can a petitioner refrain from placing notice (therefore obeying the interim order) but tell the world about the petition against his debtor on social media?

The Courts have come to the aid of the company in both scenarios:

- Premature advertisement. Telling others about the petition during the seven-day period is likely to be a serious abuse of process. In several cases decided under the Insolvency Rules 1986, the petitioner sent copies of the petition to banks and suppliers before the end of the seven day period, resulting in the Company's accounts being frozen. Those petitions were struck out as abusive in at least two such cases (Re Signland Ltd [1982] 2 All ER 609 and Ex parte Rousell [1992] BCLC 562). Also of note is a similar decision relating to a winding-up petition by a contributory (Re Doreen Boards Ltd [1996] 1 BCLC 501).

- In It was held that the purpose of the seven-day period was to enable the company to consider its position generally and apply to restrain advertisement, and 'advertising' the petition before the end of the period was abusive. The 2016 rules provide for the 'giving of notice' in the Gazette rather than 'advertisement', but there is a strong argument that the principles in these cases continue to apply.

- Alternative forms of publicity. The court will also restrain the publicization of petitions by alternative means when an interim order (or undertaking) against the giving of notice of the petition is in force. This is so even after the seven-day period between presentation and advertisement has passed. In Re a company [1986] BCLC 127, an interim injunction restraining advertisement had been granted Hoffman J (later Lord Hoffman) held that the Court had jurisdiction to grant a further injunction restraining the publicization of petitions by alternative means. To do otherwise would undermine the purpose of the injunction against advertisement.

CE-file, the Court file and the Court record

Even after an injunction restraining advertisement is granted, and even if the Court makes orders sealing its file, it may still be possible to infer that a winding-up petition exists from the Court's record or register. The public can inspect the High Court's register of cases through the system known as CE-file. A CE-file entry in respect of a winding-up petition will state "Winding Up Petition" at the top of the entry, followed by the company's name – rather giving the game away.

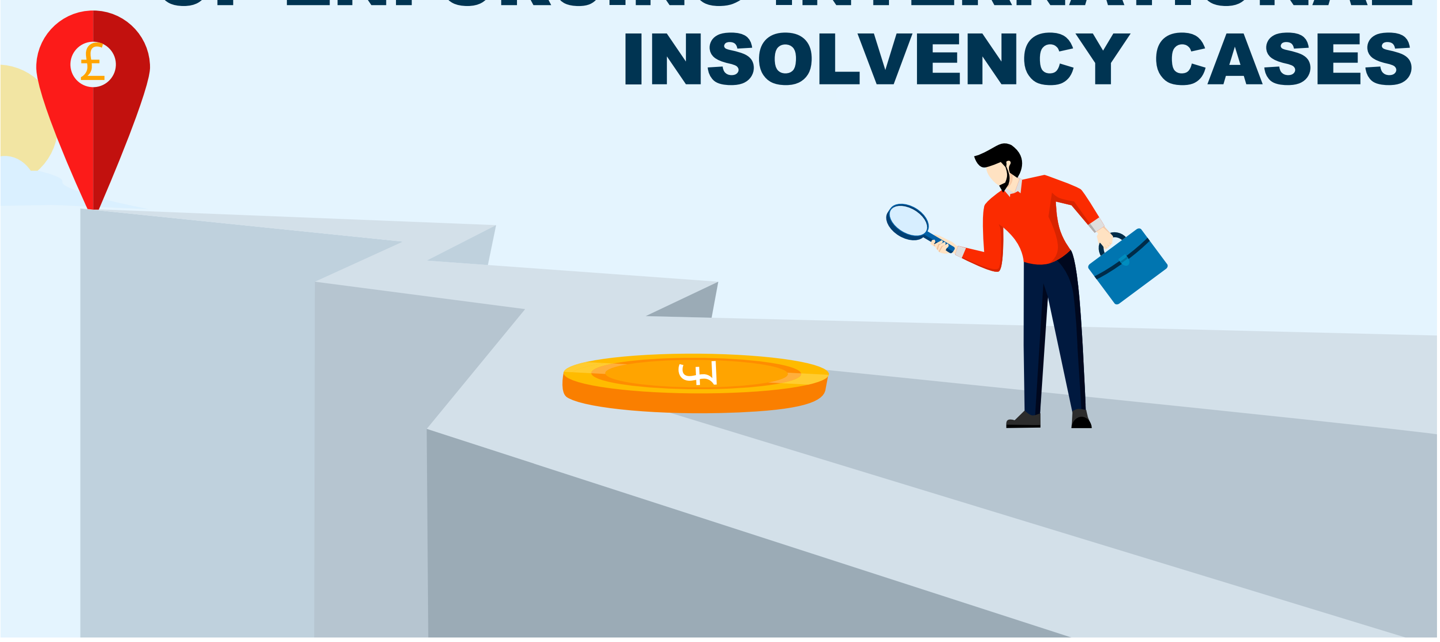
What, if anything, can be done about this?

The author acted for a company ("Company X") in a recent (confidential) case where the Court made an order in the Company's favour anonymising CE-file, following an interim application to restrain advertisement. Various third parties had seen Company X's name on CE-file, causing significant disruption to Company X's business.

At the first hearing of the application to restrain, an issue before the Court was whether the CE-file entry could be suitably anonymised to remove the Company's name. Rule 12.39 of the 2016 Rules provides the High Court with the power to seal its file in insolvency proceedings (i.e. documents filed in respect of a specific case). It does not expressly give the Court a power to anonymise or alter the Court's record (which includes the register of proceedings on CE-file). CPR 5.4, which governs the court's register or record, provides no clear power to do this either. The distinction between the Court's file and its record has been highlighted by a number of respected commentators, including the authors of Doyle, Keay and Curl and the former Chief Bankruptcy Registrar Baister.

Nonetheless, the ICC Judge held that rule 12.39 should be read as if it referred to both the Court's file and its record. If the rule were read otherwise, there would be a lacuna in the 2016 Rules which the draftsperson was unlikely to have intended. The Court therefore held that it had the power to order Company X's name on CE-file to be anonymised and replaced with "A company".

FOLLOWING A TRAIL OF BREADCRUMBS: THE CHALLENGES OF ENFORCING INTERNATIONAL INSOLVENCY CASES



Authored by: Masha Shvetsova (Co-Founder) - Vantage Intelligence, Ivan Gordienko (Partner) and Alex Green (Associate) - Steptoe Johnson

In this article we set out potential evidential issues a creditor may face in an international insolvency case and the key areas for investigations.

Consider the following scenario: You are approached by a bank which had loaned large sums of money to a company. The bank felt safe in doing so as the loan was secured by a personal guarantee given by the company's director/shareholder. Unfortunately, the company has fallen on hard times, is now insolvent and cannot repay the loan. The bank's only recourse is now to enforce the guarantee.

However, the guarantor reports that they themselves have fallen on hard times as they have recently gone through an acrimonious divorce and their spouse, pursuant to the terms of a so-called "marriage agreement" entered into months, or maybe only even weeks, earlier, has the right to keep hold of all assets held in the spouse's name. As chance would have it, anything of any real value was, at the time of the divorce, in the spouse's name and the divorce has left the guarantor destitute.

The guarantor's personal guarantee to the bank is worthless and the bank faces being left substantially out of pocket.

The bank believes that the divorce is in fact a sham, that it exists on paper only and, even if the spouses' relationship truly has broken down, the arrangement is a fiction designed to put assets beyond the bank's reach. Furthermore, an initial investigation has revealed that all valuable assets are, in fact, in England, where the debtor's family also resides, but the assets, at least on paper, belong to the guarantor's purported ex-spouse. What is the bank to do?

The answer, in an appropriate case, is for the bank to serve a statutory demand on the debtor, followed, presuming the debtor fails to pay, by a bankruptcy petition in England to seek a bankruptcy order against the debtor so that an English trustee can be appointed to investigate the debtor's affairs and, most importantly, the apparent divorce. The debtor then contests that petition on the basis that they have not been resident or had a place of residence in England in the preceding three years.[1]

The bank's pursuit of the recovery of the debt owed to it then becomes a detailed factual investigation to determine the debtor's connection to the jurisdiction and to unravel the fictitious divorce put forward to thwart that recovery. These investigations necessarily cover a wide spectrum of possible sources of information, including sources discovered by expert investigators as well as through targeted requests for disclosure in the underlying proceedings – for example:

1 As required by section 265(2)(b)(i) of the Insolvency Act 1986.

- Purchaser of any property: Who purchased any property in England, how was that purchase financed (including by whom), in whose name was the property registered and what steps have been taken in respect of that ownership since the purchase? Additionally, who has been paying utility bills and the council tax for the property and has the payee changed since the divorce date?
- Travel: Cases of this type often descend into arguments regarding how many days the debtor has spent in the jurisdiction. In respect of most countries with a visa regime with the UK, passports are a critical source of information as passports are stamped on entry into and departure from many countries, including the home country itself. Full copies of a debtor's passports therefore allow the bank to recreate the debtor's travel history and cross-check this against the debtor's own version of events. Additionally, the same can be applied to the ex-spouse to determine if the couple continued travelling together after their alleged separation.
- Business interests: Consider company records to establish whether the debtor, whilst claiming to have no connection to the jurisdiction, is in fact the director of an English company. Equally, it is worth checking whether the debtor's spouse holds any directorships, particularly if those directorships seemingly match up with the debtor's business interests and have no bearing on the spouse's own professional experience.
- Social media: The online accounts of prolific social media users provide a detailed record of that individual's lifestyle and activities. Even if the debtor in question does not use social media, the accounts of those connected to them often provide a detailed insight into the debtor's activities. In one case, a simple internet search for the spouses' names revealed romantic holiday photographs published long after the couple claimed to have separated. In another case, the debtor's children posted pictures of undisclosed trophy assets such as luxury cars and a yacht where the family happily vacationed together.
- Bank statements: In a number of cases a detailed review of the debtor's bank statements disclosed by the debtor has proven critical to unravelling the debtor's false version of events. In one case, the debtor's bank statements revealed he was making very substantial payments to his alleged ex-spouse long after they claimed to have separated, including for expensive jewellery and other items described as "gifts". In another case, the debtor's bank statements revealed a pattern of spending on everyday items at petrol stations and shops within only a couple of miles of the expensive English property with which he claimed to have no connection. The dates of those transactions could then be cross-checked with the dates the debtor was known to be in England by reference to the stamps in his passport.

Whilst many of these points are unlikely to be determinative in isolation, they all feed into the bigger picture of establishing the debtor's connection to the jurisdiction and showing the falsity of the debtor's version of events as well as helping to uncover hidden assets.

Choice of jurisdiction also matters for other reasons – for example, the English court has found that, where a bankruptcy has already been commenced in Russia, Russian law precludes the commencement of parallel bankruptcy proceedings in England.[2] Whilst there does exist a regime whereby a foreign trustee can gain recognition in this jurisdiction, that process requires the trustee's willingness to become involved in foreign proceedings, which cannot always be guaranteed.

It is therefore important that any creditor considering a bankruptcy petition, especially where various jurisdictions are potentially available, chooses the "home" jurisdiction of the bankruptcy carefully.

2 PJSC VTB Bank v Valeriy Vladislavovich Laptev [2020] EWHC 321 (Ch).

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THE CREDITOR DUTY IN LIGHT OF SEQUANA - AN EVOLVING STORY

STEPHEN HUNT -V- JAGTAR SINGH - CASE NO: CH-2022-000104

Authored by: Ben Rutledge (Associate) – Keidan Harrison

Executive Summary

Where a company is faced with defending a claim of such a size that its solvency is dependent on successfully challenging that claim, then the "Creditor Duty" (i.e. when a director's duty to act in a company's interest is modified to include a duty to have regard to the interest of creditors as a whole) arises, if the directors know or ought to know that there is at least a real prospect of the challenge failing. In this case the claim involved a current tax liability which the directors believed was capable of being challenged.

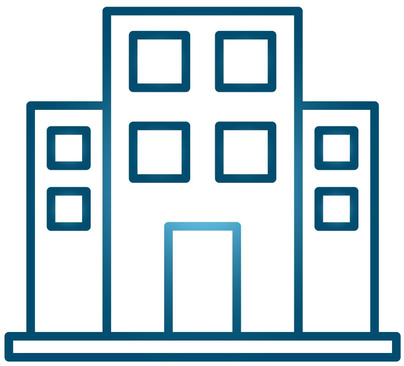
The Court noted in its reasoning that it was necessary to establish some form of knowledge of insolvency on the part of the directors for the Creditor Duty to arise, even where the company was at the relevant time actually insolvent.

The fact that the Creditor Duty is triggered is only the starting point in a claim for breach of duty. The consequences of it being triggered vary enormously depending on the facts. Although, the court did not take this opportunity to provide extensive guidance on this point.

Directors should not just blindly follow professional advice without considering all of the potential outcomes. Simply following professional advice will not absolve them of potential personal liability.

Introduction

In this appeal, the Court dealt with the question of when the Creditor Duty is engaged following the Supreme Court's decision in BTI 2014 LLC v Sequana SA ("Sequana"), in circumstances where the company is at the relevant time insolvent, but its insolvency is due to a tax liability which the directors believed at the relevant time had been avoided by a valid tax avoidance scheme entered into by the company.



Background

Marylebone Warwick Balfour Management Limited (the "Company") provided management services to Marylebone Warwick Balfour Group PLC (the "PLC"). In 2002, the PLC decided to wind down the business and embark on a realisation plan targeting returns for shareholders.

The Company provided head office staff to the PLC tasked with implementing the wind down. The Company took advice from BDO which recommended a scheme designed to enable the head office staff to receive payments without the Company incurring liabilities to HMRC, namely, PAYE and NIC contributions (the "Scheme").

The Company entered the Scheme in 2002 until 2010. The Scheme resulted in multiple pay outs to the head office staff in a sum totalling £54million over the 8 years it operated. Shortly after the Scheme was entered into HMRC became aware of it and others like it that had the intention of avoiding PAYE and NIC contributions and intended to pursue those involved in such schemes.

In 2005, HMRC offered a market wide settlement to participants of such schemes. The offer was for payment of NIC contributions together with interest ("HMRC's Offer"). HMRC's Offer which amounted to just over £3.65million was rejected by the Company.

HMRC continued their pursuit of such schemes by way of litigation. The First Tier Tribunal concluded that HMRC was entitled to pay NIC contributions but not the PAYE claimed in respect of such schemes. That decision was upheld on appeal by the Upper Tribunal.

However, the Court of Appeal in 2011, allowed the appeal of HMRC and found that such schemes failed both in respect of PAYE and NIC Contributions. BDO's advice throughout had been that the Scheme was "robust".

The Company's liability to HMRC in respect of PAYE and NIC Contributions (including interest) through the period that the Scheme was in excess of £36million. Once the company had accounted for the debt to HMRC, the Company was substantially insolvent.

The Company was advised by counsel that their position was not distinguishable from the Court of Appeal decision. The Company was placed into a creditor's voluntary liquidation in 2013 and dissolved in 2016. However, it was restored to a voluntary liquidation in 2017 and Mr Hunt appointed liquidator (the "Liquidator"). The only creditor in the liquidation was HMRC in the sum of £38,701,750.

The Liquidator brought claims (1) for breach of fiduciary duty, specifically breach of the Creditor Duty and/or (2) that the payments were transactions defrauding creditors against the directors of the Company.

Equitable compensation and the amount each director received as a result of the breach of duty was sought. As far as we are aware, claims against BDO (or any other legal advisers) of any nature were not pursued. At first instance, the judge dismissed all claims and found that the Creditor Duty had not been triggered and even if it did it would not have made any difference.

The Liquidator appealed against Mr Singh only in respect of the claim to recover the amount received by him as a result of the breach of the Creditor Duty between 2005 and 2010. The other directors either had reached settlements with the Liquidator or were not in office during the relevant period.

Appeal Decision

It is worth noting that the lower Court had not had the benefit of the Supreme Court's judgment in Sequana at the time it arrived at its decision and that the appeal in this case was unopposed.

In any event, it was agreed by the judge and counsel for the Liquidator that the principal question raised on appeal was whether the judge was wrong to conclude that the Creditor Duty had not arisen. The Liquidator also contended that the judge was also wrong to conclude that had the Creditor Duty arisen it would have made no difference.

As such, the Court considered, when the Creditor Duty arises. In doing so it noted that the Supreme Court had already confirmed the existence of a rule that in certain circumstances when a company is financially distressed the directors' fiduciary duty to the company to act in its interests is modified to include a duty to have regard to the interest of creditors as a whole i.e. the Creditor Duty.

The Court said that left two questions: (i) at what time prior to the Company's actual insolvency did the duty arise, and (ii) what was its content?

In respect of the first question, the Court queried whether, in a case where the company was at the relevant time actually insolvent, that is sufficient to trigger the Creditor Duty irrespective of the directors' state of knowledge as to the company's insolvency.

The Court assumed that it was necessary to establish some form of knowledge of insolvency on the part of the directors for the Creditor Duty to arise, even where the company was at the relevant time actually insolvent.

The Court concluded that in the context of HMRC's pursuit of the liability described above, that where a company is faced with a claim related to a current liability of such a size that its solvency is dependent on successfully challenging that claim, then the Creditor Duty arises if the directors know or ought to know that there is at least a real prospect of the challenge failing.

The Court further distinguished the rejection of the language of "real risk" of insolvency in Sequana because those comments had been in the context of the possibility that a company, that was undoubtedly solvent at the time, might become insolvent at some point in the future. However, in this case, the Company would have in fact been insolvent at the relevant time and as such the economic interest had already shifted from shareholders to creditors.

Accordingly, knowledge of a real risk that the company's challenge to the claim made by HMRC may fail, therefore, equates to knowledge that it is the creditors that are potentially currently being affected by the directors' actions and decisions.

The Court concluded in relation to the first limb of the appeal that:

"the duty to have regard to creditors' interests is triggered by actual or constructive knowledge of a real risk that the liability may exist, with questions of degree of probability of success or failure being factored into the content of the duty and whether it was breach in the particular case…"

"Had he (the judge) applied the right test, then I consider that he should have held that the creditor duty had arisen at the latest in September 2005, and continued thereafter throughout the relevant period."

As to the second limb of the appeal, the Court considered that a more nuanced approach should be followed including a range of factors that needed to be re-assessed in accordance with the Sequana test. The Court remitted the case to be reconsidered.

Whether the matter is further pursued is questionable given that Mr Singh has declared himself bankrupt. However, one of the main questions that will need to be considered is whether directors, who find themselves in a similar situation, can raise a defence in relation to a claim for breach of the Creditor Duty, in circumstances where they have taken professional advice, on the basis of section 1157 of the Companies Act 2006 (the "Act"). That section of the Act allows the Court to excuse directors from proceedings for negligence, default or breach of duty or trust if they've acted honestly and reasonably having regard to all the circumstances of the case. Much will depend on the facts therefore that debate might be for another day/ article. Watch this space!

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DOES AN EXCLUSIVE JURISDICTION CLAUSE OVERRIDE THE COURT'S INSOLVENCY JURISDICTION? THE HONG KONG COURT OF FINAL APPEAL'S ANSWER IN *RE GUY LAM*

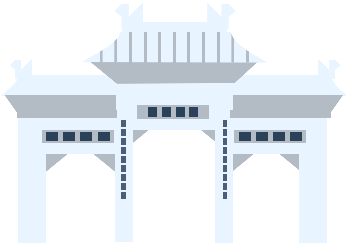
Authored by: Wilson Leung (Barrister) - Serle Court

This article analyses the Hong Kong Court of Final Appeal's judgment in Re Lam Kwok Hung Guy (2023) 26 HKCFAR 119, where Robert French NPJ held that a bankruptcy petition would generally be dismissed or stayed if the underlying contract contained an exclusive jurisdiction clause ("EJC") in favour of another forum. This decision provides crucial guidance for the courts, given the prevalence of EJCs in modern commercial practice, as well as the frequent use of bankruptcy and winding up petitions as a means of debt recovery. However, key questions remain to be answered, including whether arbitration clauses should be accorded with the same deference as EJCs, and whether other jurisdictions will follow the same approach.

Exclusive jurisdiction clauses, arbitration clauses, and insolvency jurisdiction

Exclusive jurisdiction clauses ("EJCs") are a staple feature of modern commercial contracts. Such clauses provide commercial certainty by allowing parties to agree in advance on the forum in which any disputes will be litigated. This is especially valuable given the wide variation in litigation processes around the world and the complicated nature of choice-of-jurisdiction rules. Arbitration clauses are beneficial for similar reasons, with the additional advantage of confidentiality.

However, there has been lively debate on how EJCs and arbitration clauses interact with the courts' insolvency jurisdiction. When the courts are faced with a bankruptcy or winding-up petition, in which the underlying contract contains an EJC (in favour of another forum) or arbitration clause, should the courts generally dismiss the petition and compel the parties to litigate in the chosen forum? Or do such clauses merely amount to one factor – but not a conclusive or overriding one – that the court may take into account when exercising its discretion to make a bankruptcy or winding up order?



Re Guy Lam: background

The EJC aspect of this debate was considered by the Hong Kong Court of Final Appeal ("HKCFA") in Re Lam Kwok Hung Guy (2023) 26 HKCFAR 119.

The debtor (who was resident in Hong Kong) had given a guarantee to the petitioner in respect of a company's loans. The guarantee agreement contained an EJC, under which the parties agreed to submit to the exclusive jurisdiction of the New York courts in the event of any dispute. The company defaulted on the loan. The petitioner served a statutory demand on the debtor, but he failed to comply. The company presented a bankruptcy petition against him in Hong Kong. Meanwhile, the debtor commenced proceedings in New York to claim that there had been no default.

The debtor opposed the petition in Hong Kong, arguing that the debt was disputed and should be determined by the New York courts pursuant to the EJC. The debtor's argument was rejected at first instance, but accepted by the Court of Appeal, which dismissed the petition. The petitioner appealed to the HKCFA.

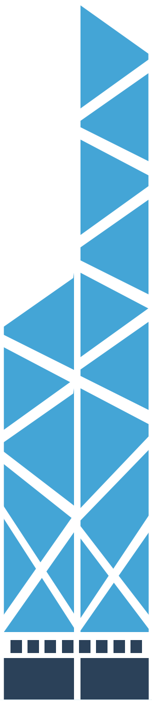
The HKCFA's decision

Robert French NPJ (giving the only substantive judgment) upheld the Court of Appeal's decision.

He held that, where the underlying contract contained an EJC, the general rule was that the petitioner and the debtor would be held to their bargain and thus compelled to litigate in their chosen forum.

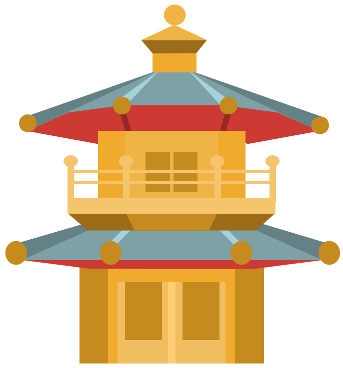
Accordingly, the court should dismiss or stay[1] the bankruptcy petition. However, this general rule could be displaced if there were exceptional "countervailing factors"[2].

French NPJ rejected the first instance judge's view that an EJC is merely one factor that the court would take into account when considering a winding up or bankruptcy petition[3].



EJC affects discretion, not jurisdiction

In reaching his decision, French NPJ clarified that parties cannot validly agree to exclude the court's bankruptcy jurisdiction. Thus, an EJC does not affect the court's jurisdiction per se. What an EJC does, however, is to inform the court's discretion to decline to exercise that jurisdiction[4]. Specifically, the court had a discretion to decline to exercise its jurisdiction to determine whether there was a bona fide dispute regarding the debt. That discretion was "enlivened" in circumstances where the parties have agreed, by way of an EJC, to have all their disputes resolved exclusively in another forum[5].



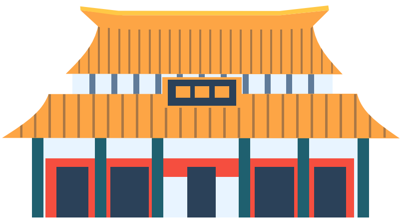
Public policy imperatives

There were two public policy imperatives that underlay the decision in Guy Lam. First, as French NPJ recognised[6], there was a fundamental public policy interest in holding parties to their agreement, including an agreement as to how and where any disputes would be resolved.

This was put by the Court of Appeal as follows: "… it is a strong policy of the law to require parties to abide by their contracts… An action brought in breach of [an EJC] will ordinarily be stopped unless there are strong reasons otherwise.[7]"

1 The Court of Appeal held that the court should generally opt for a dismissal rather than a stay unless the petitioner could show special reasons: [2022] 4 HKLRD 793, [105]
2 [105], [107]
3 [31], [105]
4 [85]
5 [100]
6 [101]-[102]
7 [2022] 4 HKLRD 793, [83]

Second, in an ordinary court action, the court would generally enforce an EJC unless the plaintiff demonstrated strong reasons otherwise. It would promote consistency in the law if the same approach also applied to bankruptcy petitions. This was implied in French NPJ's judgment[8], but the point was made more explicitly by the Court of Appeal: "It would…be an anomaly that a party bound by an exclusive jurisdiction clause in favour of a foreign forum cannot expect to proceed with an ordinary action in Hong Kong for his claim, but can resort to the more Draconian measure of presenting a petition here for winding up or bankruptcy…"[9]



Countervailing factors

French NPJ held that an EJC would generally be enforced by the court in bankruptcy proceedings unless there were "countervailing factors"[10]. Although he did not elaborate on this term, he indicated that they could include the debtor relying on a frivolous defence[11] or the presence of other undisputed creditors[12]. The Court of Appeal cited further examples, such as where assets may be in jeopardy, or there is a need to investigate potential wrongdoings[13].

Arbitration clauses

Although Guy Lam involved a bankruptcy petition, it is clear that the HKCFA's analysis equally to EJCs in the context of winding up petitions.

What is less certain, however, is whether arbitration clauses should be accorded the same primacy as EJCs. Subsequent to Guy Lam, there have been conflicting first instance decisions in Hong Kong on this question. In Re Simplicity & Vogue Retailing (HK) Co Ltd, it was held that the ratio in Guy Lam was limited to EJCs, and that an arbitration clause would be given some, but not predominant, weight by the insolvency court[14]. By contrast, in Re Shandong Chenming Papers Holdings Ltd, the court interpreted Guy Lam as laying down the same approach to both EJCs and arbitration clauses[15].

The latter appears to be the preferable view. In Guy Lam, both the HKCFA[16] and the Court of Appeal[17] cited Salford Estates (No 2) Ltd v Altomart Ltd (No 2) [2015] Ch 589, where the English Court of Appeal held that (in the absence of exceptional circumstances) an arbitration clause precludes the insolvency court from determining whether the debt is bona fide disputed. Given that the reasoning in Guy Lam was based partly on Salford, it makes sense that the same approach should govern both EJCs and arbitration clauses.

Conclusion

In Hong Kong, it is now settled by Guy Lam that a bankruptcy or winding up petition will be dismissed (or stayed) in the face of an EJC that covers the dispute, unless there are exceptional countervailing factors. This approach promotes party autonomy, as well as commercial certainty.

However, the debate on these issues is far from over. In Hong Kong, there are conflicting decisions on whether the same approach applies to arbitration clauses (see above). Further afield, other jurisdictions continue to refine their approach. In England, the Court of Appeal established in Salford that a winding up petition would normally be dismissed if the dispute was covered by an arbitration clause. However, recent decisions have differed on whether an EJC is given the same deference: Yes (according to Al Saad v Cantervale Ltd[18]); No (according to Hex Technologies Ltd v DCBX Ltd[19] and City Gardens Ltd v DOK82 Ltd[20]). Meanwhile, the Singapore Court of Appeal has largely adopted the Salford approach[21], whereas the Eastern Caribbean Court of Appeal has rejected it.[22] Given the importance of EJCs, arbitration clauses, and insolvency petitions in modern commercial practice, we can expect other appellate courts to weigh in on the issue in the near future.

8 [92]-[105]
9 [2022] 4 HKLRD 793, [84]
10 [105]
11 [101], [105]
12 [102], [105]
13 [2022] 4 HKLRD 793, [86]
14 [2023] HKCFI 1443, [35] per Linda Chan J
15 [2023] HKCFI 2065, [4]-[5] per Harris J
16 [47]
17 [2022] 4 HKLRD 793, [52]-[53], [83]-[84], [97], [105]
18 [2022] EWHC 3490 (Ch) per ICC Judge Prentis
19 [2023] EWHC 537 (Ch) per Deputy ICC Judge Addy KC
20 [2023] EWHC 1149 (Ch) per HHJ Pearce (sitting as a High Court judge)
21 AnAn Group (Singapore) Pte Ltd v VTB Bank (Public Joint Stock Co) [2020] 1 SLR 1158
22 Jinpeng Group Ltd v Peak Hotels and Resorts Ltd (BVI HCMAP 2014/0025 and 2015/0003, 8 December 2015)

60-SECONDS WITH:

STEPHEN ROSS
PARTNER
WITHERS

Q **Imagine you no longer have to work. How would you spend your weekdays?**

A I would split my time between giving guided tours of legal London to discerning and high-tipping visitors in order to keep my brain ticking over and pottering on remote beaches in Ireland and Scotland unearthing Viking treasure. Oh, and of course a lot of good work for charity.

Q **What do you see as the most important thing about your job?**

A At the moment it is trying to encourage the next generation of lawyers to develop their skills and see a long-term career in the law in face of the huge changes to the profession we are seeing and the challenges their generation(s) face generally.

Q **What motivates you most about your work?**

A That fleeting and rare moment in Court when a Judge makes a comment which makes you realise he gets your case and you are going to win. Also, the audible gasp of relief when you tell a client on the phone that a judgment has gone their way and their livelihood is secure.

Q **What is one work related goal you would like to achieve in the next five years?**

A I'd like to convince one (not to be named) Commercial Court judge that the interests of justice trump concerns over strained Court resources.

Q **What has been the best piece of advice you have been given in your career?**

A I once admitted to my mentor (see below) that I was studying from a slightly out of date legal textbook. He snatched it from my hands and drop-kicked across the office we shared. This was an impressive feat given that he was totally blind. Lesson was learned. I have never looked at an out-of-date textbook since.

Q **What is the most significant trend in your practice today?**

A Undoubtedly it is disputes coming from the new economy, whether that is people being defrauded through digital means, founders and billionaires falling out over tech companies or disputes relating to loans against digital assets. A lot of the legal issues are well worn such as unfair prejudice claims or straightforward freezing orders but the subject matter is changing and while we don't need to know how to code we need to know how these business start-up, operate and make money and how these clients think and speak.

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

A My old boss at the Office of Fair Trading, Arif Khan. He encouraged me to go into the law and showed me how hard work, diligence, kindness and a lack of ego are the keys to being a good lawyer. I doubt I'll ever match him as a person or a lawyer but it has been good to try.

Q **What is one important skill that you think everyone should have?**

A During lockdown I taught myself how to pick a lock. I think it is good to hedge your bets. On a more serious note any non-law related skill would be my answer because that means you have something to do to relax and unwind without which you won't last long in this game.

Q **What cause are you passionate about?**

A Freedom of speech. It is under threat wherever you look at the moment and you don't know what you've lost until it has gone. It is worrying to see just how offended some of the most privileged people in the world are by things and that are merely opinions.

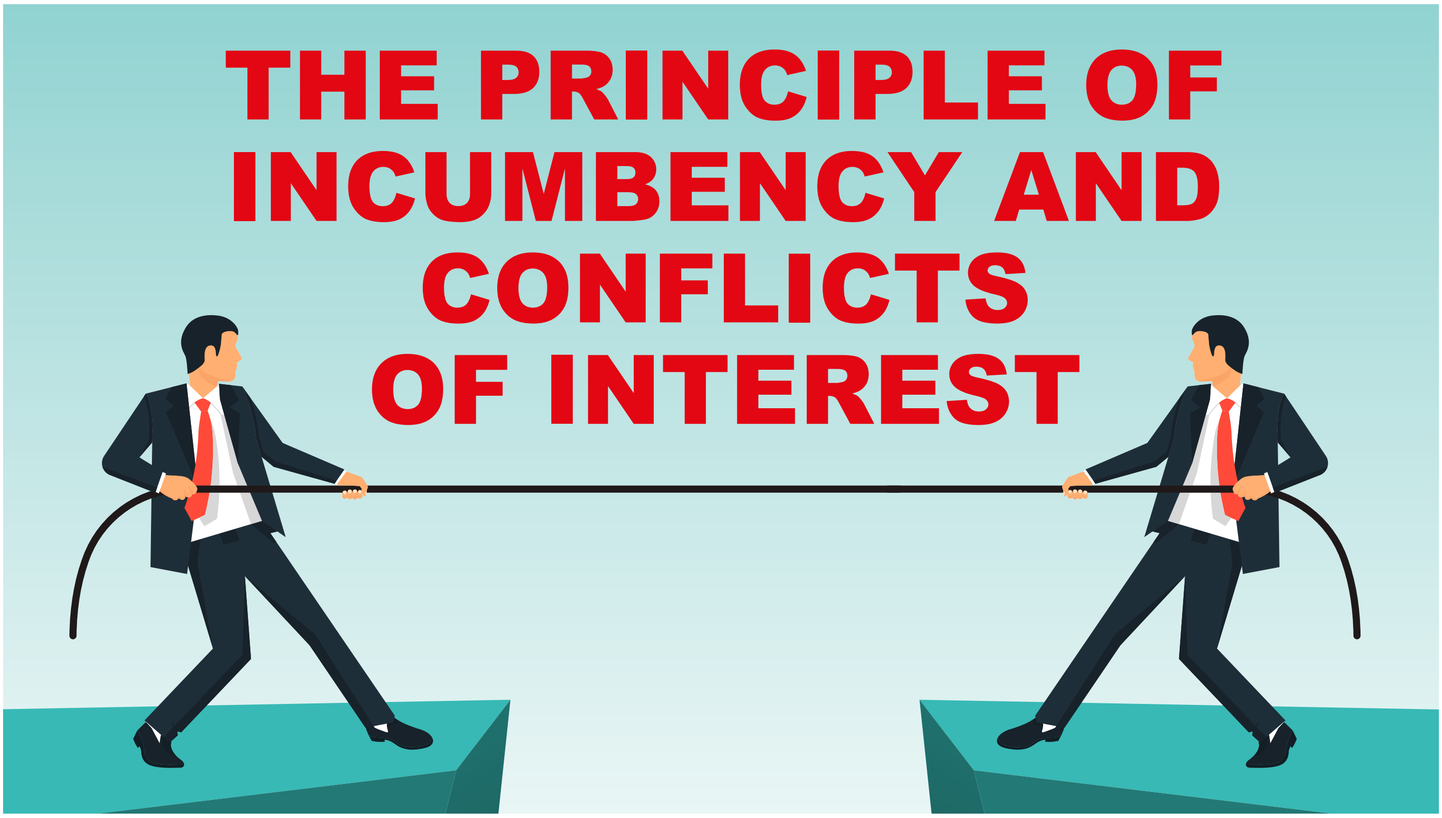
Q **Where has been your favourite holiday destination and why?**

A The Tibetan plateau. Aside from getting altitude sickness at Everest Base Camp, the journey there takes you past all the mountains of the world like one big mountain superstore. There are green craggy Scottish Highlands next to lakes and a little while after tall sandy dunes framed by Himalayan peaks.

Q **Dead or alive, which famous person would you most like to have dinner with, and why?**

A Leonardo da Vinci. I would show him some videos of parachutes, helicopters and robots. It would be wonderful to see his face.

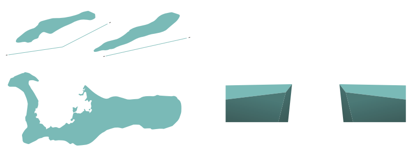
THE PRINCIPLE OF INCUMBENCY AND CONFLICTS OF INTEREST



Authored by: Jennifer Colegate (Partner) - Collas Crill

The circumstances leading to the liquidation of a company are often contentious. One bone of contention which often arises is who should be appointed as the official liquidator(s) (Identity Question), which can arise when the initial appointment of liquidators is made, and when there is an application to move a company from voluntary or provisional to official liquidation.

The recent decision of Kawaley J in Global Fixed Income Fund 1 Limited (Global Fixed Income) (unreported decision 18 August 2023) examines the legal principles relevant to the Identity Question when a company moves from provisional to official liquidation, balancing the deference that is to be shown to the incumbent officeholders against the interests of the stakeholders having an interest in the outcome of the liquidation.



Background

Joint provisional liquidators (JPLs) were appointed to three Cayman funds, one of which was Global Fixed Income 1 Limited (GFIF). An appointment was also made over a BVI fund, which was under common management along with the Cayman funds. In each case the appointment of the JPLs to each of the funds was instigated by a Mr Bruno Wang (Petitioner) who was the majority investor in each of the funds, save for GFIF.

Some two years later the Petitioner sought to place the Cayman funds, including GFIF, into official liquidation and have the JPLs appointed as Joint official liquidators (JOLs). The appointment of the JPLs as JOLs was objected to by the majority investors of GFIF and the Series 8 Investor, supported by a smaller but not insignificant investor, the Series 7 Investors (Challenging Investors). In place of the incumbent JPLs, the Challenging Investors proposed alternative insolvency practitioners to take the appointment as JOLs of GFIF.

The principle arguments advanced by the Challenging Investors were founded on the views held by the Challenging Investors that the conduct of the JPLs and their relationship with the Petitioner had created the impression that primacy had been given to the Petitioner's interests and gave rise to the appearance that the JPLs lacked the requisite independence to be appointed as JOLs to GFIF.

Notwithstanding that the Challenging Investors were the majority stakeholders of the GFIF liquidation, the Challenging Investors were unsuccessful.

The reasoned judgment of Kawaley J helpfully surveys the legal principles relevant to the Identity Question, in circumstances where the incumbent officeholders were challenged from taking office "permanent liquidators".

Principle of Incumbency

In such cases the starting assumption is that absent clear and cogent reasons the incumbent officeholders (in Global

Fixed Income the JPLs) should be appointed as JOLs (Parmalat [2006] CILR 171;). The "conventional course" (Green & Anor v SCL Group Ltd & Ors [2019] 2 BCLC 664) is for incumbent JPLs who have been in office for a substantial period of time to remain as officeholders, on the basis that it is preferable to avoid the delay and expense that would be caused if new liquidators were to take over. This is the principle of incumbency articulated by Lord Hoffman, sitting as a member of the Board of the Privy Council in Parmalat Capital Finance Limited v Food Holdings Limited and Dairy Holdings Limited [2008] CILR 202.

The principle of incumbency formulated by Lord Hoffman does not ignore the possibility that incumbent officeholders may be placed in a position of conflict although "The attitude of the court has been that any conflict of interest can be dealt with by the court (on the application of the liquidators) when they arise" [12]. In the majority of cases where a conflict arises in the course of a liquidation, the ability of the Court to appoint a conflict liquidator under its supervisory jurisdiction will be sufficient.

While the bar for a creditor seeking to challenge the proposed appointment of liquidators is necessarily a high one, requiring clear and cogent evidence, his Lordship intimated in his reasoning that "the bar for deciding whether to appoint alternative JOLs to the JPLs ought in principle to be lowered than the bar for removing a liquidator at any stage for cause" (Global Fixed Income, [9]). As regard the position of the Challenging Investors, his Lordship remarked that the majority stakeholders had "mounted opposition to the JPLs being appointed on a permanent basis. This must lower the bar to some extent" (Global Fixed Income¸[9]).

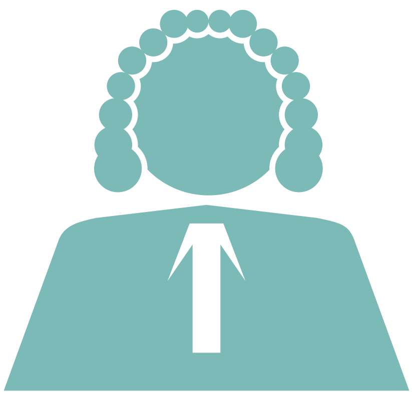
Lacking the appearance of independence

In opposing the JPLs' appointment as JOLs, the Challenging Investors invoked the 3-stage process set out in the decision of Doyle J in Global Fidelity Bank, Ltd (in voluntary liquidation) (unreported, FSD 168 of 2021) to determine whether there was an actual or perceived lack of independence on the part of the incumbent officeholders because of their prior involvement with the debtor company. Doyle J held that the Court must:

- Identify the factual circumstances of the relationship and prior involvement of the proposed officeholders;
- Conclude whether that prior relationship and all the circumstances of the case are such that the appearance of independence is impaired; and
- Conclude whether the impairment of independence is sufficiently material to the liquidation, that a fair-minded stakeholder would reasonably object to the appointment of the nominated officeholders.

The Challenging Investors also invoked the principle that the views of the majority stakeholders of a liquidation are entitled to considerable deference, providing the views held are objectively reasonable in all the circumstances of the case (Sciens Alternative Assets Recovery Fund II (in voluntary liquidation) (unreported decision 29 June 2022).

His Lordship accepted that the application of the principles set down in Global Fidelity and Sciens and opined that "the key question is whether a fair-minded stakeholder would reasonably object to the proposed appointment" (Global Fixed Income, [13](d)).



Conclusion

On the facts before the Court his Lordship was not persuaded that a fair-minded stakeholder would reasonably object to the appointment of the JPLs as JOLs. The Challenging Investors levied complaints against the JPLs for appearing to advance only the interests of the Petitioner during the course of the provisional liquidation.

In dismissing the Challenging Investors claims, his Lordship considered the wider commercial context of GFIF in which the Petitioner

"was once the majority stakeholder of GFIF, and now held a significant minority stake. It accords with commercial and legal rationality that JPLs act in furtherance of the interests of the majority stakeholders. That is no more than the law requires. Overall, the JPLs would have been acting improperly in regard to the four funds… if they did not in practical terms act to advance primarily"

the Petitioner's interests (Global Fixed Income Fund, para. [25]).

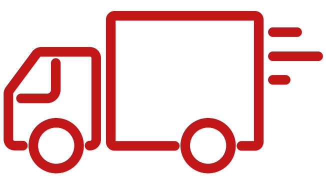
The decision of Global Fixed Income illustrates the balance which the court will seek to strike between the deference that is to be shown to incumbent officeholders of the Court, and the deference to be afforded to the objectively justifiable concerns of the majority stakeholders of a liquidation.

SHOULD INSOLVENCY PRACTITIONERS BE CONCERNED BY THE SUPREME COURT'S LATEST DECISION REGARDING THE ENFORCEABILITY OF LITIGATION FUNDING AGREEMENTS?

Authored by: Marieta van Straaten (Legal Director) and Chantelle Tang (Associate) – Kingsley Napley

In an eagerly-awaited and significant decision, the Supreme Court, in R (on the application of PACCAR Inc and others) v Competition Appeal Tribunal and others [2023] UKSC 28 ("PACCAR"), held, on 26 July 2023, that litigation funding agreements ("LFAs") under which a litigation funder receives a percentage of any damages recovered by the claimant are damages-based agreements ("DBAs") within the meaning of section 58AA of the Courts and Legal Services Act 190 ("CLSA"). As a consequence, unless the LFAs satisfy the requirements for valid DBAs as set out in section 58AA CLSA and the Damages Based Regulations 2013 ("DBA Regulations 2013") they will be unenforceable.

The Supreme Court's decision will certainly resonate in the litigation funding industry with funders scrambling to review existing LFAs which now risk being unenforceable against the funded clients including insolvency office holders.



Background

The issue arose from the applications of two claimants, UKTC and RHA, to bring collective proceedings against DAF for breaches of competition law. To obtain the collective proceedings order, UKTC and RHA needed to show that they had adequate funding arrangements in place. UKTC and RHA relied on LFAs to meet this requirement. The LFAs provided that the funder's maximum remuneration was calculated with reference to a percentage of the damages ultimately recovered. DAF argued the LFAs were unenforceable because they did not comply with the statutory rules governing DBAs. The Competition Appeal Tribunal and the Division Court both rejected DAF's arguments.

However, the Supreme Court allowed DAF's appeal. It held by a majority of four to one (Lady Rose dissenting) that where funders are entitled to a percentage of any damages recovered under LFAs, these constitute DBAs.

Section 58AA CLSA provides that where a LFA takes the form of a DBA it will be unenforceable unless certain conditions are complied with. It was common ground in this case that the LFAs at issue did not satisfy the relevant requirements and therefore, if the agreements were found to be DBAs, they would be unenforceable.

Under section 58AA CLSA, as amended in 2013, DBAs are defined as "an agreement between a person providing advocacy services, litigation services or claims management services and the recipient of those services […]". The question before the court was whether "claims management services" include the provision of litigation funding, which was the funder's only involvement in the proceedings.

The Supreme Court adopted a conventional approach to statutory interpretation and held that the words "claims management services" referred to in section 58AA CLSA were capable of including the provision of litigation funding. As a result, the LFAs fell within the definition of DBAs under the legislation and were unenforceable.

Impact on Insolvency Practitioners

Insolvency Practitioners must consider the impact of the Supreme Court's decision on cases where they have LFAs in place which provide for the litigation funder to receive a percentage of any damages recovered by the office holder. This will be the majority of LFAs, but the Supreme Court's decision in PACCAR does not affect claims Insolvency Practitioners have assigned or sold to a litigation funder.

The powers granted to office holders under the Insolvency Act 1986 ("IA") allow them to sell or realise property vested in the insolvent estate. 'Property' as defined by section 436 IA includes a cause of action. Furthermore, section 118 of the Small Business Enterprise and Employment Act 2015 inserted section 246ZD into IA, with effect from 1 October 2015. Section 246ZD IA grants a liquidator or an administrator the power to assign a right of action (including the proceeds of an action) arising out of claims under IA (the so called 'office holder claims').

Since the introduction of section 246ZD IA, many Insolvency Practitioners elect to assign causes of action to litigation funders or third parties, rather than entering into agreements for the funding of the litigation.

The Supreme Court's decision in PACCAR does not impact cases where an Insolvency Practitioner assigns a cause of action as the agreements are constructed differently to LFAs and are believed to fall outside the definition of 'claims management services' in section 58AA CLSA.

There are still instances where Insolvency Practitioners will enter into LFAs rather than assign the cause of action. For example, where an Insolvency Practitioner is appointed as a trustee in bankruptcy office holder claims are not capable of assignment under section 246ZD IA. The section only applies to administrations and liquidations.

If an Insolvency Practitioner currently has a LFA in place, it is imperative to take immediate steps to review the terms of that LFA to ensure it complies with the requirements of section 58AA CLSA and the DBA Regulations 2013. If the LFA does not comply with the requirements for DBAs, the Insolvency Practitioner will be unable to enforce the funder's obligations under the LFA. This means the funder could in theory fail to meet their obligations to pay lawyers at any stage. It could also, on a security for costs application, result in the court finding the Insolvency Practitioner does not have adequate funding arrangements in place due to the LFA being unenforceable. In cases where a LFA currently in place does not meet the requirements for DBAs, the Insolvency Practitioner should take steps to negotiate new terms with the funder and amend the LFA to ensure it complies with the requirements of DBAs. We expect to see a wave of re-drafting and re-structuring of these funding agreements.

The one question many Insolvency Practitioners and litigation funders may be asking is what, if any, impact the Supreme Court's decision in PACCAR will have on concluded cases where the LFAs did not comply with the requirements of section 58AA CLSA and the DBA Regulations 2013 and were, as a result, unenforceable. Could Insolvency Practitioners potentially face claims from creditors where part of the damages recovered was paid to the litigation funder under a LFA which is now unenforceable? Should Insolvency Practitioners review their completed cases to see whether they are obliged to recover the percentage of damages paid to the litigation funder due to the LFA now being unenforceable?

It is important to keep in mind that the Supreme Court's decision in PACCAR only rendered these LFAs 'unenforceable'. The definition of an 'unenforceable contract' is a contract that, although valid, cannot be enforced by legal action. In most of the concluded cases litigation funders have already voluntarily performed their obligations under the LFAs. Whilst the litigation funders received a percentage of the damages recovered, in many instances no recovery would have been possible if it was not for the litigation funders voluntarily complying with their obligation under the LFAs to fund the litigation.

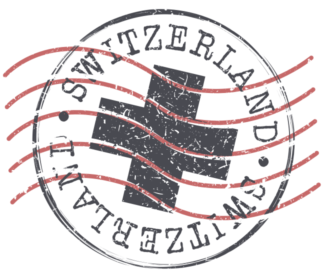
It remains to be seen how wide an impact the decision will have on the industry, but it appears that in completed cases any claims seeking to recover, either from the Insolvency Practitioners or the litigation funders, payments received under completed LFAs are most likely not going to succeed as the obligations under these LFAs have already voluntarily been performed.

DO YOU KNOW ABOUT THE SWISS WORLDWIDE FREEZING ORDER?

Authored by: Natalia Hidalgo (Senior Associate), Yves Klein (Partner) and Edouard Kaiflin (Senior Associate) – Monfrini Bitton Klein

The worldwide freezing order (also known as Mareva injunction) available in common law jurisdictions has been described as one of the nuclear weapons of the law. The conjunction of an injunction that may be obtained ex parte and that restrains a defendant from disposing of its assets up to a certain value and its ancillary disclosure obligation requiring the defendant to provide an affidavit setting out the value and location of its assets is indeed an extremely powerful asset recovery tool that many practitioners in civil law jurisdictions envy.

Few persons know, however, that an equivalent of the worldwide freezing order is available to litigants against Swiss defendants when they are insolvent or try to conceal their assets.



In Switzerland, enforcement of monetary claims is mainly regulated by the Swiss Federal Act on Debt Enforcement and Bankruptcy ("DEBA").

DEBA provides for three types of bankruptcy procedures: ordinary bankruptcy (Article 159-176), bankruptcy for bill of exchange (Article 177-189), and bankruptcy without prior debt enforcement procedure (Article 190-194).

In the context of ordinary bankruptcy proceedings, a creditor must have completed the full debt enforcement procedure before being able to request from the court the bankruptcy of its debtor, which may take years if the claim needs to be recognized in a judgment. The bankruptcy for bill of exchange provides for a more expedited procedure but may take several months before interim measures are available.

Unlike the first two types of bankruptcies, bankruptcy without prior debt enforcement of Articles 190 and 191 DEBA, can, under certain conditions, be requested directly from the court.

The possibility for the creditor to request the bankruptcy without prior debt enforcement procedure exists only if creditors' interests are threatened within the meaning of Article 190 DEBA, namely:

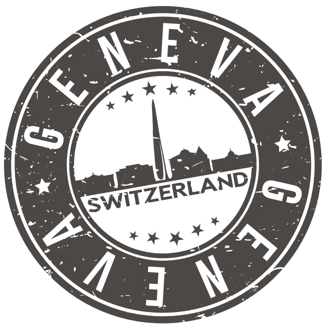
- If the debtor has no known residence, if it has absconded in order to evade the fulfilment of its obligations, if it has committed or attempted to commit acts to defraud creditors or has concealed its assets during debt collection proceedings.
- If the debtor has generally stopped payments to its creditors. This condition is fulfilled if the debtor does not pay uncontested and due debts, if there are payment orders from various creditors to which the debtor consistently declares its opposition, or even if the debtor fails to meet minor debts. It is not required, however, for the debtor to stop all payments but it is, for example, sufficient if the refusal to pay concerns a substantial part of its business activities. Even a single unpaid debt could be sufficient to prove that the creditor's interests are threatened if the amount is significant and the refusal to pay lasts. This is notably the case when the debtor refuses to satisfy its primary creditor.

The procedure of bankruptcy without prior debt enforcement procedure is conducted through summary proceedings and the debtor has a right to be heard.

Under Article 170 DEBA, the judge has discretionary powers to order all interim measures deemed necessary in the interest of the creditors to prevent dissipation of assets.

These measures can be requested as soon as the bankruptcy request under Article 190 DEBA is filed and can be ordered ex parte.

Among such interim measures, the court may issue an order restraining the debtor from disposing of its assets worldwide. The creditor may in addition seek garnishee orders at the location of the debtor's assets when local conditions are met.



In addition, the court may order an inventory of the debtor's assets, compelling the debtor to disclose and document its worldwide assets to the local Bankruptcy Office, typically within ten days. The creditor has access to this disclosure and supporting documentation and may request the Bankruptcy Office to take additional steps. The creditor may then use this information to obtain garnishee orders, including outside of Switzerland.

Interim measures ordered on an ex parte basis cannot be immediately appealed against but must be first confirmed by the court after both the debtor and the creditor have been heard. Depending on the time of year, a hearing may only be scheduled after several weeks, which may feel like an eternity to the debtor.

The consequences of a breach of those orders are more dire than the breach of other court orders, which are usually only punished with a fine of up to 10,000 Swiss francs (Articles 292 and 323 of the Swiss Penal Code – "PC"), as under Article 169 PC, a person who disposes of an asset that has been frozen, prejudicing its creditors, is liable to imprisonment for up to three years.

In short, Swiss bankruptcy law provides for interim measures, which combined effects are similar to a common law worldwide freezing order: 1) the debtor is restrained from disposing of its assets; 2) the debtor has an ancillary obligation to report on its assets worldwide; 3) the consequences of a breach of the freezing order are very severe, as they may be punished by a prison term of up to 3 years.

These interim measures are, however, more limited than a worldwide freezing order, as they only apply to debtors residing in Switzerland who stopped payments, who absconded or concealed their assets, which is probably the reason why they are not more known globally. They remain nevertheless a very powerful tool in the arsenal of the Swiss asset recovery practitioner.

THE CORPORATE INSOLVENCY AND GOVERNANCE ACT 2020 – THREE YEAR PROGRESS REPORT

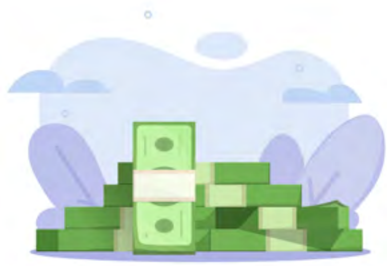
Authored by: Phillip Patterson (Barrister) – Gatehouse Chambers

Some readers may share the author's surprise at learning that 26 June 2023 marked the three-year anniversary of the coming into force of the Corporate Insolvency and Governance Act 2020 ("CIGA") in the middle of the "Tiger King phase" of the COVID-19 pandemic.

Much focus at the time was on the temporary measures put in place to mitigate (or at least control) some of the effects on businesses and the operation of the Courts as a result of the Government's measures to control the spread of the virus. It also provided an opportunity, however, for some permanent changes to the insolvency framework in the UK. These changes came about as a result of consultations which took place between 2016 and 2018. Three permanent measures worthy of particular mention are the introduction of the stand-alone company moratorium by way of a new Part A1 of the Insolvency Act 1986, the suspension of termination (ipso facto) clauses and the introduction of the new restructuring plan procedure.

In July this year, the Government published a Post Implementation Review ("PIR") offering its assessment of these permanent measures against the policy objectives which drove the changes back in 2020.

Many practitioners will have noted that the impact of these measures appears to have been limited. For a time, it might fairly have been argued that it was too early to tell what lasting impact they might have. This PIR, however, offers a frank and evidence-based appraisal which tends to suggest that, without further legislative amendment, the permanent measures in CIGA are unlikely to have the profound impact on the insolvency landscape which policy makers intended.



In relation to the stand-alone moratorium, the PIR states:

In terms of meeting the policy objectives, the evidence for the moratorium is more ambiguous than for the other measures. Whilst is has been shown to be working well in some instances, areas of concern have been raised.

A problem identified by IPs who took part in the review was that the principal appeal of this procedure was to SMEs. Typically, these are businesses with a single main financial creditor, usually their bank. The absence of a stay imposed on financial creditors resulted in a failure to achieve the policy objective to provide companies a period of protection so they can seek advice, negotiate with creditors, and agree plans for their rescue as going concerns.

The report noted that a majority of respondents to the survey felt unable to express a view on whether the moratorium provided greater opportunities for the survival of the company or not.

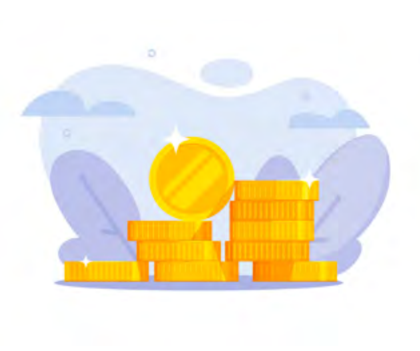
It also reported information deficiencies with significant numbers of respondents being unaware whether or not the procedure was available for them to use.

A reputational risk was also felt to have arisen in relation to IPs who chose to act as monitors in cases in which a company rescue is not achieved.

The report was more positive, albeit cautiously and with significant caveats, about the impact of the suspension of termination clauses. This measure, contained in section 233B of the Insolvency Act 1986 restricts the contractual rights of suppliers to terminate contracts or impose onerous conditions on companies in the event that they enter into an insolvency procedure.

Whilst noting that it was too early overall to tell whether this measure had met its policy objectives, there were promising early signs. Respondents noticed that the measures did appear to have helped (at least in a sizeable number of cases) to ensure continuity of supply of goods to businesses in an insolvency procedure. It had been less successful at preventing “ransom payments” being demanded, however. A significant majority felt that this measure had assisted the “rescue culture” objective, however, decidedly mixed reviews were offered about the efficacy of the hardship provision aimed at preventing the transfer of risk on to suppliers. The report suggested that further detailed guidance could be published to better inform IPs and businesses in relation to this.

The most positive assessment was reserved for the restructuring plans. This is consistent also with limited anecdotal evidence among practitioners particularly in more recent months. The report noted that restructuring plans are seen as a success by stakeholders and have achieved all four of the stated policy objectives (at least in part).



The restructuring plans were praised for the way in which they can be used to stop a secured. Creditor from blocking a company rescue in circumstances where the proposals otherwise enjoyed broad support.

The major concern raised about the restructuring plans related to costs. Being a court-based process, costs associated with them can be particularly high. Those costs were estimated at between £2m and £10m at the top of the market and between £1m and £2m at the mid-market level. A majority of respondents considered these costs to be prohibitive from the perspective of SMEs. Concerns were also raised about the costs of challenging restructuring plans. A case involving costs of challenge of £1m was noted and it was suggested as a consequence that only certain creditors would be able to avail themselves of the protections built into the restricting plan procedure. Creditors also complained of an information asymmetry which meant there was a very limited opportunity for creditors to put forward an alternative to the restructuring plan.

The tone throughout the PIR is positive. It concludes:

Areas of improvement have been identified for all three measures, though these should not detract from the overall benefit of the measures and that they have, on the whole, been well received by stakeholders. The measures have strengthened the insolvency regime, placing it in a stronger position than prior to the measures coming in force.

Realistically, however, the impact of the measures has overall been limited and the issues raised in the PIR are serious. The claim in the PIR that CIGA represents the most significant change to the UK’s corporate insolvency regime in 20 years is a bold one. Whilst in due course it may prove to be accurate, particularly if use of restructuring plans continues to grow. At present, however, it appears a little overstated.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FOLLOWING THE CASH IN INSOLVENCY CASES

Authored by: Oleg Lykov (Associate Director) – Grant Thornton

Complex, high-value asset recovery exercises often involve analysing huge volumes of data from multiple sources across several jurisdictions. Based on real-world examples, this article explores some of the practical elements to consider when making recoveries in insolvency matters.

In one project, we analysed over five million wire transfers that were scattered in several thousand Excel and PDF files. Over 90% of the transactions were in USD with the rest in Euro, Russian Roubles and several other currencies. These transactions were between roughly 725,000 unique accounts.

Preparing the data

The bank account statements obtained via disclosure orders were received in a variety of formats. Many of them were not machine-readable due to poor quality of scans, foreign languages, with different sets of available information, different currencies, and layouts. Even with perfectly scanned/generated statements, OCR [1] would leave some room for errors. Any automated scanning would require a manual verification.

To address these complexities and ensure the data was accurate and agile, a joint database was built of relevant transactions from all sources by merging, adapting and cleaning the data, while combining automated input with manual verification and data entry. At the same time, this approach eliminated possible duplication that can occur when project members change. Using a unified transactional database instead of a collection of thousands of spreadsheets, PDFs, and other files, saved an enormous amount of time, not to mention optimised the quality of data analysis.

The approach taken was aimed at achieving high efficiency, without incurring unnecessary additional costs. This agile technique allows newly acquired data to be added to existing analysis without the need for restarting the process.

Since Excel has a limit of about one million of rows in a table, it was obviously not an option for us to hold the source data, but sufficient for the relevant transactions database (about 35,000 transactions). Therefore, we turned to MS Access to hold the source data for the following reasons:

- No additional software costs.
- Short learning curve for team members to be able to use basic functionality of MS Access.
- Possibility to use the same infrastructure that we normally use (i.e., laptops, network drives, etc.).

The majority of the data came from just two banks, but in different layouts.

To simplify things and manage the size of each database and preserve the integrity of the data, we decided to have separate databases dealing with each bank's data. These separate databases were to hold data for further analysis

1 OCR – optical character recognition, a process to convert images of alphanumeric data into machine-readable data.

and possible inclusion into the relevant transactions database.

It is important that the project team follows certain naming conventions when populating the database, i.e., the same legal entity/individual should be always named the same. While it is possible to use built-in i2 Analyst's Notebook (i2AN) functionality to quickly find same entities with different names, it advantageous to adhere to the same naming convention from the start to ensure analysis is consistent across different tools. With that purpose, building and maintaining a list of legal entities that are encountered in the project is the way to go. The same list (with certain amendments to convert it in search terms) will be also used to update the database with relevant transactions along the project execution.

Tracing transactions

The joint transactional database allows an investigator, using various automation techniques, to find chains of subsequent transactions. Nevertheless, visual representation of transactions is often the best and fastest way to find key entities and direct further searches. Figure 1[2] shows an example of an actual analysis of a subset of data to identify hidden connections between various entities and their importance. Data from individual transactions are aggregated using MS Access and then processed by i2AN so that each link shows the total amount of turnover between entities and period of the transactions.

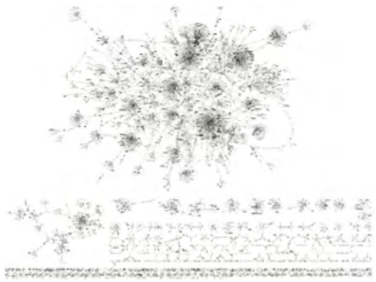

Figure 1: One of stages of analysis of about 50,000 transactions

The graph represents a subset of data of about 50,000 transactions, selected based on a list of keywords, that took place over a period of twelve years. The total value of these transactions is USD 29.3 billion. Using i2AN we can easily identify the main cluster of linked transactions with several smaller clusters not linked to each other, and many counterparties connected just to each other. It is already a useful result to understand relationships between various parties. Each link has an amount and dates that were populated from our source data and aggregated for each pair of counterparties.

Subsequent analysis required finding connections between multiple parties. This process is fully automated in i2AN and provides an opportunity to analyse the identified subnetwork separately from the main diagram (Figure 2).

Figure 2: Automatically finding connections between various parties

Another result of this analysis was a possibility to connect two previously independent sets of transactions and achieve a significant progress towards identifying final destinations of chains of wire transfers by mapping cash flows through a highly complicated network of transactions.

To illustrate some of the complex relationships, for example, chronological sequence of events and transactions, it was more efficient to use another type of diagram, a timeline graph (see Figure 3).

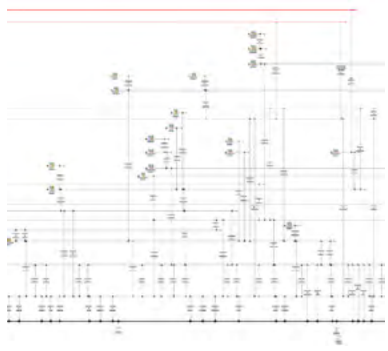

Figure 3: A fragment of the timeline analysis showing chronological sequence of events from various sources

The timeline was also created automatically, manually formatted for presentation purposes with some supplemental elements that were added manually. The chart showed dates, amounts and currencies of wire transfers, and was highly useful to prove connections between sources of money, series of transactions across multiple legal entities and personal interactions between various individuals.

These graphs provided a powerful way to efficiently analyse millions of transactions and explain findings to various audiences on all stages of the project.

2 The screenshots at Figures 1-3 are intentionally created to be unreadable to preserve confidentiality, however the visual result of the analysis is clear.

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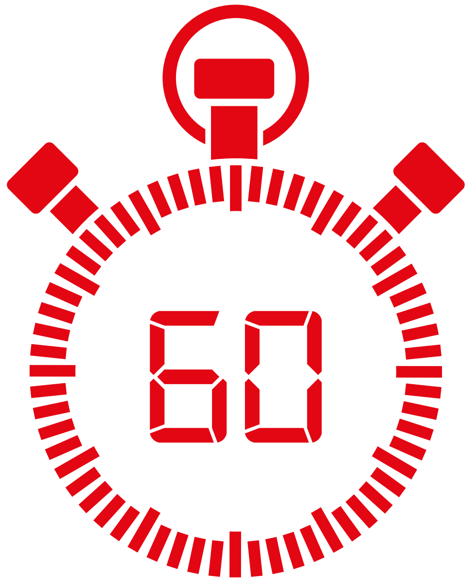


Q Imagine you no longer have to work. How would you spend your weekdays?

A I would spend a few months on a beach getting through the big pile of books that I've bought but not had time to read. Then I'd go back to work – I like my job and I'm too young to retire!

Q What do you see as the most important thing about your job?

A Helping clients to achieve their goals, and also helping them to understand what goals are achievable. You have to be your client's unstinting promoter to the world, while also being a realist behind closed doors. But in both cases your job is to serve the client – within ethical constraints. The bar ethics code tells us that our duty is to our client, subject only to our duty to the Court. I find that remembering that simple maxim is surprisingly helpful in showing the way through a difficult situation.

Q What motivates you most about your work?

A Of course, I like to succeed in court. The English legal system very cleverly harnesses the innate desire to win that lies in most people's hearts.

Q What is one work related goal you would like to achieve in the next five years?

A I would like to do more cross-examination.

Q What has been the best piece of advice you have been given in your career?

A If you're on trial for murder and have the choice of the cleverest barrister in the world, or the most charming barrister, pick the charming one. I heard this from a criminal barrister! In a technical area like insolvency you do, of course, have to be on top of difficult legal points and complex factual material. However, you can't lose sight of the fact that your job, in court, is to be persuasive, which is more than just cleverness.

Q What is the most significant trend in your practice today?

A It's not really a trend, but the impact of the Supreme Court's recent decision in R (on the application of PACCAR Inc and others v Competition Appeal Tribunal is going to be pretty big. The Court found that many common litigation funding agreements are impermissible "damages-based agreements" under the relevant regulatory regime, and hence unenforceable. There will need to be a lot of redrafting, and also a lot of working out what to do where money has already been paid out. In the UK, I think we are unfortunately still seeing businesses struggling post-covid and now with the increase in interest rates and decrease in consumer spending, which will inevitably mean more insolvencies.

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

A Hilary Stonefrost was my mentor in South Square when I first started practice. She's really smart, has a very straightforward and engaging advocacy style and is nice to everyone. If I could come close to her I'd be very pleased.

Q What is one important skill that you think everyone should have?

A The ability to recognize their own strengths and weaknesses, and play to these.

Q What cause are you passionate about?

A Children's right to a happy childhood with a good education and without material deprivation. I believe that a lot of social issues would fall into place with a greater investment in nurseries, schools, children's social care and child benefits. I'm a trustee of a fantastic academy trust in Enfield, the North Star Community Trust, which runs four schools serving some of the most economically deprived areas in the UK. The Trust does an amazing job of supporting the children who attend its schools and their families in a really holistic way, with community outreach and targeted support. The schools have achieved fantastic results this year, far above the national average, which is extraordinary given the challenges many of the children face. Targeting the worst effects of childhood deprivation can, I believe, have a positive effect which lasts a lifetime. Sadly, government spending priorities mean this is not currently happening for many.

Q Where has been your favourite holiday destination and why?

A I spent an amazing three weeks travelling in Japan for my honeymoon in 2016. We saw beautiful and varied countryside, ate great food, and met lots of interesting people. The culture is fascinating and there were so many interesting places to visit. Also they have a great culture of public spa baths which I can really get on board with. I'd love to go back again.

Q Dead or alive, which famous person would you most like to have dinner with, and why?

A Montaigne, the sixteenth century French essayist. He is one of my favourite writers, and his personality just shines through on every page. In his writing he is funny and sharp without being at all cynical. He was interested in everything and had an original and completely unexpected take on every subject that he came upon. I would have loved to meet him.

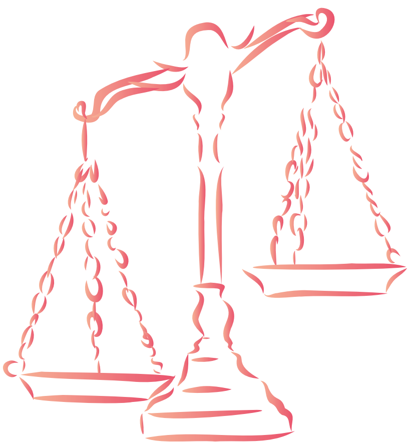
TO STAY OR NOT TO STAY

RE LAM KWOK HUNG GUY (2023) 26 HKCFAR 119, [2023] HKCFA 9 AND THE ENGLISH APPROACH TO (NOT) STAYING PETITIONS PRESENTED DESPITE EXCLUSIVE JURISDICTION CLAUSE ("EJC")

Authored by: Thomas WK Wong (Barrister) – Twenty Essex (London/Singapore) and Denis Chang's Chambers (Hong Kong)

Introduction

How should the English Courts decide a bankruptcy or winding-up petition based on a disputed debt which is contractually subject to resolution in another forum? Does it matter if that forum is arbitration or a foreign court? This article reviews – and exposes the diametric contradistinction between – the current respective legal positions vis-à-vis the two fora, expressing the hope that they will be harmonised in due course.



Arbitration Clause: Salford Estates (No 2) Ltd v Altomart Ltd (No 2) [2015] Ch 589 (CA)

Starting with arbitration, Salford concerned a winding-up petition presented despite an arbitration clause. Although the petition was based on an arbitral award, the debtor company contended that the outstanding amount was disputed and had to be referred to arbitration. The English Court of Appeal ("CA") discretionarily stayed the petition under section 122(1)(f) of the Insolvency Act 1986 so as to compel the parties to resolve their dispute by arbitration, holding (at [40]) that, otherwise:

"[It] would inevitably encourage parties to an arbitration agreement—as a standard tactic—to bypass the arbitration agreement and the 1996 Act by presenting a winding up petition. The way would be left open to one party, through the draconian threat of liquidation, to apply pressure on the alleged debtor to pay up immediately or face the burden, often at short notice on an application to restrain presentation or advertisement of a winding up petition, of satisfying the Companies Court that the debt is bona fide disputed on substantial grounds. That would be entirely contrary to the parties' agreement as to the proper forum for the resolution of such an issue and to the legislative policy of the 1996 Act."

EJC: Guy Lam

What about EJCs? The latest Hong Kong Court of Final Appeal ("CFA") case of Guy Lam involved an EJC contained in a Credit and Guaranty Agreement, in the New York courts' favour. Under the Agreement, the creditor T would advance loans to a company C, and the debtor G agreed to guarantee the full payment of all amounts due. T petitioned for G's bankruptcy in Hong

Kong on the outstanding debt owed by C, while he commenced proceedings in New York against it, claiming that there had been no event of default, under the Agreement.

The CFA held that:

- **The Hong Kong Court, like the English Court in Salford, could discretionarily refuse to determine whether the debt was bona fide disputed on substantial grounds, taking into account (inter alia) the EJC ([100]–[101]):**

"… A circumstance enlivening that discretion is the fact that the parties agreed to have all their disputes under the agreement giving rise to the debt be determined exclusively in another forum.

It is at this stage that the public policy interest in holding parties to their agreements comes into play. It is not the only consideration. The public policy underpinning the legislative scheme of the court's bankruptcy jurisdiction is still present. The more obviously insubstantial the grounds for disputing the debt, the more it comes into prominence."

- **The Court further clarified (at [104]-[105]) that:**

"The above approach to the exercise of the discretion to decline jurisdiction… is in some sense multi-factorial….

It is clear… that the so-called 'Established Approach' [namely, absent the EJC or an arbitration provision, a petitioner will ordinarily be entitled to a bankruptcy / winding-up order if the petition debt is not subject to a bona fide dispute on substantial grounds] is not appropriate where an EJC is involved. And in the ordinary case of an EJC, absent countervailing factors such as the risk of insolvency affecting third parties and a dispute that borders on the frivolous or abuse of process, the petitioner and the debtor ought to be held to their contract."

Therefore, Hong Kong's apex Court adopted, in the EJC's context, a discretionary approach similar to Salford in the arbitration provision's context, although it also highlighted its multi-factorial character, particularly embracing the fundamental policy underlying the legislative scheme of the Court's bankruptcy jurisdiction, as well as the seriousness of the debtor's grounds for disputing the petition debt.

Post-Guy Lam: What Now for England?

Thus considered, would England follow Guy Lam, which, after all, is consistent with Salford, for cases with an EJC? The author would hope so; there is only one problem: contrary binding English CA authority exists. In BST Properties Ltd v Reorg-Apport Penzugyi RT [2001] EWCA Civ 1997, a two-judge CA held (at [31]) that "whether or not proceedings raising a dispute as to the effect of the loan agreement could be stayed on the basis of clause 18 [an EJC], that does not… affect the question which was facing the Companies Court, namely whether the petition debt is bona fide disputed on substantial grounds." The effect of this was, as the recent decision in City Gardens Ltd v DOK82 Ltd [2023] EWHC 1149 (Ch) explained ([42]):

"[BST] is binding authority for the proposition that the Companies Court, in considering the exercise of its power to wind up under section 122 of the Insolvency Act 1986, is itself charged with determining whether the petitioner is genuinely a creditor. For that purpose, it has to determine whether the alleged debt is disputed in good faith on substantial grounds. Even where the alleged debt is based upon a contract which has an [EJC] in favour of a foreign jurisdiction, the judgment as to the exercise of the winding up power remains that of the domestic court. It follows that the petition should not have been dismissed on the grounds of the existence of the [EJC]".

This is clearly in diametric contradistinction to the Salford approach for arbitration agreements – without any apparent reason identified. Accordingly, we must await a suitable occasion for the UK Supreme Court to determine whether Guy Lam should now be followed in England instead of BST in cases involving an EJC. It is hoped that Guy Lam will prevail, thereby harmonising the approach for EJCs with the Salford approach for arbitration agreements.

AN OFFICE HOLDER'S ABILITY TO OBTAIN A FREEZING INJUNCTION LIMITED TO THE ESTATE'S ASSETS

WHERE ARE WE NOW?

Authored by: Stephen Cope (Associate), Gemma Kaplan (Partner) and Jennifer Craven (Legal Director) - Pinsent Masons

In Hunt v Ubhi[1], the Court of Appeal reaffirmed that an applicant for an interim injunction or freezing order must give an unlimited cross-undertaking to cover any loss or damage that the respondent might suffer as a consequence of the injunction or order. This is the "default position" and applies even when an applicant is an insolvency practitioner acting as an office holder of an insolvent estate. Should the applicant wish to limit their cross-undertaking in damages then they must demonstrate to the court why the default position should be departed from.

It is common and, in most cases, perfectly reasonable, for office holders to seek to limit costs and expenses to the net realisations available in the insolvent estate when those costs and expenses are incurred in accordance with their functions as office holder. It is not a stretch, therefore, to envisage a scenario where an office holder seeking a freezing order will wish to limit the cross-undertaking in damages in the same manner.

Whilst they are not barred from doing so, an insolvency practitioner will need to provide comprehensive evidence and give full and frank disclosure of all material matters of law and fact as to why the court should depart from the default position and limit a cross-undertaking in damages.

The Background

This case arises from a winding up petition presented against an allegedly insolvent partnership called Black Capital.

The petitioning creditors had invested significant sums in Black Capital and claimed they were owed £18m at the date of their petition. On the same day they presented the petition, the petitioners applied for the appointment of Mr Hunt as provisional liquidator.

Mr Hunt was appointed as provisional liquidator after the petitioning creditors gave a cross-undertaking in damages to a limit of £200,000.

Upon his appointment, Mr Hunt applied for a freezing order against the partners of Black Capital and gave a cross-undertaking in damages which was limited to the net realisations in the partnership's insolvent estate.

The freezing order was granted in the first instance however, one of the partners of Black Capital, Mr Ubhi, appealed against the court's decision to grant the freezing order on the basis that Mr Hunt's cross-undertaking was inadequate and the freezing order should be set aside and refused on the basis that the application failed to give full and frank disclosure to the court.

1 STEPHEN HUNT v RAVNEET UBHI [2023] EWCA Civ 417

The 'cross-undertaking' question

In considering whether Mr Hunt's limited cross-undertaking in damages was adequate, the court referred to JSC Mezhdunarodbniy Promyshlenniy Bank v Pugachev[2] as the leading authority on the provision of cross-undertakings and reaffirmed that the default position is that a person giving a cross-undertaking in damages should be unlimited. The court noted that, whilst there are exceptions (such as where the application has no personal interest in the litigation and is bringing the action on behalf of others) an office holder does not have an automatic right to depart from the default position solely by virtue of their appointment alone and, although it is a relevant consideration, the burden still lies on the office holder to persuade the court to depart from the default position to allow a limited cross-undertaking in damages.

In this case, there was no evidence that Mr Hunt had asked the creditors for indemnity and noted that the petitioners had provided a cross-undertaking (albeit limited to £200,000), and as they had invested significant sums into the partnership and were owed £18m, and had already expended significant sums to recover their debt, it was fathomable that they may have been in a position to provide Mr Hunt with at least a limited indemnity. This, however, was not explored.

There was also no suggestion that Mr Hunt needed to obtain injunctive relief in a hurry and which may have made it impractical to obtain an indemnity from creditors or take out insurance.

The court, therefore, found that Mr Hunt had not satisfied the steps required to justify the court's departure from the default position.

The court of appeal also considered whether Mr Hunt upheld his duty to give the court full and frank disclosure. Whilst it was argued that the cross-undertaking in damages should be limited since Mr Hunt is an office holder and is not expected to put his own money up the judge that was not justification alone to limit the cross-undertaking.

The court of appeal found that the first instance judge ought to have been told of the principles which emerged from Pugachev (that (i) the default position is that the cross-undertaking must be unlimited, (ii) that litigation is brought by an office holder is not enough to cap the cross-undertaking and (iii) it is relevant to consider whether a creditor could be expected to indemnify or provide funding to the office holder) and, having failed to do so, Mr Hunt had breached his duty of full and frank disclosure.

Lessons

This case is a useful reminder of the steps required by office holders seeking to limit a cross-undertaking in damages and the importance of considering whether it is possible or practical to obtain an indemnity from petitioning creditors or insurance. The burden of proof will be on the applicant to show why it is appropriate to depart from the default position of an unlimited cross undertaking in damages: insolvency practitioners should be prepared to demonstrate why this is necessary, and they must ensure that there is strong evidence justifying the departure, that can be placed before the court. It is, of course, imperative that the applicant prepare for and present his application in accordance with the duty to give full and frank disclosure: naturally that will include a duty to provide credible and up to date information as to the applicant's ability (or lack of) to meet any cross undertakings in damages.

Any derogation from this duty or failure to comply will put the entire application at risk of failing.

2 [2015] EWCA Civ 129

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SERVING THE PROTECTIVE PURPOSE: INVEST BANK PSC V EL-HUSSEINI AND S.423 INSOLVENCY ACT 1986

Authored by: Rory Forsyth (Barrister) - Maitland Chambers

A harsh observer might say that s.423 Insolvency Act 1986 (“s.423”) is doubly misleading. The first problem is its title. It carries the name “transactions defrauding creditors”, even though there is no requirement to prove fraud: see Hunt v Balfour-Lynn [2022] EWHC 784 (Ch). The second concerns its location. There is no requirement for the “debtor” entering into the “transaction” to be insolvent, notwithstanding the fact that the provision was enacted within a piece of insolvency legislation.

Whilst s.423 is undoubtedly of great utility to insolvency practitioners, its scope embraces any “transactions entered into at an undervalue” for either of the two prohibited purposes in s.423(3). The provision serves a broad protective purpose: safeguarding creditors against attempts to put assets beyond their reach or otherwise prejudice their interests.

The significance of this point is illustrated by the Court of Appeal’s recent decision in Invest Bank PSC v El-Husseini [2023] EWCA Civ 555. Two key principles emerge from the judgment of Singh LJ, with whom Males LJ and Popplewell LJ agreed:

- The phrase “a person enters into such a transaction with another person” should be interpreted to include “a person who causes a company (which he controls) to enter into such a transaction with another person”; and
- A “transaction” can fall within the scope of s.423 “even though the asset which is alleged to have been disposed of at an undervalue was not beneficially owned by the [debtor]”.

Background

Invest Bank PSC (“the Bank”) pursued primary debt claims against Mr Ahmad El-Husseini (“Ahmad”) arising from judgments in the UAE, along with secondary claims against a range of other defendants for relief relating to assets against which the Bank wished to assert an entitlement to enforce Ahmad’s liability.

The Bank alleged that Ahmad had taken steps to disguise his beneficial ownership of these assets. However, the appeal centred upon the Bank’s alternative case that Ahmad had caused these assets to be transferred to members of his family for one of the prohibited purposes in s.423(3). Even if certain assets were beneficially owned by a limited company, Ahmad was the sole director and owner of that company. Accordingly, the Bank argued that he had “entered into” the impugned “transactions” by causing his company to transfer the assets.

The first appeal (brought by the Bank) concerned the question of “whether it is possible for a debtor to enter into a transaction with another person (a third party) within the meaning of [s.423] if his acts are to be regarded in law as the acts of a company”. Following a preliminary hearing at first instance, Andrew Baker J held that s.423 was “not applicable unless the debtor acted separately in a personal capacity and not only as the instrument by which his company acted” (as paraphrased by the Court of Appeal). This aspect of his decision was concerned only with a situation where the debtor acts as the instrument of the transferor company “without more”, and the Judge accepted that an individual could “enter into” the transaction if they had some other involvement with the proposed transfer.

The Court of Appeal held that such an individual could be said to have “entered into” the transaction “without more”. There was no strict requirement for the individual to also be involved in some other sense, such as a hypothetical “kitchen table conversation” with a broader set of parties.

The second appeal was brought by the third and fourth defendants (referred to for convenience as “the Defendants”), both of whom were sons of Ahmad.

It raised the even more fundamental question of “whether a “transaction” can be entered into within the meaning of [s.423] if the

assets are not beneficially owned by the debtor". Andrew Baker J held that the answer to this question was 'yes', and his decision was upheld by the Court of Appeal.

1 The first appeal: dispelling the "disattribution heresy"

At first instance, Andrew Baker J accepted the Defendants' argument that when the individual in question "does no more than act as the instrument by which his company acts, he is not treating with his company, or directing or instructing it to act, he is his company."

Singh LJ respectfully concluded that the Judge "fell into the error of assuming that, because the company can only act through a human person, and because in law the act is treated as the act of the company, it could not also have some legal significance when it comes to the individual debtor". It is axiomatic that a company's separate legal personality must be respected, whilst the shareholders have no ownership of a company's assets. However, it does not follow that the director's factual acts cannot also have any legal significance.

The Judge's reasoning was an example of the so-called "disattribution heresy", initially described by Neil Campbell and John Armour in their 2003 article 'Demystifying the Civil Liability of Corporate Agents' [2003] Camb LJ 290, at 292. The "heresy" posited that, where an agent's acts are attributed to a company on the basis that they were acting "as the directing mind and will of the company", it was consequently impossible for those same acts to be "legally attributed to the agent". Yet this idea had already been dispelled by the House of Lords in Standard Chartered Bank v Pakistan National Shipping Corp. [2002] 3 WLR 1547.

As Campbell and Armour noted in their article, the "heresy" emerged from the "metaphysical notion" that such a director becomes the "embodiment" of a company (rather than "simply acting as its agent"). But whilst the company law regime ensures that "the company but not shareholders bears liability", it does not serve the same function in relation to corporate agents. There is "no convincing reason why the company being liable should exclude or immunise the agent from being liable."

Accordingly, it is possible for both the company and the individual by which it acted to have "entered into" a "transaction" within the scope of s.423. Of course, the definition of a "transaction" for these purposes "includes a gift, agreement, or arrangement": s.436(1) Insolvency Act 1986. There is no requirement for the debtor to be legally bound by the "transaction" in their personal capacity.

2 The second appeal: corporate vehicles and the "protective purpose"

The Defendants argued that the Court of Appeal was bound by its previous decision in Clarkson v Clarkson [1994] BCC 921 (CA), a case involving an alleged transaction at an undervalue by a bankrupt under s.339 Insolvency Act 1986. On that footing, it was said that a transaction impugned under s.423 "must involve the giving away of property which would otherwise have formed part of the debtor's bankruptcy estate".

Yet this submission elided the distinguishing feature mentioned at the start of this article: s.423 has been framed without any reference to the debtor's solvency. The fact that it happens to have been enacted within a piece of insolvency legislation does not provide a reason to confine its scope to property within a debtor's hypothetical insolvency estate. Furthermore, the opening words of s.436(1) made it clear that the definitions applied "except insofar as the context otherwise requires", and accordingly a "broader interpretation" should be given to the phrase "enters into a transaction" in s.423 than might be the case under s.238 or s.339.

With that in mind, there was no requirement for the debtor to be the beneficial owner of the assets in question.

Conclusion

On both issues, the Court's reasoning was linked to the protective purpose served by the legislation itself. The Defendants' interpretation of s.423 would have made it significantly easier for sophisticated debtors to subvert this purpose by the use of corporate vehicles. With that in mind, the decision should be welcomed.

Yet it also carries a broader lesson for practitioners in this sphere.

It is not enough to ask whether the transaction in question has led to the debtor ceasing to possess an asset; one must also consider whether the transaction has diminished the value of the debtor's continuing assets.

The Court's analysis in El-Husseini is capable of being applied to a wide range of circumstances, some of which may be far removed from the typical asset recovery exercise. In principle, the Court's reasoning should apply equally to the transfer of intellectual property rights, NFTs, or any other intangible assets owned by a debtor's company.

Practitioners may even wish to consider using s.423 to impugn "transactions" which have not involved any transfer of assets at all. As Singh LJ noted at [60], s.423 "does not appear to require the transfer of any assets, let alone assets of which the debtor is the beneficial owner". In light of El-Husseini, it is conceivable that s.423 could be engaged in circumstances where a debtor causes their company to enter into an "arrangement" whereby it informally refrains from exercising a contractual right at a given moment in time (with a resulting impact upon its share price). The ultimate inquiry concerns the transaction's impact upon the economic value attached to the debtor's assets.

HOW TO USE BLOCKCHAIN ANALYTICS TO INVESTIGATE INSOLVENCY IN CRYPTO LENDING SERVICES

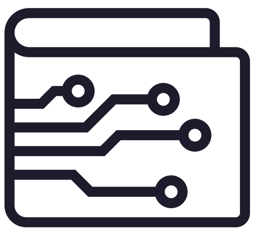
Authored By: Meredith Fitzpatrick (Director) and Peter Bott (Senior Associate) - Forensic Risk Alliance

Insolvency is a proliferating issue within the cryptocurrency ecosystem, specifically in the realm of crypto lending services. Many of the largest services have recently filed for bankruptcy, with Genesis, Voyager Digital, Celsius, and BlockFi falling in spectacular and contentious fashion[1]. Blockchain analytics are a critical component to analysing the flow of funds in these situations, especially for identifying the causes of insolvency and designing fair resolution.

Elevated Risks in Crypto Lending

While commonly associated with decentralized finance (DeFi), crypto lending services do have centralized components as they endeavour to integrate traditional banking concepts into the blockchain environment. Like their traditional counterparts, crypto lending services offer loans and interest to customers depositing their crypto.

However, these services and their customers are exposed to higher risk as there is no equivalent of deposit insurance. Moreover, regulatory agencies are struggling to adapt current regulations or create new ones for these crypto financial platforms that have no direct traditional banking equivalent. These elevated risks are exacerbated when fraud and other illicit activity make the insolvency resolution contentious, as we've seen in the examples mentioned.



The Illustrative Case of Celsius Network

One of the most high-profile contentious insolvency cases in the crypto world of late is that of US-based cryptocurrency lending service Celsius Network. It first indicated pains surrounding their business model around April 2022, when matters of asset custody arose from questions posed by regulators and general volatility in the crypto market. This situation swiftly devolved over the summer of 2022, culminating in Celsius Network filing for Chapter 11 bankruptcy in July 2022. CEO Alex Mashinsky was arrested on fraud and market manipulation charges a year later in July 2023[2].

Celsius Network reached settlements in July 2023 to facilitate the returning of assets to customers and manoeuvrer the company out of bankruptcy proceedings[3]. The company faces a staggering $78.2 billion in unsecured claims. As the situation is fraught with fraud and market manipulation charges via the CEO's legal proceedings, navigating the company through this legal maelstrom will require sophisticated investigative techniques.

The crypto element may sound like an added complication in a contentious case like this, but the ability to apply blockchain analytics and investigative techniques can make identifying the ultimate destination of funds more feasible than with traditional, fiat currency-based enterprise.

1 https://apnews.com/article/cryptocurrency-technology-financial-services-bankruptcy-bitcoin-f7d97ff9cc12afc1fd845648b5f13ea7

2 https://www.coindesk.com/markets/2022/07/15/the-fall-of-celsius-network-a-timeline-of-the-crypto-lenders-descent-into-insolvency/

3 https://cointelegraph.com/news/celsius-network-reaches-settlements-exit-bankruptcy

When blockchain analytics are combined with traditional financial investigation expertise, companies in situations like that of Celsius Network stand a better chance of reconstructing fund flows, locating assets, and ultimately reaching resolution.

Needles in two Haystacks: The Blockchain and Unstructured Data

When effectively harnessing blockchain analysis in tandem with unstructured data, the two data sources inform each other, and quicken the process of reconstructing the flow of funds and identifying the locations of assets. Unstructured datasets (email addresses, text messages, internal communication platforms) are critical in reconstructing what happened and how in any financial investigation. The public nature of the blockchain allows the examination of all transactions occurring in a particular case. Both sources of information can be leveraged in an investigation to accelerate the identification of needles in either haystack.

From unstructured data to the blockchain

In crypto insolvency cases, unstructured communication datasets can contain information pertaining to critical crypto transfers and transactions, like transaction hashes and addresses. These critical identifiers, especially when found in a critical conversation, can be put into blockchain analytics tools to focus investigators' efforts in tracing funds.

In the Celsius Network case, the FTC asserted that the company lacked any system to track assets and liabilities until mid-2021[4], meaning there was a four-year accounting blind spot up to that point from the company's founding in 2017. Leveraging unstructured data to find known addresses or transactions and thereby reconstructing fund flows can fill some gaps in this four-year blind spot, identifying where assets went and what liabilities were incurred.

Additionally, this process can help resolve issues pertaining to the veracity of transactions, comparing transfers likely involving legitimate business operations with apparent anomalies, thus triaging pools of transactions and addresses potentially linked to fraudulent activity.

Reversing the process

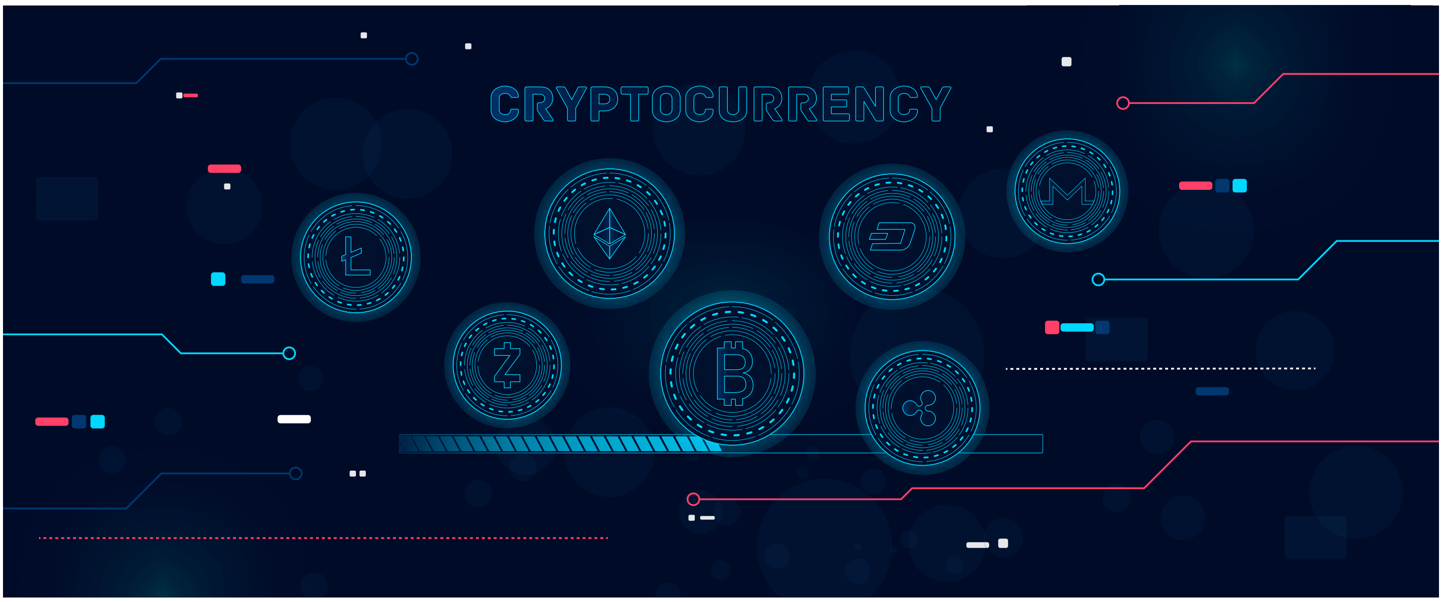
The reverse is also true. Once a holistic and sophisticated blockchain investigation has taken place, information obtained can then be fed back into the investigative process to uncover further evidence amongst unstructured datasets. Effective use of sophisticated blockchain analytics tools can identify significant transactions on the blockchain that inform an investigator where to look amidst massive volumes of chat logs to see who knew what and when.

Blockchain analytics can unveil transaction patterns and return critical details such as timestamps of transfers. By making note of timestamps of large or patterned transfers, one then can analyse email, text, and internal communications surrounding these timestamps and potentially harvest further evidence and information on whether these transactions occurred for legitimate or illegitimate reasons.

Conclusion

So long as the popularity of DeFi platforms continues to grow faster than the regulation and safeguards around it, contentious insolvency cases in the cryptocurrency sphere likely aren't going away anytime soon. Enabling investigation teams to amplify traditional investigation techniques with the power of blockchain analytics will empower companies to better guide themselves out of tumultuous financial situations.

4 https://www.ftc.gov/news-events/news/press-releases/2023/07/ftc-reaches-settlement-crypto-platform-celsius-network-charges-former-executives-duping-consumers



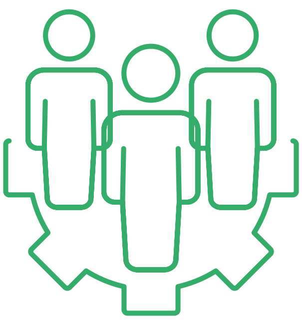
WHEN DOING NOTHING IS NOT ENOUGH

THE LIABILITY OF DIRECTORS FOR INACTION

Authored by: Daniel Lewis (Barrister) – Wilberforce Chambers

"The only thing necessary for the triumph of evil is for good people to do nothing" (JFK, 1961, misattributed to Edmund Burke).

This popular adage is not true. The inaction of "good" people is not the only thing necessary for the triumph of evil; what is necessary is for "bad" people to act to advance their cause. In company law terms, when will the "good" director be in breach of duty for doing nothing to stop a "bad" director? When is it open to the "good" director to say that the loss would have happened anyway regardless of what he or she might have done to stop the "bad" director?



Collective responsibility

It is often said that directors have "collective responsibility" for the decisions they take. That might suggest that – just as a government minister is (or perhaps, was) expected to publicly support the collective decisions of the cabinet – a director is answerable for the board's collective bad decisions. The principle of collective responsibility is however based upon individual responsibility. Each individual director owes duties to the company to inform himself about its affairs and to join with his co-directors in supervising and controlling them. In doing so, a proper degree of delegation and division of responsibility is permissible.

The liability of a director for the decisions and actions of others can arise in two situations: (i) the "complete abrogation" cases; and (ii) the "delegation" cases.

Complete abrogation

These are the cases where the defendant director has done absolutely nothing – they neither made the decisions which caused the company loss, but nor did they do anything to inform themselves of the decisions being taken or to consider whether they were in the company's best interests. This most commonly arises in the context of "family" companies where the running of the business is left to certain family members.

The classic example of this was Re Park House Properties Ltd [1998] B.C.C. 847. Memorably, when asked what his reaction would have been had his wife and co-director raised some question over breakfast about the preparation or filing of annual accounts or the payment of VAT, the director said he would have choked on his cornflakes. In these types of case, the inactive director may be found liable since "if he does nothing, he is likely to be in breach of his duties, and if the company is involved in inappropriate activity, he risks associating himself with, and taking some responsibility for, that inappropriate activity".

Delegation "down"

In contrast to the complete abrogation cases, there are those cases where the director has delegated certain responsibilities to others. They can be thought of as involving either delegation "down" or delegation "up".

Delegation "down" is where the director

delegates a specific function to someone below them in the management structure. There are a number of potential stages to the question of liability for "delegation down":

- **Was the function one which it was reasonable to delegate in the first place?** There are some functions that can be described as non-delegable, for example the duty of a financial director to review the company's financial statements and satisfy themselves of their accuracy.
- **Was the delegate a reasonable person to whom to have delegated the function?** In particular, were they reasonably believed to be competent and honest? Were they known to be amenable to proper supervision and control?
- **Having delegated the particular function, did the director exercise proper supervision of the discharge of the delegated functions?** To what extent did the director monitor the performance of the delegated functions, to satisfy themselves both that the instructions given were being followed and that they were being performed competently.

Unlike the complete abrogation cases, the delegation "down" cases depend upon the reasonableness of the decisions taken, unless the delegated function was by its nature non-delegable or the director failed in the irreducible obligation of supervision.

Delegation "up"

Delegation "up" can encompass a range of behaviour. The most common is where the director relies upon the competence of an executive director in their area of responsibility. As with delegation "down" the question will be whether the reliance placed upon that co-director was reasonable, taking into account the fact that, for a company to function, a director is not required to treat every interaction with his fellow-directors with suspicion and mistrust. The directors are entitled to rely upon the accuracy of the figures presented by the executive team in plans and budgets in the absence of identifiable issues which cause concern.

Delegation "up" also includes those cases where a "big character" dominates the board's decision-making. Where the board is so bamboozled by the dominant personality that they do little or nothing to consider the correctness of what is being done in their collective name, liability is likely to be decided on the same basis as a complete abrogation of responsibility. On the other hand, there are the credible fraudsters by whom certain directors are, not unreasonably, taken in: perhaps best exemplified by Madoff v Raven [2013] EWHC 3147 (Comm).

Coulda, woulda, shoulda…

Even if breach is established against the otherwise innocent director in any of the abrogation and delegation cases, questions of whether the loss would have occurred anyway are likely to arise.

"Whether it is open to the director to argue the counterfactual (i.e. the company would not have taken advantage of the opportunity) depends upon whether the transaction in question related to "existing trust property of the company":

- If it does, equitable compensation will be assessed on the substitutive basis so that the director cannot argue the counterfactual.
- If it does not, equitable compensation will be assessed on the reparative basis, so that the loss is assessed on the basis of what would have happened but for the breach of duty (for this distinction, see Davies v Ford [2023] EWCA Civ 167, and the first instance decision [2021] EWHC 2550 (Ch))."

Even in cases of complete inactivity or advertent wrongdoing, two recent cases show that it does not follow that the director will be prevented from arguing the counterfactual.

Of the former type of case, in Dickinson v NAL Realisations (Staffordshire) Ltd [2018] BCC 506 (upheld on appeal [2020] B.C.C. 271) while the passive directors were liable for breach of duty for taking no part in supervising the company's affairs, it was held not to follow that this was causative of any loss. Their disengagement did not in any real sense enable the dominant director to misapply company funds. The Judge went on to hold that had the passive directors protested, the dominant director would have engineered their removal.

More strikingly still as a case of advertent wrongdoing (although only decided to the summary judgment standard) in Auden McKenzie (Pharma Division) Ltd v Patel [2020] B.C.C. 316 the Court of Appeal accepted that it was at least arguable that the director who had caused the misapplication of company funds to himself and his sister by the issue of sham invoices could defend on the basis that the company would be in precisely the same position if the payments had been made lawfully by the payment of dividends or bonus or other remuneration. The Court of Appeal noted that while a similar defence had been rejected by it in Bairstow v Queens Moat Houses Plc [2002] BCC 91 (usually cited in answer to similar counterfactual arguments), permission to appeal to the House of Lords had been granted before the case settled.

What these cases demonstrate is that even where breach of duty by a director for some degree of inactivity (whether total or partial, by delegation) is established, the question of whether the loss would have arisen anyway is not the dead duck it might once have appeared.

UK FINANCE ANNUAL FRAUD REPORT: WHAT'S TRENDING?

Authored by: Matthew Hancock (Shareholder) and Freya Mead (Associate) - Greenberg Traurig

Instances of authorised and unauthorised fraud decreased by 8% between 2021 and 2022. This was one of the findings by UK Finance, which published its Annual Fraud Report earlier this year.

While this overall decline is certainly positive, the scale of the problem should not be underestimated. Last year's collective losses totalled £1.2 billion, which equated to some £2,300 per minute being lost to fraudulent behaviour. Fraud accounted for over 40% of all criminal offences committed in England and Wales. In addition, UK Finance found that criminals are becoming increasingly sophisticated in adapting to the post-Covid-19 environment and technological advancement to commit fraud, as well as taking advantage of the ongoing cost of living crisis and financial anxieties.

TRENDS

In general, 2022 saw a slight fall (less than 1%) in the amount lost to instances of unauthorised financial fraud, which totalled about £730 million. Similarly, the number of authorised push payment (APP) frauds also fell in 2022, with losses totalling about £490 million – a decrease of 17% compared to 2021.

Remote purchase fraud – involving the use of stolen card details to buy something – accounted for the largest proportion of unauthorised card fraud, representing 81% of all cases reported in 2022. #

Phishing emails and scam text messages, as well as the exploitation of social media platforms and legitimate online retailers' websites, are typical examples of data theft methods that criminals use to obtain card details. With reliance on online shopping set to continue, instances of remote purchase fraud may well increase in 2023.

Similarly, while losses due to unauthorised remote banking fraud (including internet, telephone and mobile banking) fell by 18%, losses from mobile banking fraud within this category rose by 33%.

The overall decrease was to be expected in the face of lockdown restrictions easing and a return to in-person banking. The rise of mobile banking fraud is equally explicable (and will possibly increase in the coming years) as the functionality of mobile banking continues to improve and customers become more comfortable using these platforms.

APP fraud continues to be driven by the exploitation of online platforms, with 78% of cases originating online in 2022. Criminals use these platforms to defraud their victims though a variety of scams such as false search engine and social media advertisements, romance scams and purchase scams. Online APP scams tended to include lower value frauds and therefore accounted for 36% of the total APP fraud losses last year.

A total of 18% of reported APP fraud cases originated from telecommunications, which tended to be higher value transactions, accounting for 44% of total losses to APP fraud.

Purchase scams, whereby a victim pays in advance for goods or services that are never received, were the most common form of APP fraud in the past year. Criminals now routinely use social media websites to advertise goods that never materialise – a total of £67 million was lost to purchase scams in 2022.

TACKLING FRAUD

The past few years have seen the banking and finance sectors take a more proactive approach to tackling fraud, particularly by using innovative technology, which is starting to garner results. Protections such as Strong Customer Authentication, which took effect in March 2022 and provides additional security for consumers by requesting confirmation of identity when making purchases online, and Confirmation of Payee, the name checking service that provides customers with greater assurance that they are sending payments to the intended recipient, are having a positive impact in preventing instances of fraud.

At a legislative level too, there appears to be recognition that further measures are required to curb fraudulent activity. The government's proposed Online Safety Bill, (due for its third and final reading in the House of Lords in September and hoped to receive Royal Assent before the end of 2023), will mean that, for the first time, an onus will exist for technology and social media companies to remove scam advertisements from their platforms.

Similarly, the proposed Economic Crime and Transparency Bill, which is in its final stages of amendment, aims to tackle economic crime and the prevention of money laundering within corporate structures by improving the transparency of information sharing and making reforms to Companies House. Importantly, the Economic Crime and Transparency Bill also proposes the incorporation of a new corporate offence, "failure to prevent fraud", which stipulates that a large organisation will be criminally liable if an individual "associated" with the organisation commits fraud for the benefit of the organisation or any person who receives services from the organisation. An organisation's only possible defence is if it had reasonable fraud "prevention procedures" in place at the time of the offence. If found guilty, an organisation will face a potentially unlimited fine.

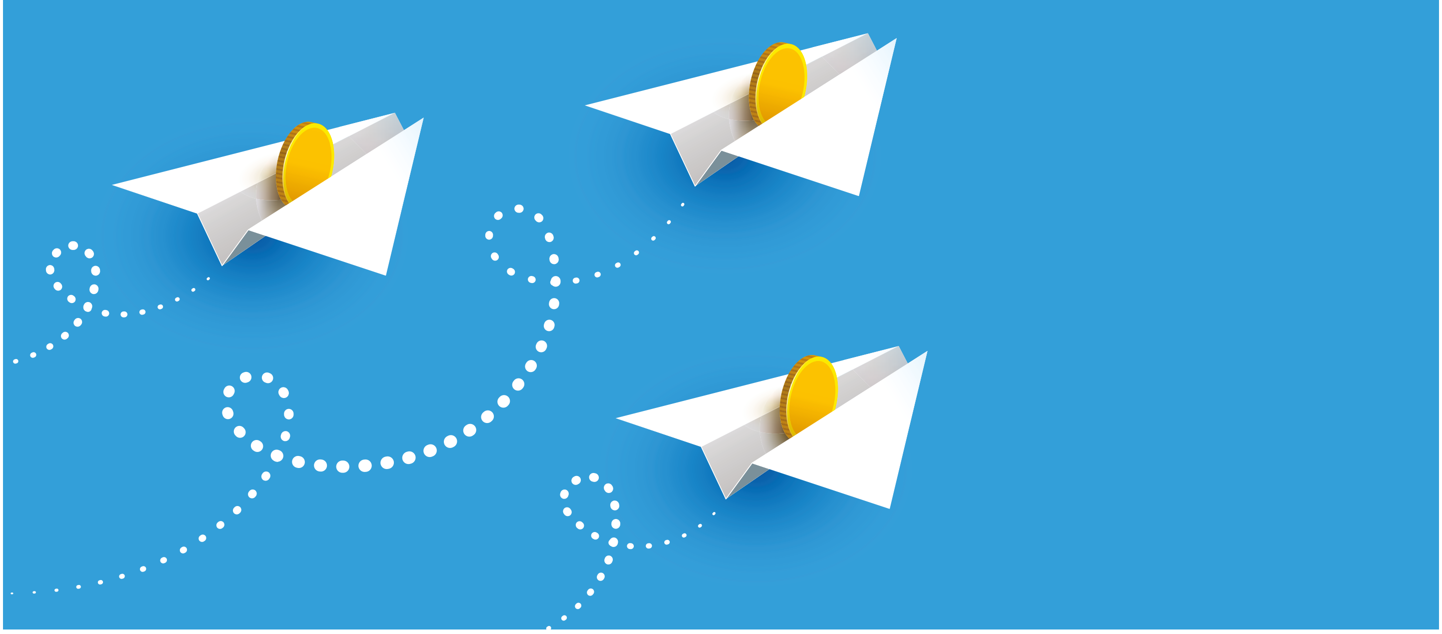
In addition, the Payment Systems Regulator (PSR), is in consultation regarding the UK's approach to fraud reimbursement to replace the APP voluntary code (signatories to which commit to adhering to certain protection standards to prevent and reimburse victims of APP scams). Importantly, unlike in the case of unauthorised payment fraud, current legislation offers victims of APP fraud no legal ramifications for losses (meaning victims of APP fraud have been turning to the Courts to attempt to recover sums lost). While the voluntary code is clearly having some impact (in 2022, APP fraud reimbursement rates exceeded 50% for the first time), the PSR's new measures aim to enhance consumer protection even further. Proposals include splitting liability between sending and receiving institutions, and publicly sharing data regarding how frequently individual banks refund victims. This would, for the first time, provide consumer visibility of their bank's competence at handling instances of fraud; those shown to perform badly may risk losing customers.

Despite advances, there remains a need for broader action to stop instances of fraud at source.

Given that most fraud offences originate online, arguably greater assistance is required from technology and social media companies to tackle prevention.

Assistance from these sectors will be particularly important in the coming years, which will likely see fraudsters turning to emerging technologies to augment their attacks.

DIRECTORS' DISQUALIFICATION COMPENSATION ORDERS – HAS THEIR TIME FINALLY COME?



Authored by: Catherine Doran (Barrister) – Radcliffe Chambers

The regime by which disqualified directors can be ordered to pay compensation for the benefit of creditors has been little used, but we may at last be seeing an uptick in cases.

The regime

In July 2013, the then Secretary of State for Business Innovation and Skills, Vince Cable, made a speech proposing improvements to the law on directors' disqualification:

> ***Requiring disqualified directors to undertake some form of education before they can go on to run another business is an option here. We might also allow the courts to make financial awards against directors they are disqualifying to compensate creditors who have suffered as a result of their actions. This would hit directors where it hurts and provide more direct accountability to those affected by misconduct[1].***

Less than two years later the Small Business Enterprise and Employment Act 2015 was passed. It conferred on the court a new power to make a compensation order against a person, on the application of the Secretary of State, where the conduct for which that person had been disqualified had caused loss to one or more creditors of the insolvent company. The Secretary of State could accept a compensation undertaking from a person where the conditions for the making of a compensation order were met, just as the Secretary of State could already accept a disqualification undertaking from a director rather than having to apply to court for a disqualification order.

Little used

Sections 15A and 15B Company Directors Disqualification Act 1986 came into force on 1 October 2015, and the Compensation Orders (Disqualified Directors) Proceedings (England and Wales) Rules 2016 came into force on 1 October 2016. Then, it appears,

1 https://www.regulation.org.uk/library/2013_trust_why_it_matters.pdf

very little happened. According to an Insolvency Service response to a Freedom of Information request, in the period 1 November 2019 – 24 February 2023 only one compensation order was made[2]. That single compensation order was granted by Insolvency and Companies Court Judge Prentis in Re Noble Vintners [2019] EWHC 2806. As indicated by its name, Noble Vintners Ltd bought and sold wine on behalf of clients. Shortly before going into liquidation its director transferred £560,000 of company funds to another company of which he was sole director and shareholder, without any legitimate purpose. At the time of writing Re Noble Vintners remains the only reported case on compensation orders.

Between 1 November 2019 and 24 February 2023, 29 compensation undertakings offered by directors were accepted by the Secretary of State[3]. To avoid legal costs many directors will choose to offer an undertaking rather than fight. Unfortunately that means few cases going to court, with the result that those advising directors only have Re Noble Vintners to go on. ICC Judge Prentis' judgment is therefore essential reading for advisors. It contains helpful guidance on the principles the court should apply when considering whether to make a compensation order, and on the terms of the order.

Abuse of pandemic financial support schemes

As has been widely publicised, for several years the Insolvency Service has been targeting for disqualification directors who abused the Covid-19 pandemic financial support schemes.

Between 1 April 2022 and 30 June 2023, 1200 directors were disqualified.

Of this figure, 611 were disqualified for misconduct involving abuse of Covid-19 schemes[4].

These cases, often involving bounce-back loans, provide the perfect opportunity for the Secretary of State to seek compensation orders on a wider scale.

By way of reminder, under the bounce-back loan ("BBL") scheme, a business could borrow up to 25% of its turnover in the previous year, up to a maximum of £50,000. The funds could only be used to provide economic benefit to the business.

Recent cases

On 25 July 2023 Chief Insolvency and Companies Court Judge Briggs heard the uncontested disposal of a claim for disqualification against a director accused of providing false or inaccurate information to his company's bank about the company's turnover when applying for a BBL, with the result the company obtained a BBL to which it was not fully entitled. It was further alleged that the director had failed to use the BBL for the economic benefit of the company and instead used it to benefit himself. The claim was undefended, and the director did not attend the hearing. At the time of writing the Insolvency Service has not issued a press release naming the director. This may be because the disqualification only actually takes effect 21 days after the disqualification order is made, and within this time the director may decide to apply for permission to appeal.

In what is likely to have been an ex tempore judgment Chief ICC Judge Briggs referred to a passage in the Court of Appeal's decision in R v Dag and Dagistan [2023] EWCA Crim 636, an appeal from a prosecution by the Insolvency Service:

43. However, in our judgment, the Recorder was right to recognise that the Bounce Back Loan Scheme presented an exceptionally vulnerable target at a time of national emergency which the appellants had ruthlessly exploited and that this increased the level of their culpability…

Chief ICC Judge Briggs made a top-bracket 13-year disqualification order against the director. Turning to the Secretary of State's application for a compensation order, the judge noted that it was clear that a loss had been caused to the company's bank. In addition to ordering the director to pay the £49,985 of the BBL which had not been used for the company's benefit, the judge permitted the Secretary of State to claim interest at the contractual rate of 2.5% per annum (as per the terms and conditions of the BBL).

It is understood that Insolvency and Companies Court Judge Barber has reserved judgment in another compensation order case, and that judgment is imminent. This may be Re Pure Zanzibar Ltd (see [2022] EWHC 971 for ICC Judge Barber's disqualification judgment). The misconduct in Pure Zanzibar was rather niche: taking holiday bookings and payments without a valid ATOL licence. But given that it has been four years since the last reported case on compensation orders, we can hardly be picky!

2 https://www.gov.uk/government/publications/insolvency-service-foi-responses-january-to-march-2023/foi2223-145-number-of-compensation-orders-and-undertakings-that-involved-compensation

3 https://www.gov.uk/government/publications/insolvency-service-foi-responses-january-to-march-2023/foi2223-145-number-of-compensation-orders-and-undertakings-that-involved-compensation

4 https://www.theguardian.com/world/2023/jul/16/half-of-uk-company-directors-struck-off-linked-to-alleged-covid-loan?CMP=Share_AndroidApp_Other

The International Law Book Facility Essay Competition 2023

JANE COLSTON

Partner at **Brown Rudnick** and trustee of the **International Law Book Facility ('ILBF')**

As a trustee of the International Law Book Facility (ILBF), I was delighted to be a judge again for this year's ILBF law undergraduate essay competition. This is the second year we've run the competition with the goal to engage law undergraduates with a question that is relevant to legal practice and involves a topic that takes them beyond their undergraduate studies, with the chance to win a great prize that will enhance their legal careers. This year we asked law students to address the question: 'What difference can lawyers make in tackling the climate emergency'. Entries came from students at universities across the UK. Their essays showed that law students fully grasp the existential threat to the planet caused by the climate crisis and what role lawyers in all fields of practice can play to mitigate that threat as well as advocate for those most impacted. It was a privilege to read such thought-provoking essays as part of the judging panel. Ultimately the winner was chosen by Lord Thomas of Cwmgiedd and Lord Carnwath of Notting Hill CVO. We are so grateful to them both for being our essay judges and helping make the competition the success it is.

Lord Thomas of Cwmgiedd and Lord Carnwath of Notting Hill CVO decided that this year's worthy competition winner was Clarissa Wong, first year undergraduate at the London School of Economics. https://ilbf.org.uk/2023/03/law-undergraduate-essay-competition-announcement-2/

Congratulations to Clarissa! You can read Clarissa's winning essay below.

Clarissa's prize was to spend time at Latham & Watkins and LexisNexis PSL Environment team. What did Clarissa think about the competition and what did the prize mean to her?

"I have always believed that lawyers have a role to create a better future" Clarissa said. "Researching for my ILBF essay allowed me to better understand the unique role which the legal community has in tackling global problems like climate change. During my time at Latham & Watkins and LexisNexis, I witnessed the dynamic and collaborative way in which the legal ecosystem drives such change — with lawyers of different specialties each cultivating their technical know-how, informed by a wealth of knowledge curated in real time by supporting professionals. Seeing how the lawyers interact with the ever-evolving law, I am reminded that legal professionals have the responsibility and privilege to keep their eyes trained on, and potentially influence, the front seat of change."

With lawyers of the future like Clarissa, the future is bright. I encourage all law undergraduates to take part in the ILBF's next law undergraduate essay competition. I am delighted that the upcoming competition in 2023-2024 will be sponsored by McDermott Will & Emery. Watch out for more news and announcements over the coming months.

I look forward to being on the judging panel in 2024. It has been a privilege.

Want to know more about how you can support the good works this book charity does? Watch our film (made on mobiles during Covid!).

https://www.youtube.com/watch?v=fsgmqBjZ6JM

WHAT DIFFERENCE CAN LAWYERS MAKE IN TACKLING THE CLIMATE EMERGENCY?

Authored by: Clarissa Wern Ting Wong (1st Year Undergraduate) - LSE

Climate change has driven up weather damage losses beyond USD 300 billion annually[1], while making them increasingly uninsurable[2]. Naturally, citizens and corporations are looking to the law and legal practice to urgently future-proof their societal and economic interests. For the law to rise to this challenge, lawyers must work beyond the confines of traditionally compliance-focused environmental law. Instead, they must proactively adapt law and legal practice to give the world the best chance at achieving swift and coordinated climate action.

Firstly, where law-making processes struggle to produce timely climate regulation, solicitors and in-house lawyers can incentivise climate action by institutionalising climate-conscious decision-making. Secondly, where the law provides inadequate guidance on the norms of responsibility and accountability we should expect of climate actors, lawyers can shape those norms via strategic litigation. Thirdly, where climate goals lack actionability, lawyers can design context-sensitive, performance-verifying enforcement mechanisms.

Incentivising environmentally-sustainable strategy through climate-conscious decision-making

Corporations are a key climate actor, as they have control over the sustainability of production processes. In-house lawyers and solicitors can leverage on their foresight-provision role within corporations to influence production decisions, by mapping decisions' climate-related risks. Businesses can suffer economic risk in the form of losses from weather damage, with losses amplified through supply chains; they can suffer liability risks from non-compliance with the law:

1 Aon (Aon 2023) rep <https://www.aon.com/getmedia/f34ec133-3175-406c-9e0b-25cea768c5cf/20230125-weather-climate-catastrophe-insight.pdf> accessed February 28, 2023

2 Stone A, "Insurers Struggle to Address Climate Risk" (Forbes January 31, 2020) <https://www.forbes.com/sites/andystone/2020/01/30/climate-change-will-make-more-of-the-world-uninsurable/?sh=775f9df1655a> accessed February 28, 2023

for example, Volkswagen had to foot €31.3 billion euros in the wake of its “dieselgate” scandal;[3]businesses can suffer transition risks, which refer to the possibility that carbon-intensive investments like coal-fired power plants will lose their value in a future low-carbon economy.

Setting up climate-conscious due-diligence frameworks ensures corporations have foresight of these risks before making decisions or mitigating the risks, such as by adopting climate-friendly contract clauses.

In this way, lawyers can help corporations to develop future-proof strategies even if regulations do not develop quickly enough to provide certainty of future business conditions. The difficulty of formulating long-term governmental climate strategy -- bureaucracy hinders its pace and it is vulnerable to inconsistency across election cycles -- arguably puts corporations in a better position to enact long-term climate strategy, a view echoed by the UK Law Society[4].

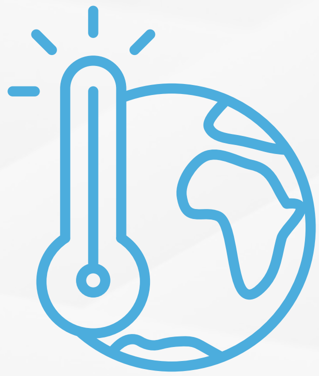
Setting norms of responsibility and accountability for climate actors

Many a remedy-seeking litigation claim for damage caused by climate change has fallen at the hurdle of establishing legal causality.[5]After all, climate change is produced by complex, difficult-to-isolate interactions between many actors. Attributing weather to a specific cause is fraught with much scientific uncertainty.

If ex-post litigation cannot clarify the standards of responsible behaviour to be expected of climate actors where the law is silent -- there is no legal regime allocating responsibility with regard to climate change’s impacts on property[6] -- strategic ex-ante litigation is an attractive alternative.

For example, ClientEarth, an NGO, successfully challenged the Polish energy group Enea’s decision to build a coal-powered power plant[7]. The claim, filed based on ClientEarth’s standing as a minority shareholder, creatively circumvented the challenge of establishing causality by basing the claim on the directors’ fiduciary duties to avoid harming shareholders’ interests. With an array of legal tools in areas like tort, human rights and public international law at their disposal, lawyers can innovatively shape norms of responsibility among climate actors.

Furthermore, legal scrutiny can function like a forum moderator in upholding an honest and trustworthy climate narrative. Since the truth behind the effectiveness of climate action is highly scientific, it is difficult to verify at first glance. This year, researchers allegedly discovered that 90% of carbon credits sold by the leading carbon standard are worthless “phantom credits”[8]. In the absence of oversight mechanisms, inquiry in court and in academia allows us to break through the opacity of a climate actor’s claims and pursue accountability. For example, a recent legal challenge revealed the UK government’s net zero strategy was inadequate to achieve its obligations under the Climate Change Act[9]. With the mushrooming trend of climate change-related litigation -- 25% of all climate change-related claims ever filed was filed between 2020 and 2022[10] -- litigation lawyers will greatly influence the urgent race to shape the standards of responsibility and accountability which climate actors should adhere to. Because the legal system is singularly adept at and concerned with upholding precedent, lawyers, through their individual cases, can make a lasting difference to the climate narrative.



Enabling actionability of climate goals

While litigation may achieve case-specific enforcement measures and establish wider norms of behaviour, it cannot enforce climate action across the board. Given the urgency of climate action -- the world must decrease carbon emissions by 45% by 2030 to reach its Paris Agreement target[11] -- large-scale climate action is necessary, if not by the carrot, then by the stick.

Because emissions produce transboundary effects, coordinated international climate action is imperative. Lawyers

3 Reuters, “Volkswagen Says Diesel Scandal Has Cost It 31.3 Billion Euros” (ReutersMarch 17, 2020) <https://www.reuters.com/article/us-volkswagen-results-diesel-idUSKBN2141JB> accessed February 28, 2023

4 Chittenden T, Brook N and Sedilekova Z (The Law Society of England and Wales 2021) rep <https://www.lawsociety.org.uk/topics/research/climate-change-risks-the-future-of-law-as-we-know-it> accessed February 28, 2023

5 Otto FE and others, “Causality and the Fate of Climate Litigation: The Role of the Social Superstructure Narrative” (2022) 13 Global Policy 736

6 Vaughan J, “Climate Change: Is It a Legal Issue? ”(UK: Climate Change: Is It A Legal Issue? July 27, 2022) <https://www.mondaq.com/uk/climate-change/1216114/climate-change-is-it-a-legal-issue> accessed February 28, 2023

7 Clientearth v Enea” (Climate Change LitigationAugust 2, 2019) <http://climatecasechart.com/non-us-case/clientearth-v-enea/> accessed February 28, 2023

8 Greenfield P, “Revealed: More than 90% of Rainforest Carbon Offsets by Biggest Certifier Are Worthless, Analysis Shows” (The GuardianJanuary 18, 2023) <https://www.theguardian.com/environment/2023/jan/18/revealed-forest-carbon-offsets-biggest-provider-worthless-verra-aoe> accessed February 28, 2023

9 The Queen (on the application of (1) Friends of the Earth Limited (2) ClientEarth (3) Good Law Project and Joanna Wheatley v Secretary of State for Business, Energy and Industrial Strategy [2022] EWHC 1841 (Admin)

10 Setzer J and Higham C (LSE Grantham Research Institute on Climate Change and the Environment 2022) rep <https://www.lse.ac.uk/granthaminstitute/wp-content/uploads/2022/08/Global-trends-in-climate-change-litigation-2022-snapshot.pdf> accessed February 28, 2023

11 UN, “For a Livable Climate: Net-Zero Commitments Must Be Backed by Credible Action” (United Nations) <https://www.un.org/en/climatechange/net-zero-coalition> accessed February 28, 2023

can facilitate this through their unique expertise in designing harmonised, non-discriminatory and enforceable international standards.

Lawyers involved in intergovernmental climate efforts -- such as the establishment of carbon markets or the removal of trade barriers impeding the trade of key environmental goods -- can provide technical input by ensuring that standards like “environmental good” appropriately anticipate and accommodate the technical and political nuances of the term. Lawyers in international organisations overseeing transboundary emissions-emitting activities -- like shipping and aviation -- can develop regulations and compliance-monitoring systems, such as the International Air Transport Association’s flight path-dependent carbon offsetting scheme for airlines[12]. By establishing such oversight mechanisms, lawyers can ensure climate action is delivered on sufficiently verifiable grounds rather than easily-abused trust and faith.

Conclusion

The mission to boost lawyers’ climate literacy and capacity to drive climate action is underway. Climate-conscious lawyering across the corporate, legal and regulatory spheres is not simply a response to client demands or a newly-recognised professional duty[13]. It is a chance for lawyers to build up the rule of law in the growing domain of climate action, to give it the best chance at proceeding in a swift and coordinated way: unmarred by a lack of planning foresight, misleading climate narratives or the unenforceability of transnational visions.

12 IATA 2020) rep <https://www.iata.org/contentassets/fb745460050c48089597a3ef1b9fe7a8/paper-offsetting-for-aviation.pdf> accessed February 28, 2023

13 (International Bar Association Climate Crisis StatementMay 5, 2020) <https://www.ibanet.org/medias/822C1967-F851-4819-8200-2FE298164922pdf?context=bWFzdGVyfGFzc2V0c3w3ODQ4MDZ8YXBwbGljYXRpb24vcGRmfGhmMC9oN2MvODc5NjMzNjIyNjMzNC84MjJDMTk2Ny-1GODUxLTQ4MTktODIwMC0yRkUyOTgxNjQ5MjIucGRmfDQzYTY0MjUxMDE0OTVjZTE4YjBhZmU1NzY0YTRkOTM3YjljNjg0NjdiY2QxNDY0MzBkYzJjOTNiOGUzNmVlMWE> accessed February 28, 2023

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