Volume 14 Issue 9 March 2015

Tolley's Company Law and Insolvency

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Dear Subscriber,

Welcome to the latest newsletter. Following the news section this newsletter contains five analysis pieces. In the first analysis piece Michael Swainston QC at Brick Court Chambers examines the decision in *JSC Bank of Moscow v Kekhman* [2015] EWHC 396 (Ch), [2015] All ER (D) 288 (Feb), a leading judgment on the accessibility of English bankruptcy to foreign debtors, and the question—When do English courts have discretion to annul an order in international bankruptcy cases?

In the second analysis piece Matthew Weaver of St Philips Chambers considers how and to what extent can undertakings given on the appointment of a provisional liquidator be enforced by the company in liquidation, following the recent decision in *Abbey Forwarding Ltd* (*In liquidation*) *v Revenue and Customs Commissioners* [2015] EWHC 225 (Ch), [2015] All ER (D) 91 (Feb).

Why did the High Court decide to allow the annulment of a bankruptcy order in *Mowbary v Sanders*? In the third analysis piece, Nick Brown, commercial litigation barrister at St Philip's Chamber (Birmingham), discusses the reasoning behind the ruling and the practical lessons the decision offers for insolvency office-holders.

When can notification of proceedings be served using social media? In the fourth analysis piece Derek Jones, of Harrison Clark Rickerbys, comments following a recent ruling that Facebook could be used to effect notification of bankruptcy proceedings.

Does the extension of the temporary exemption allowing no win, no fee agreements for insolvency proceedings give hope for a future permanent exemption? In the fifth analysis piece Frances Coulson, head of insolvency litigation at Moon Beever and former president of R3, offers her thoughts on this latest development.

This newsletter contains three summary reports of case law apposite to the jurisdictions of insolvency law and company law.

Finally, two areas of new legislation are outlined. The Insolvency Practitioners (Amendment) Regulations 2015 mean insolvency practitioners will no longer need to maintain records containing specified information on individual cases from 1 October 2015. There will be a broader requirement to keep records sufficient to show and explain the administration of a case and any decisions which materially affected the case. Finally, The Bankruptcy (Miscellaneous Amendments) (Scotland) Regulations 2015 make a number of amendments to the Regulations implementing the Bankruptcy and Debt Advice (Scotland) Act 2014 in respect of sequestrations.

I would be pleased to hear from subscribers who have any comments or suggestions regarding the content of this Newsletter, or any comments or queries on company law, insolvency law and practice and procedure in general in those areas. Letters which raise issues of interest may be published in the Newsletter. Please address letters to the editor of this newsletter: Dr John Tribe, Kingston Law School, Kingston University, Kingston Hill, Kingston upon Thames, Surrey, England, KT2 7LB, Email: j.tribe@kingston.ac.uk.

Dr John Tribe

Newsletter Editor

NEWS

(1) European Council announces new insolvency rules

New rules aimed at making cross-border insolvency proceedings more efficient and effective have received their first reading in the European Parliament. The European Council believes the new rules will benefit debtors and creditors, facilitate the survival of businesses as well as present a second chance for entrepreneurs.

Every year in the EU, insolvency proceedings affect an estimated 200,000 businesses, putting 1.7 million jobs at stake, according to figures provided by the European Commission. One quarter of them have a cross-border element.

The scope of the new rules has been extended so they go further than the liquidation proceedings covered by existing regulations. They also cover proceedings:

- which provide for the restructuring of a debtor at a stage where there is only a likelihood of insolvency;
- which leave the debtor fully or partially in control of his assets and affairs; and
- proceedings providing for a debt discharge or a debt adjustment of consumers and self-employed persons.

Under the new rules, Member States will be required to publish relevant information in cross-border insolvency cases in a publicly accessible electronic register. This will prevent the opening of parallel proceedings and improve the information of creditors and courts involved.

The European Parliament will adopt the text at second reading at its session of May or June 2015. The regulation will come into force on the twentieth day following its publication in the Official Journal of the European Union.

(2) SRA to stop regulating solicitor IPs

From 1 November 2015 the Solicitors Regulation Authority (SRA) will no longer regulate solicitors who act as insolvency practitioners (IPs). The SRA Board has taken the decision that insolvency work is not central to the work of a solicitor, and consumers would be better protected if solicitors were regulated by professional bodies with specialist expertise in insolvency practice.

There are currently 129 solicitors operating as IPs. An SRA consultation ran from November 2014 to January 2015 on its regulation of solicitor IPs.

A total of 17 responses to the consultation were received, with IPs opposing the proposal.

The SRA will now apply to the Legal Services Board (LSB) to revoke the Insolvency Practice Rules 2012 and to amend the necessary regulatory arrangements. If it agrees with the proposal, the Insolvency Service will lay an order before the Secretary of State for the Law Society's Recognised Professional Body status to be removed.

The change should take effect from 1 November 2015. The SRA is contacting solicitor insolvency practitioners to inform them of the decision.

(3) Pre-pack scrutiny body making progress

The recruitment of a pool of experienced business experts to review pre-packaged administration (pre-packs) agreements has made good progress, the Insolvency Service announced. The group was formed after recommendations by a regulations expert who stated a process should be developed to scrutinise sales to connected parties.

The steering group recruiting the pool is composed of a number of creditor and insolvency organisation representatives, including the Chartered Institute of Credit Management, the British Property Federation, and the Institute of Directors.

The pool is expected to begin scrutinising sales to connected parties later in 2015, at the same time as a new statement of insolvency practice comes into force.

This statement will require insolvency practitioners to disclose additional pre-pack sale information to creditors, particularly on the marketing and valuation of businesses.

In its letter to the Business Secretary, the steering group noted pre-packs were an important part of the insolvency landscape, saving jobs and preserving value for distressed businesses, but needed greater transparency to allow creditors to get the best deal.

This formed part of the Insolvency Service Spring Newsletter, which included information on:

- a public database for registered bankrupts, notifying the public about those who have previously registered for bankruptcy in order to keep them from harm;
- the adoption of a revised European Commission Regulation on insolvency proceedings, which will include a broadened scope to include more rescue and pre-insolvency proceedings;
- the publication of an annual review of insolvency practitioner regulation;
- policy updates, including the approval of plans to increase bankruptcy creditor petition limits to £5,000 from 1 October 2015; and
- recent and forthcoming publications by the Insolvency Service.

(4) Amendments to Recast EU Insolvency Regulation

An amended version of the draft Recast of the EU Insolvency Regulation issued by the Council of the European Union contains some restructured recitals, with some larger texts now having been divided into two, and a new provision which introduces a committee of representatives of Member States to assist the Commission in assessing further amendments.

The Recast of the EU Insolvency Regulation was published by the European Commission in December 2014. Its adoption aims to achieve the Commission's objective that cross-border insolvency proceedings should operate efficiently and effectively.

Since the Regulation has been amended several times, and further amendments are to be made, the draft Recast has been made in the interest of clarity.

(5) Insolvency Service looks back on 2014 developments

The Insolvency Service has published its annual review of practitioner regulation for 2014. The review sets out key achievements for 2014 such as the strengthening of the regulatory regime and the formation of the Complaints Gateway, which dealt with 555 complaints in the second half of the year.

At the end of 2013, the Service said it wanted to strengthen the regulatory framework, increase its own visibility as oversight regulator and demonstrate a continued commitment to transparency.

The report outlines that:

- the publication of all disciplinary sanctions against insolvency practitioners via the Insolvency Service website has given much greater transparency to work carried out by regulatory bodies;
- around 555 complaints against insolvency practitioners were handled by the Complaints Gateway in the second half of 2014;
- recommendations have been taken on board to establish a pool of experienced business people to scrutinise connected party pre-pack sales; and
- key legislative and fee changes are in the process of being brought forward including the Deregulation Bill and Small Business, Enterprise and Employment Bill (both currently before Parliament).

In addition, the Insolvency Service has picked out the main developments expected for the next 12 months, such as the introduction of a common panel of reviewers for complaints and legislative changes in 2015/16.

(6) Director disqualified for mishandling clients' money

David Pollard, director of TAG (Chesterfield) Ltd and The Recovery Partnership Ltd, an accountancy firm and insolvency practice both based in Manchester, has been disqualified for six years following an investigation by the Insolvency Service. The investigation found Pollard had held on to client funds and claimed duplicate fees.

Pollard was the director of TAG (Chesterfield) Ltd and The Recovery Partnership Ltd, which were wound up by the court in the public interest on 9 May 2013 owing creditors and shareholders £90,434 and £8,484 respectively.

The misconduct identified included Pollard breaching his fiduciary duties by inappropriately handling clients' and liquidation moneys held on trust. He had failed to separate the financial affairs of the two companies—with the result that it was not possible to determine elements of each company's income and expenditure.

Investigators also found that at least £24,157 was retained after companies were compulsory wound up or dissolved, duplicate fees of at least £12,100 were taken and payments of at least £30,020 were made to connected parties and not disclosed to creditors. Those payments have not been recovered.

David Pollard gave an undertaking on 21 January 2015 in respect of his conduct in the two companies to the Secretary of State not to be a director for six years. The period of disqualification commenced on 12 February 2015.

(7) Bankruptcy restriction after man spent £6,500 on wedding

A bankrupt residential homeowner has been given a seven-year bankruptcy restriction by the Insolvency Service. The individual had failed to complete tax returns for nine years, and spent £6,500 on wedding arrangements. A bankruptcy petition was presented against him.

Blessious Mutebi Kalemeera was found to have paid less than £150 to HMRC between April 2012 to March 2013, while receiving payments into his account of over £300,000.

On 8 July 2013 a Bankrupty Order was placed against Mr Kalemeera, who had a total deficiency of around £876,863.

Mr Kalemeera was ordered by the court to be bound by the restrictions set out in insolvency law until October 2021. The order was made in February 2015, backdating the restriction to October 2014.

Mr Kalemeera has also been banned from managing or controlling a company during the period without court leave.

An investigation by the Insolvency Service found that Mr Kalemeera had neglected business affairs between April 2004 to July 2013, and had increased his liability to HMRC by £176, 403.

It also found, though only £135 had been paid to HMRC between April 2012 to March 2013, payments into his bank account in the time period had totalled £396,898.

Mr Kalemeera had also made payments from his bank account between June 2013 to July 2013 totalling £6,500, which he stated had been for wedding expenses.

(8) Insolvency Service: Director disqualifications 4 March 2015

A number of directors have been disqualified following investigations by the Insolvency Service over the last month:

- Stephen Melville and Martin Melville have been banned from acting as company directors for nine years and eight years respectively for entering into a series of transactions with a company they knew, or out to have known, was in the process of being placed into liquidation;
- Alan James Proto, an accountant and director of GML Construction Limited, has been disqualified from acting as a director for 12 years for creating false documentation and operating a scheme to defraud the company's creditors; and
- Kathryn Joy Clark and Richard Aston Clay, officers of three Nottingham-based financial services firms, have been disqualified from acting in the management of a company for a combined 29 years for mishandling over £7m of investment funds.

(9) Court fee increases coming into effect on 9 March 2015

The Law Society has said that due to an increase in some civil court fees from Monday 9 March 2015, law firms should consider issuing claims during the week ending 6 March in order to avoid the increase. The Society said the increases affect money claims—both 'specified' and 'unspecified'.

The Law Society set out examples of the fee increases as follows:

- for a claim valued at £20,000 the fee will rise to £1,000 from £610, an increase of 64%;
- for a claim valued at £150,000 the fee will rise to £7,500 from £1,315, an increase of 470%; and
- for a claim valued at £250,000 the fee will rise to £10,000 from £1,720, an increase of 481%.

The Law Society has been critical of the fee increases and has sent a pre-action protocol letter to the Ministry of Justice.

(10) Credit insolvency guide website launched

Trade body R3 has launched a website to help creditors understand the insolvency process. The site contains a step-by-step guide on what happens at each stage and offers tips on how to oversee the process as a whole. It also includes a guide to insolvency terminology.

The Chartered Institute of Credit Management and the British Property Federation have offered their support for the website.

The website is meant to help creditors understand the process so they can approve insolvency fees and increase their chances of seeing money returned to them.

The launch forms part of a wider strategy to improve creditor engagement in insolvencies. The Small Business, Enterprise and Employment Bill aims to introduce further measures and is currently in its final stage in Parliament.

(11) Legislation to end hourly rates of insolvency practitioners

Insolvency practitioners will be required to provide extra information to creditors about their fees from October 2015. They will need to give a summary of estimated costs and work to be undertaken, following concerns the current system permits excessive hourly fees to be charged.

At the moment, insolvency practitioner fees in England and Wales are charged on an hourly rate without any indication of how long the work will take. A review of the system was launched in 2013 followed by a consultation looking at ways to tackle the issues identified in the report.

The changes apply to insolvency practitioners, whose fees are based upon time costs. They are intended to help creditors know what costs to expect, giving them more of a chance to challenge bills which appear unreasonable.

A new statutory instrument will introduce measures requiring practitioners to give an upfront estimate first for creditor approval. They will also be prevented from drawing fees above the approved estimate unless creditors give further approval.

In addition, the legislation will permit the High Court to transfer simple cases to the County Court at Central London, so it can focus on more complex cases.

The Small Business, Enterprise and Employment Bill, which is currently before Parliament, is due to introduce further measures to strengthen the regulation of insolvency practitioners.

ANALYSIS

(1) Accessibility of English bankruptcy to foreign debtors

Michael Swainston QC at Brick Court Chambers examines the decision in *JSC Bank of Moscow v Kekhman* [2015] EWHC 396 (Ch), [2015] All ER

(D) 288 (Feb), a leading judgment on the accessibility of English bankruptcy to foreign debtors, and the question—When do English courts have discretion to annul an order in international bankruptcy cases?

The Chancery Division considered an appeal against a decision of the Chief Registrar, in which he declined to annul a bankruptcy order made against K, a Russian businessman. The court held that, while the Chief Registrar had erred in principle in his approach to his jurisdiction to annul the bankruptcy order, the court had not had a discretion to annul the order, and the appeal would be dismissed.

Briefly, what was the background to this case?

Mr Vladimir Kekhman has been a very successful entrepreneur in Russia, building a huge fruit importation business under JFC Group, a BVI company, with subsidiaries in Russia, the BVI, Cyprus, Luxembourg, Panama, Costa Rica and Ecuador. On his case, he pulled back from this business when he began his subsequent career as head of the Mikhailovsky Theatre in St Petersburg, and left the running of it to his partners, Mr Afanasiev and Mrs Zakharova.

Mr Kekhman subsequently enjoyed great success in the running of the Mikhailovsky which has been restored to the first rank of international arts venues.

Meanwhile, however, the fruit business failed. JFC Russia is subject to a Russian bankruptcy process and Mr Kekhman has been exposed to multiple liabilities, including substantial English law liabilities, as a guarantor of loans to JFC Group companies.

Russian law does not have a personal bankruptcy regime for individuals who are not registered entrepreneurs. Mr Kekhman therefore sought to invoke English jurisdiction and English bankruptcy law to secure a transparent administration of his international affairs and to assist with his business rehabilitation.

He accordingly visited London for two days during which he presented a petition for his own bankruptcy. Chief Registrar Baister made the order requested, and subsequently rejected an annulment application by the Bank of Moscow. This refusal of annulment was challenged before Morgan J on the subject appeal.

What were the legal issues that the judge had to decide?

Mr Justice Morgan had to consider whether Chief Registrar Baister decided correctly when he refused to annul the bankruptcy order.

Why did these issues arise?

The question arose because the Bank of Moscow objected to the English bankruptcy order being made, and sought to argue that it 'ought not to have been made' under the Insolvency Act 1986, s 282.

What were the main legal arguments put forward?

The challenges by the Bank of Moscow came down to arguments that:

- on the analogy of corporate insolvency cases, there needed to be a sufficient connection with the English jurisdiction before the English court should, as a matter of discretion, exercise its jurisdiction and make a bankruptcy order, and that no sufficient connection existed;
- such an order would operate unfairly among Mr Kekhman's creditors; and
- an English bankruptcy order would offend comity when, according to Mr Kekhman's Russian 'personal law', he could not be subject to bankruptcy.

What did the judge decide, and why?

The judge held that a connection with the jurisdiction was required, and that it existed in this case because of Mr Kekhman's English law liabilities, which were subject to English jurisdiction, and which would abate as a result of an English bankruptcy. He rejected the argument that an English bankruptcy order would operate unfairly among creditors, essentially because the objections taken were theoretical rather than real on the facts of the case. In particular, the judge did not disturb the Chief Registrar's assessment that the order would not be recognised in Russia. The real impact of an English order would therefore be outside Russia—in England in relation to English law liabilities subject to English jurisdiction, and in other jurisdictions which may choose to recognise the English order depending on whether they preferred free-for-all or orderly distribution. Accordingly, there was no incursion on comity as against Russia. There was also benefit to an English order because it would discharge Mr Kekhman's English law liabilities, and provide an opportunity for his partial rehabilitation in England and/or in other jurisdictions that recognised the order.

To what extent is the judgment helpful in clarifying the law in this area?

This is a leading judgment on the accessibility of English bankruptcy to foreign debtors, and especially those beset by liabilities subject to English law and jurisdiction. It represents a value judgment in favour of the English law policy of rehabilitation coupled with orderly and transparent distribution of a debtor's assets. An English court will further that policy where there are sufficient connections with the jurisdiction (especially English law liabilities) and where there is an international estate, even if the debtor is subject to a free-for-all at home.

What practical lessons can those advising clients in this area take away from the case?

The case illustrates the potential for a commercial and pragmatic approach to bankruptcy of individuals with international business interests, where a significant part of their liabilities are subject to English law and jurisdiction. English law may offer a route to their international rehabilitation even where the law of their home-state does not.

(2) Undertakings given on the appointment of a provisional liquidator

Matthew Weaver of St Philips Chambers considers how and to what extent can undertakings given on the appointment of a provisional liquidator be enforced by the company in liquidation, following the recent decision in *Abbey Forwarding Ltd* (*In liquidation*) *v Revenue and Customs Commissioners* [2015] EWHC 225 (Ch), [2015] All ER (D) 91 (Feb).

The applicant company was investigated by the respondent Revenue and Customs Commissioners (HMRC). HMRC gave an undertaking to abide by freezing orders. The applicant brought proceedings, seeking an inquiry as to damages to be carried out on the undertaking. The Companies Court held that, on the evidence, none of the reasons adduced by HMRC would make it inappropriate for the inquiry for damages to occur.

What was the background to the case?

The company in question was wound up by the court on 18 March 2009 pursuant to a petition presented by HMRC on 4 February 2009. The petition was based upon assessments of excise duty raised by HMRC but not, at the date of the petition, served on the company so as to create, by statute, a debt (subject to appeal by the company). On the same day as the petition was presented, HMRC applied, without notice, for the appointment of a provisional liquidator. The application was based principally on the alleged fraudulent behaviour of the company which, it was said, gave rise to the assessments of unpaid excise duty. The court appointed the provisional liquidator on 4 February 2009.

Immediately following the appointment of the provisional liquidator, a worldwide freezing order against three of the company's four directors was sought and obtained in aid of misfeasance proceedings which the provisional liquidator undertook to issue against those directors on the grounds of their part in the company's alleged fraudulent activities.

HMRC gave an undertaking in damages on the appointment of the provisional liquidator and provided the company, under the control of the provisional liquidator, with an indemnity for the undertaking in damages the company was required to give upon the making of the freezing order and for any adverse costs order which might be made against the company within the misfeasance proceedings.

As Blackburne J had anticipated when appointing the provisional liquidator, the company's business was closed down shortly after the appointment. At the return date of the petition, it was unopposed and the provisional liquidator was appointed as liquidator on 18 March 2009.

Misfeasance proceedings were issued and were founded exclusively on the same case as HMRC had advanced for the appointment of a provisional liquidator and, indeed, relied exclusively on evidence from HMRC. These proceedings were dismissed by Lewison J after a 13-day trial in July 2010, principally because the judge concluded there had been no evasion of excise duty by the company, finding that all 301 of the consignments of alcohol from the company and challenged by HMRC had, in fact, arrived at their destination in France and that there was no evidence that the company was aware of any fraudulent activities of any of its business partners. The liquidator did not seek to appeal this decision.

Despite the judgment of Lewison J, HMRC refused to withdraw the assessments upon which the petition had been based and the liquidator declined to appeal them. The directors of the company obtained permission to bring the appeals against the assessments on behalf of the company and appeals were lodged in January 2011, with the hearings listed for 9 August 2011. HMRC initially opposed the appeals but, on 4 August 2011, withdrew its opposition and consented to the appeals and were ordered to pay £215,000 adverse costs.

In August 2012, after pressure from the company's shareholders, the liquidator agreed to be removed and was replaced. The new liquidator issued an application in November 2013 for an inquiry as to damages on the undertakings given by HMRC on the appointment of the provisional liquidator.

What were the issues that the judge had to decide in this application?

After much discussion between the court and the parties, David Richards J ordered the following issues to be determined on the application:

Should the court make an order for an inquiry as to damages, having regard to:

- the failure of the misfeasance claim;
- the withdrawal of the assessments by HMRC;

- the delay on the part of the company in applying for such an order;
- the fact that a winding up order was made on 18 March 2009; and
- the absence of any application to set aside the appointment of a provisional liquidator or any opposition to the petition on 18 March 2009?

If an inquiry is ordered, on what factual basis is the loss to the company to be assessed? In particular, is it to be assessed on the basis that the company would have been wound up (as it was) on 18 March in any event?

What were the main legal arguments put forward?

The company's position was straightforward. It submitted that without the undertaking by HMRC, the provisional liquidator would not have been appointed. It was now clear that the appointment was wrong on the grounds that the assessments raised had been withdrawn and the allegations of fraud advanced had been subsequently dismissed. The court is to use hindsight and consider whether the order was wrongly made, given the subsequent events, and is not limited to considering whether Blackburne J was wrong to make the order on the evidence and submissions available to him at the time. In addition, there is no need to apportion fault on the part of HMRC. The undertaking ought to be enforced in the absence of special circumstances and no such circumstances exist in this case.

HMRC resisted the inquiry on the basis that a winding up order had in fact been made after the appointment of the provisional liquidator, which was not opposed or appealed. The appointment of a provisional liquidator was an interim measure and the undertaking given came to an end when the winding up order was made just as an undertaking in damages on the grant of an interim injunction comes to an end when a final injunction is made at trial.

HMRC also relied on:

- the delay in making the application for an inquiry;
- prejudice suffered by HMRC in withdrawing the assessments on the understanding that an inquiry as to damages could not be ordered;
- prejudice suffered by HMRC because many of its employees with first-hand knowledge of the matter had left its employment; and
- prejudice to HMRC because the liquidation and passage of time will mean that much of the relevant evidence regarding the company's trading will have been lost or 'degraded'.

In addition, HMRC argued that the current practice of the courts (albeit a practice not in place in 2009) is not to require undertakings in damages from HMRC in such cases and, as such, an inquiry as to damages would be contrary to public interest.

What did the judge decide, and why?

David Richards J ordered an inquiry as to damages and ordered it on the basis that the company would not have been wound up on 18 March 2009. In doing so, he made the following findings:

- The parties had agreed that, as general principles:
  - undertakings are given as the price for an interim order of any sort;
  - the undertaking is intended to provide a means of compensating the respondent if it subsequently appears that the order was wrongly made;
  - whether an order was wrongly made is to be judged retrospectively (ie not solely in light of the circumstances known at the time); and
  - once it is established that an order was wrongly made, absent special circumstances, the court will ordinarily order an inquiry as to damages.
- Whether a final injunction or order is made following an interim injunction, while the usual test, is not the only basis for determining whether an interim injunction was wrongly made. Dismissal of a winding up petition, while normally a basis for ordering an inquiry in respect of a provisional liquidator's appointment, is not a pre-condition to such an inquiry. Appointments of provisional liquidators cannot helpfully be compared to other forms of interim injunction or remedy and the court is entitled to exercise a broad discretion when determining whether to order an inquiry.
- An undertaking given on the appointment of a provisional liquidator does not automatically terminate on the making of a winding up order so as to deprive the court of jurisdiction to enforce the undertaking.
- The fact that a winding up order has been made and the fact that there was no opposition to the making of the order will be highly relevant factors in all cases but not determinative ones.
- The key feature of the current case was that the petition was presented and the application for the appointment of the provisional liquidator was made on the basis that HMRC were creditors in the sum of a little under £6m on the basis of assessments raised

on 2 February 2009. When the company eventually appealed these assessments, HMRC agreed to withdraw them, thereby abandoning its only standing claimed for presentation of the petition. HMRC cannot continue to claim that the company was liable for excise duty as sought by HMRC and to do so would be an abuse of process in the circumstances.

- The allegations of fraud against the company's directors do not need to be looked into on the basis that the assessments were not properly raised and, as such, the company did not owe the excise duty claimed within those assessments.
- In respect of the company's failure, or that of its shareholders, to apply to set aside the appointment of the provisional liquidator or to oppose the winding up petition, it was unrealistic to expect the provisional liquidator herself to do so. Further, while it will plainly be relevant whether a company or its directors took such steps or simply sat back and failed to adduce evidence which would have resulted in the petition being dismissed, each case will depend on its own facts. In this case, the directors and shareholders of the company:
  - o were taken by surprise by the provisional liquidation and the petition;
  - o were faced with voluminous evidence in support of the petition and the application to appoint the provisional liquidator;
  - o were excluded from the company's premises and access to its books and records;
  - o were prevented from using the company's funds to finance opposition of the petition; and
  - o were severely restricted by the freezing order in the use of their own resources to do so.

In addition, one of the directors suffered serious ill-health as a result of the provisional liquidation and freezing order. The judge described the suggestion that the directors ought to have defended the petition as having 'more than an element of unreality'.

- While applications for inquiries on undertakings must be made promptly, the authorities did not impose promptness as a mandatory condition. The approach to delay is to consider all the circumstances of the case and determine whether the delay is such to make it inappropriate to order an inquiry. Until the appointment of the new liquidator, it was not for HMRC to claim that some form of delay by the company had caused it to delay in withdrawing its own assessments. The original liquidator did not have the funds to challenge HMRC's assessments or to make an application to enforce the undertaking and was, in any event, unlikely to bring proceedings against HMRC who was, at the time, supporting her appointment as liquidator in the face of challenge from the company's shareholders. The new liquidator had large amounts of documentation to consider and from the date of his appointment onwards, there was no unreasonable delay such as to render an inquiry inappropriate.

- It was for HMRC to identify and demonstrate any prejudice. The fact that HMRC withdrew its assessments on the mistaken belief that the undertaking was no longer in force is not the fault of the company and, as such, provides no defence to the application.
- The evidence that former employees of HMRC could give was not relevant to the application for an order for an inquiry. The assessments, to which the employees could give evidence, were withdrawn and no more needs to be said about them.
- While the liquidation of the company and the passage of time will have degraded the evidence as to trading, it cannot be said that an inquiry cannot be undertaken with the available evidence.
- The judge was not satisfied that a practice existed that no longer required HMRC to give undertakings on the appointment of provisional liquidators and concluded that the public interest in enforcing undertakings given freely to the court, particularly by a public authority, was the overriding public interest here.
- As to the factual basis of an inquiry, the judge concluded that as the basis for the petition itself, namely the assessments, had fallen away, he was satisfied that, but for the provisional liquidator's appointment, the company and its directors would have been able to successfully defeat the petition and avoid liquidation by demonstrating the necessary genuine dispute on substantial grounds. As such, the appropriate measure of loss under the undertaking was the value of the company's business on or immediately before 4 February 2009.

To what extent is the judgment helpful in clarifying the law in this area?

This is the first reported decision in respect of undertakings given on the appointment of a provisional liquidator and how and to what extent they can be enforced by the company in question.

It helpfully sets out:

- the court's jurisdiction for ordering an inquiry;

- the impact of the company's subsequent liquidation on such an application;
- the effect of delay in bringing the application; and
- dismisses the idea that HMRC are exempt from providing such undertakings.

What practical lessons can those advising take away from the case (in particular in terms of those acting for creditors other than HMRC)?

The same principles that apply to HMRC will apply to any creditor seeking to appoint a provisional liquidator. An undertaking will be required by the court and is a condition of any appointment of a provisional liquidator. It is intended to provide protection to the company should it later be discovered that the appointment was inappropriate (whether that is because the locus of the creditor is undermined or because the risk to the company or its assets turns out not to be sufficient). As such, the court will treat the undertaking as enforceable unless special circumstances exist.

If the company would have been wound up in any event notwithstanding any problems in the application for the provisional liquidator, the losses claimed under an undertaking may be limited but if the basis for the petition is also undermined, the losses claimed could be significant. Creditors and their advisors must give this serious thought before embarking on such applications.

What was the judge's approach to the suggestion that it was not usual practice for HMRC to give undertakings in light of the Supreme Court's decision in Sinaloa?

The judge dismissed the view that a practice had grown up not requiring HMRC to give undertakings in applications to appoint provisional liquidators. While it was correct to say that the case of *Financial Services Authority v Sinaloa Gold plc* (*Barclays Bank plc intervening*) [2013] UKSC 11, [2013] 2 All ER 339 involved the Supreme Court confirming the Court of Appeal's view that the Financial Services Authority (now the Financial Conduct Authority and Prudential Regulation Authority), as a public authority fulfilling its public law function and duty, was not required to give an undertaking in damages for the grant of a freezing injunction, it could not be said that this covered the situation of HMRC seeking the appointment of a provisional liquidator.

Sinaloa did not consider such a circumstance and, as far as the judge was concerned, the position of HMRC as a creditor of a company choosing to present a winding up petition and choosing to seek the appointment of a provisional liquidator was not that of a public authority acting pursuant to its public law function and duty.

HMRC has other options available to enforce payment of a debt owed by a company but chooses to present a petition. The Court of Appeal decision in *Revenue and Customs Comrs v Rochdale Drinks Distributors Ltd* [2011] EWCA Civ 1116, [2012] STC 186 spelt out clearly that the practice of the courts is to require HMRC to provide an undertaking when seeking the appointment of a provisional liquidator and nothing in the *Sinaloa* case alters or cast doubt on such a practice.

(3) Annulling bankruptcy orders—limitation defences

Why did the High Court decide to allow the annulment of a bankruptcy order in *Re Julie Ann Mowbray* (*A Bankrupt*); *Mowbray v Sanders* (*Trustee in Bankruptcy of the Estate of Julie Ann Mowbray*) [2015] EWHC 296 (Ch), [2015] All ER (D) 161 (Feb)? Nick Brown, commercial litigation barrister at St Philip's Chamber (Birmingham), discusses the reasoning behind the ruling and the practical lessons the decision offers for insolvency office-holders.

The appellant debtor appealed against an order of a deputy district judge dismissing her application for the annulment of a bankruptcy order. In her grounds of appeal, the appellant had raised a limitation defence. The Chancery Division, in allowing the appeal, held that the belated revelation of the second respondent's only real answer to the appellant's limitation defence after the bankruptcy order had been made, without any explanation why it had not previously been put forward, materially altered the legal landscape and was an exceptional circumstance justifying review of the validity and enforceability of the petition debt.

What was the background to the case?

The case was an appeal to the High Court against an order of a deputy district judge who had dismissed the appellant's application, pursuant to the Insolvency Act 1986, s 282(1)(a), for the annulment of her bankruptcy, such application having been made on the grounds that the debt upon which the petition was founded was in dispute and that the bankruptcy order should, therefore, never have been made.

What were the legal issues the judge had to decide?

Whether the deputy district judge had been in error to conclude, on the annulment application, that there had been no 'exceptional circumstances' permitting the court to re-consider the validity of the petition debt, such issue having been aired at the original bankruptcy hearing. In addition, whether the deputy district judge had been in error to conclude that the petition debt was valid.

Why did these issues arise?

One of the bases upon which the appellant had always disputed the petition debt was that the claim that led to the default judgment against her (and ultimately the petition) had, for the purposes of the Limitation Act 1980, been time-barred. The appeal judge remarked that such a defence 'was plainly a good one unless something had happened to extend the limitation period'. He then further noted that the 'central curiosity of this unusual case' was that it was not actually until the appellant applied to annul the bankruptcy order that it was advanced by the second respondent (the assignee of the debt) that the appellant had, in fact, repaid a small part of the debt at a point which 'acted as an acknowledgment of the debt so as to re-set the Limitation Act clock' and so as to make the original claim within time (para [7]).

What were the main legal arguments put forward?

That the deputy district judge had, by limiting her consideration of 'exceptional circumstances' to the appellant's personal difficulties, paid insufficient regard to the significant change in the legal landscape which had arisen in consequence of the second respondent's factual assertions (only made belatedly within the annulment proceedings) as to the appellant's part-payment of the debt (para [61]). Further, that the deputy district judge ought not, as she did, to have concluded as a matter of fact that the appellant did make such payment, given that this was contested and the evidence had not been tested under cross-examination (paras [38] and [74]).

What did the judge decide and why?

That the appeal should be allowed because there had never been a 'plain and obvious' answer to the appellant's limitation defence that could have warranted the making of a bankruptcy order (para [11]). Although, exceptionally, this involved permitting annulment with reference to matters raised before the bankruptcy order was made, it appeared to the judge that the petition debt had, at all times, been disputed on substantial grounds and that the error in allowing proceedings to continue as far as bankruptcy had, 'in all justice', to be corrected (para [11]).

To what extent is this judgment helpful in clarifying the law in this area?

The case represents a useful summary of and reminder as to the (ultimately discretionary) nature of the annulment power and the nature of an appeal from a refusal to annul.

In respect of the former, the judge noted, following *Turner v Royal Bank of Scotland* [2000] BPIR 683, that 'only in exceptional circumstances' can a court allow points which were considered when the bankruptcy order was made to be re-litigated on an annulment application (para [42]).

As to the latter, the judge noted, following Cozens v HM Commissioners of Customs and Excise [2000] BPIR 252, that an appeal from a refusal of annulment is 'in the nature of a true appeal: it is not a rehearing or review' (para [48]).

What practical lessons can insolvency office-holders and those advising them take away from the case?

The judgment ends with a set of useful observations as to the determination of a trustee's costs in annulment cases (paras [88]–[99]). The judge was content, as determined at first instance, that the first respondent trustee should be entitled to recover his proper costs and expenses even though the bankruptcy order should never have been made, the question then being whether these should be met by the appellant or the second respondent. Having given consideration to the full history of the matter (which included factoring in a number of procedural failures on the appellant's part such as her failure to make an application to set aside the default judgment) the judge concluded:

> 'The balance is an unusually fine one. I have provisionally concluded that the costs and expenses should be allocated for payment between them, and that, as a matter of broad fairness, the Appellant should pay the costs and expenses up to the date of the annulment application, but the Second Respondent should pay the costs and expenses from then on' (para [98]).

(4) Court 'Likes' notification via social media

When can notification of proceedings be served using social media? Derek Jones, of Harrison Clark Rickerbys, comments following a recent ruling that Facebook could be used to effect notification of bankruptcy proceedings.

What was the background to the case?

In *Re A Debtor* (*No 0274 of 2010*) on 22 October 2014 District Judge Lethem, sitting in the County Court at Tunbridge Wells, made an order requiring a bankrupt to be summoned for examination under the Insolvency Act 1986, s 366, 367. The applicant trustee in bankruptcy (Quantuma LLP) had previously sought to effect both personal and substituted service upon the debtor who had proved elusive.

What were the legal issues that the District Judge had to decide?

The judge was satisfied on the evidence before him that the debtor was a regular user of his Facebook account and granted leave to the applicant to notify the bankrupt of the terms of the order:

> 'by means of an email and/or posting upon the Respondent's Facebook account in the following terms: "… TAKE NOTICE that on the 22nd October 2014 the Court made an Order in connection with these proceedings which requires your personal attendance before the Judge at 42–46 London Road, Tunbridge Wells, Kent, TN1 1DP. For further details please telephone the Court office on 01892 700150…" '

This is understood to be the first time that the use of social media has been extended by the courts to encompass insolvency proceedings in England and Wales.

This is a particularly important step for trustees in bankruptcy dealing with recalcitrant bankrupts who have failed to cooperate with either the official receiver or themselves.

Albeit only a first instance decision, it shows that where a debtor is active on social media the bankruptcy court has the power under the Civil Procedure Rules 1998, SI 1998/3132, r 6.15 (CPR) to authorise the use of social media not only for the service of proceedings themselves but also for notifying a debtor that relevant orders have been made—whether or not the precise terms of the orders are disclosed.

Have there been any similar cases in the UK, and can we expect to see many more instances of service effected by way of social media?

In *Blaney v Persons Unknown* (October 2009) in the High Court, Mr Justice Lewison allowed a claimant to serve an injunction against an anonymous Twitter user by sending a direct message containing the link to the injunction. This is understood to be the first English case involving the use of any form of social media for the service of proceedings under CPR 6.15.

In another case, Hastings County Court reportedly granted permission for a court order to be served on the defendant via Facebook on or around 15 March 2011. This was in line with Blaney.

AKO Capital LLP and Master Fund Ltd v TFS Derivatives involved a £1.3m claim for overpayments of commission. In February 2011 the High Court gave permission for a CPR, Pt 20 claim form and particulars of claim to be served by electronic means by attaching them in pdf format to a message sent via Facebook to an individual defendant. This was the first decision of the High Court that ordered service via Facebook.

Have there been cases in other jurisdictions?

Australia

In *Citigroup Property Ltd v Weerakoon* [2008] QDC 174 (Queensland District Court—16 April 2008), the judge refused an application for substituted service of the statement of claim on a defendant by email to his Facebook page because of the 'uncertainty' of Facebook, the fact that anyone could create an identity that could mimic the true person's identity, and the fact that the judge was not satisfied that the person who created the Facebook page was indeed the defendant although the judge accepted that it 'may well be'.

New Zealand

In *Axe Market Gardens Ltd v Axe* (2008), leave for service of court documents via Facebook on an individual whose whereabouts were unknown was granted. Newspaper advertising could not be effectively targeted. The court accepted that it was clear that the defendants had undertaken banking transactions online.

Canada

In *Knott v Sutherland* (2009) service was allowed on an individual defendant by sending notice to the defendants Facebook page by way of substituted service.

In *MKM Capital Property Ltd v Corbo and Poyser* (Australian Capital Territory Supreme Court, No SC 608 of 2008) the defendants failed to keep up repayments on a loan and the lender obtained a default judgment. The rules required the default judgment, and associated order for possession, to be served personally upon the defendants but they could not be found. The claimants lawyers discovered the defendant's Facebook profiles which confirmed their dates of birth, email addresses and friend lists. The co-defendants were friends with each other.

The court was persuaded to order that:

> 'Service of the Default Judgment be effected on both of the Defendants by sending a private message via computer to the Facebook page of the First and Second Defendants and informing the Defendants of the entry and terms of the Default Judgment.'

Ireland

In a case in Ireland, reported on 4 June 2012, Mr Justice Peart sitting in the Irish High Court, granted permission to a plaintiff to serve proceedings on a non-resident defendant by serving them by way of private message on the defendant's Facebook page. The defendant had left the jurisdiction and the plaintiff was then able to serve him. The judge was satisfied on the basis of an affidavit submitted by the plaintiff that exhaustive efforts had been made to locate the defendant. The plaintiff was also able to satisfy the court that the Facebook page in question was both genuine and also used regularly by the defendant.

Re the Irish Education Research Institute in Liquidation, a decision of the Irish High Court on 10 September 2014, paved the way for service of proceedings via LinkedIn. The judge made an order providing for papers to be served by furnishing a message to the relevant party detailing the case and attaching a link to the URL containing the papers using the technical features available on LinkedIn—the liquidator would be able to determine that the message had been delivered and indeed that it had been read.

South Africa

In CMC Woodworking Machinery (Property) Ltd v Pieter Odendaal Kitchens (Unreported case No 6846/2006, 3 August 2012), Mr Justice Steyn sitting in the KwaZulu-Natal High Court in Durban, made an order for substituted service for a notice of set-down and pre-trial directions on the respondents, the defendant in the main action, via a message on Facebook in addition to the notice being published in the local paper.

The judge said:

> 'Changes in the technology of communication have increased exponentially and it is therefore not unreasonable to expect the law to recognise such changes and accommodate [them]… Courts, however, have been somewhat hesitant to acknowledge and adapt to all the aforesaid changes and this should be understood in the context that Courts adhere to established procedures in order to promote legal certainty and justice.'

US

In the US, in *Fortunato v Chase Bank USA*, na 11 CIV 6608 (JFK), on 7 June 2012 the third-party plaintiff sought court approval from the US District Court for the Southern District of New York, to seek alternative service including by email, a Facebook message and publication in the local press. While allowing service by publication in the local press, the District Court refused to allow service via email or Facebook concluding that the plaintiff had not set forth enough facts to give a sufficient degree of certainty that the third-party defendant actually maintained the email address or the Facebook account. The court expressed concerns that 'anyone can make a Facebook profile using real, fake or incomplete information.'

Service by social media has also now raised its head in the family courts (at least in the US). In *re Adoption of KPMA* OKLA Lexis 85, a majority of the Oklahoma Supreme Court found, on 14 October 2014, that a Facebook message would be legally insufficient notice.

What practical lessons can practitioners take away from the case?

The practical lesson from this is that where there is a need to apply for alternative service then social media should always be considered where there is evidence to show active use of it by the party to be served.

(5) LASPO extension—relief for insolvency practitioners

Does the extension of the temporary exemption allowing no win, no fee agreements for insolvency proceedings give hope for a future permanent exemption? Frances Coulson, head of insolvency litigation at Moon Beever and former president of R3, offers her thoughts on this latest development.

'No win, no fee agreements' in insolvency proceedings will continue to operate on the same basis as before the coming into force of the Legal Aid, Sentencing and Punishment of Offenders Act 2012 (LASPO 2012) for the time being, with any conditional fee agreement success fees and after the event insurance (ATE) premiums remaining recoverable from the losing party. A Written Statement by the Minister of State for Civil Justice and Legal Policy on 26 February 2015 says more time is needed for insolvency practitioners to prepare for to the changes.

What does the government statement today actually mean, in your view?

We are hopeful this means the government will agree to a permanent exemption in the long run as this announcement indicates the government have accepted the logic of the argument. However, the insolvency community should continue lobbying on this issue.

What does this mean for insolvency litigators and insolvency practitioners in practice?

This announcement raises two issues:

- it assists in keeping (in particular smaller) cases going that would be unfeasible without the exemption; and
- while the temporary exemption is to be welcomed, it won't be enough to settle the market.

The challenge of how to approach ATE premiums remains. However, there are things that can be done to limit ATE premiums. For example, the profession could look at its collective negotiating power as a whole to perhaps limit costs.

It is fair to say there is a place for funding and a place for ATE—this area remains a melting pot. The difficulty for practitioners remains that if the exemption doesn't become permanent the irrecoverability of fees would make many cases too risky to start as the economics of the case wouldn't benefit creditors.

In your view, is this the end of the road now, and the exemption is here to stay, or is this a short term measure?

Although to be welcomed, the lobbying efforts need to continue and the insolvency community needs to continue to support a permanent exemption. Academic research conducted by Professor Walton of Wolverhampton University published last year shows that the exemption is the best option

With a general election in May 2015, we are unable to predict the political landscape in the coming months so the position will remain uncertain until after the ballots close in May. However, all the parliamentarians I have spoken to have said the issue is a no-brainer. In addition, the Shadow Justice Team has been strongly supportive of a permanent exemption and even tabled an amendment to the Small Business Bill to give a permanent exemption. Almost 10% of cross party MPs signed an Early Day Motion likewise in favour of the exemption.

In reality this is probably now a post-election issue, but keeping awareness of the issue on the political agenda is important. Things could happen rapidly post-election.

Can you give any practical tips to IPs or lawyers wondering what they should do now if contemplating litigation in future?

Again, every case is different, and lawyers and IPs will need to do the sums on whether it is worth getting cover now regardless (eg immediate cover of £x for a small fee) compared with an individual application for ATE on each case whether it is ready for issue or not.

This issue is very important as fraud and misfeasance which can be tackled through the insolvency legislation costs creditors and the taxpayer many millions of pounds each year, if not hundreds of millions. Maintaining the ability for redress is important as the criminal law and the Insolvency Service can't solve everything. IPs provide a huge additional resource for fostering compliance and competition.

CASE LAW

(1) Pui-Kwan v Kam-Ho [2015] All ER (D) 133 (Mar), [2015] EWHC 621 (Ch)

In the Chancery Division, Companies Court, before Sir Terence Etherton.

Company – Administration – Administrator – Ending administration – Statutory provision for transition from administration to voluntary winding up – Requirement for notice to registrar of companies – Company purportedly being entered into administration – Administrator purportedly sending notice for company to enter into creditors voluntary winding – Applicant *seeking declaration as to validity of appointment of administrator and order for transfer of money – Appointment of administrators ceasing before registrar registering notice – Whether company being validly entered into administration – Whether registration of notice being effective – Insolvency Act 1986, Sch B1, para 83(6).*

Facts:

The applicant, C, and her mother, H, were the two directors of the second defendant company (Melodious), which was incorporated in the British Virgin Islands and registered in England. The records at Companies House showed that Melodious went into administration on 1 November 2007, with the fourth defendant, P, as its administrator, and that it went into creditors' voluntary liquidation on 23 October 2008, with P as its liquidator. P's appointment as administrator had been due to expire on 31 October 2008, namely 12 months after his appointment. An issue arose as to whether Melodious, had in fact, entered into administration or liquidation. Under Melodious' articles of association, both of its two directors had to be present in order for a meeting of the directors to be quorate and, according to the minutes of a directors' meeting on 29 October 2007, which purported to enter Melodious into administration, C alone had been present (the directors' meeting). Both C and H gave evidence that H, who had been in the United Kingdom at the time, had not attended that board meeting. H was aged 65, ordinarily resident in Hong Kong and did not speak English. The first defendant, L, who was C's former partner, presented two winding up petitions in relation to Melodious: (i) a creditors' petition based on Melodious' alleged insolvency and indebtedness to him; and (ii) a contributor's petition on the ground that Melodious was a quasi-partnership between himself and C, and that the relationship had irretrievably broken down. On L's application in the creditors' winding up petition, a judge ordered that the net proceeds of sale of certain investment properties be paid into an account (the stake-holder account) with the third defendant bank, in the joint names of C's then solicitors, and L's then solicitors. C applied to the court, contending that P had never been validly appointed its administrator or liquidator because the meeting of the board of directors of Melodious, purporting to place Melodious into administration out of court, pursuant to para 22(2) of Sch B1 to the Insolvency Act 1986, was inquorate. She further contended that if Melodious had gone into administration, the administration had expired by effluxion of time on 31 October 2008 before P had sent or the registrar of Companies had received a notice (the conversion notice), under para 83(3) of Sch B1 to the Act for conversion of the administration into a creditors' voluntary liquidation. C also applied for an order that the money in the stake-holder account should be transferred into an account in the joint names of the solicitors for herself and L.

The issues for consideration were: (i) whether Melodious was or had ever been in administration or liquidation; and (ii) whether the transfer of the money in the stake-holder account was precluded by administration or liquidation of the company. The defendants submitted that P had been validly appointed and that the resolution at the board meeting in question was saved by r 7.55 of the Insolvency Rules 1986, SI 1986/1925 (the Rules), which provided that: 'No insolvency proceedings shall be invalidated by any formal defect or by any irregularity, unless the court before which objection is made considers that substantial injustice has been caused by the defect or irregularity, and that the injustice cannot be remedied by any order of the court'. In respect of her contention concerning effluxion of time, C submitted that, in circumstances where there was a possibility that Companies House had not received Form 2.34B until after 31 October 2008, Melodious had not moved into creditors' liquidation and P's office as administrator had expired on 31 October 2008. Consideration was given to para 83(6) of Sch B1 to the Act (see [37] of the judgment).

Held:

(1) Paragraph 83(6) of Sch B1 to the Act was triggered where the conversion notice was sent before the date on which the administrator's office was due to expire, even if the notice was received by the registrar after that date (see [106] of the judgment).

On the evidence, it was not accepted that H had been at the directors' meeting. The overwhelming probability was that she was not. Accordingly, the directors' meeting had been inquorate and, so, on the face of it, the resolution to appoint an administrator, under para 22(2) of Sch B to the Act, was invalid. The resolution was not saved by r 7.44 of the Rules. Rule 7.55 applied to insolvency proceedings. There were no insolvency proceedings unless there was a resolution of the directors pursuant to para 22(2). Rule 7.55 of the Rules had no application in the present case since there was never a decision of the directors of Melodious to appoint an administrator, pursuant to para 22(2) of Sch B1 to the Act, which complied with the company's rules of internal management. P had known that there were two directors, but had proceeded on the assumption that it was sufficient for C alone to pass the resolution, under para 22(2) of Sch B to the Act (see [63], [70]–[72], [75], [76] of the judgment).

It followed that Melodious had never been placed into administration (see [108] of the judgment).

Property Professionals + Ltd, Re [2014] 1 BCLC 466 applied; E Squared Ltd, Re; Re Sussex Pharmaceutical Ltd [2006] 3 All ER 779 applied; Frontsouth Ltd (in admin), Re [2012] 1 BCLC 818 considered; Euromaster Ltd, Re [2013] 1 BCLC 273 considered.

(2) The transfer of the money in the stake-holder account to another account or accounts under the control or direction of C, L or both of them was not precluded by administration or liquidation of the company (see [109] of the judgment).

John McDonnell QC (***instructed by Charles Russell Speechlys LLP***) ***for C.***

James Pickering (***instructed by SBP Law***) ***for the defendants.***

(2) LBI hf v Merrill Lynch International Ltd [2015] All ER (D) 78 (Mar), E-28/13

In the European Free Trade Association Court, before Judges Carl Baudenbacher, President, Per Christiansen (Judge-Rapporteur), Páll Hreinsson.

European Union – Companies – Liquidation – Applicant company registered in Iceland operating as financial undertaking – Applicant issuing bonds subject to English law to respondent credit institution – Applicant making three payments to respondent in respect of bonds – Applicant subsequently collapsing and decision taken to wind applicant up – Applicant seeking rescission of payments made to respondent – Respondent challenging applicant's decision to rescind on basis that EU law only permitting rescission if possible under English law – Directive (*EC*) *2001/24, art 30*(*1*)*.*

Facts:

The applicant operated as a financial undertaking, registered in Iceland, until it collapsed in October 2008. The applicant had business relations with the respondent company, another credit institution. Between 2001 and 2008, the applicant issued bonds in the form of Temporary Global Notes. According to the national court, the agency agreement, bonds and payment coupons were subject to English law. In 2008, the applicant made three separate payments to the respondent in relation to the bonds in accordance with three bonds which were due in July and September 2008 and October 2010, respectively. In October 2008, the Icelandic Financial Supervisory Authority dismissed the plaintiff's board of directors and appointed a resolution committee to exercise all the functions of the board and see to all the plaintiff's affairs. By the Financial Supervisory Authority's decision of 9 October 2008, the plaintiff's domestic activities were transferred to another legal entity established for that purpose. Following the adoption of the Act No 44/2009, which amended certain provisions of Chapter XII (arts 98–105) of the Icelandic Act No 161/2002 on Financial Undertakings (the Financial Undertakings Act), the applicant was to be put into winding-up proceedings, commencing on the date of entry into force of the Act on 22 April 2009, with a reference date of 15 November 2008. In May 2012, the applicant brought a claim against the respondent before the Reykjavik District Court (the referring court).

Pursuant to art 134 of the Bankruptcy Act, the applicant sought rescission of the three aforementioned payments, arguing that those payments should be regarded as repayment by an insolvent actor of debts before the date of maturity. The respondent argued that the situation had to be qualified as a purchase by the applicant of its own securities and not as the repayment of a debt. In any event, under art 30 (also with reference to art 10) of Directive (EC) 2001/24 of the European Parliament and of the Council (on the reorganisation and winding up of credit institutions) (the Directive), the measures in question could only be rescinded if that would be permissible also under English law. In the respondent's view, rescission would not be possible under English law.

The applicant rejected that argument, arguing that it was not relevant to the resolution of the case whether art 30 of the Directive also applied to rescission under Chapter XX of the Icelandic Act No 21/1991 on Bankruptcy (the Bankruptcy Act), since the Directive could not overrule Icelandic law. The referring court decided to seek an advisory opinion from the European Free Trade Association Court (the Court) and referred certain questions to that court.

By its questions, the requesting court sought in essence, firstly, to clarify whether the expression 'voidness, voidability or unenforceability' of legal acts in art 30(1) of the Directive referred merely to rescission under contract law, or also to rescission in bankruptcy law on the basis of avoidance rules, such as those included in Chapter XX of the Bankruptcy Act. Avoidance rules in the context of bankruptcy allowed for the reversal of transactions and other acts made before the opening of the bankruptcy proceedings deemed to be to the detriment of a fair distribution of the bankrupt estate's property among the unsecured creditors. Secondly, to ascertain what the beneficiary had to prove and which standard of proof was required under the second indent of art 30(1) of the Directive in order to trigger the non-application of the law of the home European Economic Area (EEA) state.

Held:

(1) Article 30(1) of the Directive did not limit the basis on which to invoke voidness, voidability or unenforceability of an act. The decisive criterion was the capacity of an act to be prejudicial to creditors' rights. According to the description given in the request, it appeared that the rules on rescission in Icelandic bankruptcy law could apply to acts that affected the creditors as a whole in a detrimental manner. Accordingly, in winding-up proceedings of financial undertakings governed by the Directive, the rules in the home state on rescission in bankruptcy law, such as those included in Chapter XX of the Bankruptcy Act, should not apply to an act detrimental to the creditors as a whole, if the act in question was subject to the law of an EEA state other than the home state and the law

in that other EEA state did not allow any means of challenging that act in the case in point. Accordingly, if the national court found that the payments in question were acts detrimental to the creditors as a whole, which entailed that art 30(1) of the Directive was applicable, it should apply the methods of interpretation recognised by Icelandic law as far as possible in order to achieve the result sought by that provision (see [37], [38], [44] of the judgment).

The expression 'voidness, voidability or unenforceability of legal acts' in art 30(1) of the Directive also referred to rescission in bankruptcy law on the basis of avoidance rules, such as those included in Chapter XX of the Bankruptcy Act (see [46] of the judgment).

(2) Under the second indent of art 30(1) of the Directive, the beneficiary had to prove that, whether for substantive or procedural reasons, under the law governing the act detrimental to the creditors as a whole, there was no possibility, or no longer any possibility, to challenge the act in question. A concrete assessment of the specific act in question should be undertaken. Consequently, even if the act could in principle be challenged under the law of the EEA state governing it, it was sufficient that the beneficiary proved that the requirements for such a challenge were not fulfilled in the case at hand. It had to be assessed according to the rules of the home EEA state whether or not the beneficiary had proved that the law applicable to the act did not allow any means of challenge (see [79]–[81] of the judgment).

(3) Re BW Estates Ltd; Randhawa v Turpin [2015] All ER (D) 27 (Mar), [2015] EWHC 517 (Ch)

In the Chancery Division, Companies Court (Birmingham), before HHJ David Cooke.

Company – Administrator – Remuneration – Applicant creditors of company challenging remuneration and/or expenses of administrators – Whether administrators entitled to remuneration – Whether applicants or administrators to bear costs of application – Insolvency Rules 1986, SI 1986/1925, r 2.109.

Facts:

The proceedings concerned a company in administration, which was engaged in the business of property investment. The respondent administrators had been appointed by a director of the company, without application to the court. It was conceded that the company had been unable to pay its debts at the date of appointment. Following their appointment, the administrators devoted time and effort to finding out whether another company (Belvadere) existed as a possible creditor of the company, thereby incurring costs. The applicants, who were not members of the company, but who had an indirect interest in a majority of its shares, did not contend that the appointment of the administrator was invalid, but contended that there had been no good reason for the company to go into administration at all; the company had cash at the bank sufficient to discharge all its outstanding debts and since the appointment of the administrators, costs had been incurred for no good purpose and with no benefit to creditors. They contended that the administration had ended and that the company was in exactly the position it had been in prior to the appointment of the administrators, save that its assets had been depleted by the costs of the administration. The applicants applied, under r 2.109 of the Insolvency Rules 1986, SI 1986/1925, and para 74 of Sch B1 to the Insolvency Act 1986 for orders: (i) that the remuneration of the administrators, over some £80,000, be deemed excessive and be either disallowed entirely or reduced to such an extent as the court thought appropriate; and (ii) that the administrators paid the costs of the application personally and not as an expense of the administration.

The issues for consideration were: (i) whether the administrators were entitled to the remuneration sought; and (ii) who should bear the costs of the application. In respect of issue (i), the applicants submitted that the administrators were not entitled to the remuneration sought because they could not properly have made the statement required under para 29(3)(b) of Sch B1 to the Act, namely that in their opinion, the purpose of administration was reasonably likely to be achieved. Therefore, they could not have given any thought to the matter prior to doing so. The applicants further criticised the amount of time and effort that had been spent on the administration, which they contended had achieved very little. Consideration was given to the duties of a prospective administrator, once appointed, in considering whether the statement as to the statutory purpose could be made.

Held:

(1) The Act gave directors power to appoint an administrator and the responsibility for the decision to do so fell on them. It did not oblige them to carry on trading whenever they could properly do so, so that it was not necessarily improper to appoint an administrator in circumstances where the directors could equally properly have taken some other course of action. Even if the administrator took the view that the directors were being unnecessarily timid in seeking to make an appointment when bolder directors might have carried on, it was not the function of the prospective administrator to refuse appointment so as to compel them to take risks they were unwilling to do. If the directors had acted for an improper purpose, or were otherwise in breach of their duty to the company in making the decision to appoint an administrator, that was something that might give rise to a claim against them. When they had made that

decision, the responsibility on the prospective administrator in considering whether the statement as to the statutory purpose could be made was to look ahead of that, at what would or might happen during the administration if he was appointed, and not behind at the motives which might have led the directors to choose to make the appointment. In so far as the directors had taken advice in coming to the decision to make an appointment, those who advised them might also have come under a duty to the company in the giving of that advice. That included the prospective administrators (see [27]–[29] of the judgment).

The contention that the administrators could not or should not have made the statement as to the statutory purpose, which had led to their appointment, would be rejected. The argument that they should not be entitled to any remuneration at all for their services would be rejected. The suggestion that, once appointed, they should have brought the administration to an end immediately, or continued it only for the purposes of complying with their statutory obligations, would also be rejected. In principle, it was appropriate for them to pursue a policy of ascertaining what the assets were and obtaining control of them and seeking to explore whether the Belvedere claim was a genuine liability or not with a view to taking a decision as to how to proceed when assets were available in their hands. However, there was force in the suggestion that the administrators should not have incurred significant costs in investigating the Belvedere claim (see [31], [32] of the judgment).

Having determined the principal issues, if the level of remuneration could not be agreed, it would be necessary to have a further hearing to give directions for a detailed consideration of those matters (see [33] of the judgment).

(2) In respect of costs of the application, the ordinary rule was that costs were to be paid by the applicant. There was no basis for departing from that in relation to the issues addressed so far, but it was a matter that would be considered against at the end of the contested process to determine the amount of remuneration in detail (see [33] of the judgment).

William Edwards (instructed by DWF LLP) for the applicants.

Matthew Weaver (instructed by Cameron Legal Ltd) for the administrators.

LEGISLATION

(1) Insolvency Practitioners (Amendment) Regulations 2015

SI 2015/391: Insolvency practitioners will no longer need to maintain records containing specified information on individual cases from 1 October 2015. There will be a broader requirement to keep records sufficient to show and explain the administration of a case and any decisions which materially affected the case.

Insolvency practitioners, as regulated professionals, were required under the Insolvency Practitioners Regulations, SI 2005/524, to maintain comprehensive records for insolvency cases over which they were appointed, so as to demonstrate effective management and progression was occurring. This included justifications behind all material decisions taken on the case.

The government stated this led to many practitioners maintaining duplicate records. As part of the insolvency aspect of the government's 'Red Tape Challenge', amendments have been made which are hoped to improve the efficiency of insolvency proceedings and the return to creditors.

Insolvency practitioners will no longer be required under SI 2005/524 to maintain records which contain at least specified information as was applicable to each case, and were capable of being reproduced separately to other records.

Insolvency practitioners will now be required only to maintain records which show and explain administration of each case, as well as the insolvency practitioner's decisions which materially affected the case.

Where insolvency practitioners were previously required to notify a recognised professional body of where the records were maintained, this will no longer be necessary, except in cases where they are authorised by a competent authority.

(2) Bankruptcy (Miscellaneous Amendments) (Scotland) Regulations 2015

SI 2015/80: These Regulations make a number of amendments to the Regulations implementing the Bankruptcy and Debt Advice (Scotland) Act 2014 in respect of sequestrations.

The Bankruptcy (Scotland) Regulations 2014

These Regulations amend the Bankruptcy (Scotland) Regulations 2014, SI 2014/225, reg 24 (the Bankruptcy Regulations) to harmonise the wording of the provisions relating to sequestration before 1 April 2015.

These provisions provide that the Bankruptcy Regulations do not apply to sequestrations where a creditor petition for sequestration is presented to court or a debtor application for sequestration is received by the accountant in bankruptcy (AIB) before 1 April 2015. These Regulations also add reg 15, Form 26 and reg 22 to the list of exemptions to the Bankruptcy Regulations.

A new reg 25 is inserted into the Bankruptcy Regulations which provides that the Bankruptcy Regulations do not have effect as regards any trust deed granted before (except in relation to reg 22—moratorium on diligence: notice of intention to apply).

Minor amends are made to the Bankruptcy Regulations, Sch 1 to ensure the provisions apply more clearly to executors and entities.

The Bankruptcy (Applications and Decisions) (Scotland) Regulations 2014

These Regulations add a new s 2A to the Bankruptcy (Applications and Decisions) (Scotland) Regulations 2014, SI 2014/226 (the Applications and Decisions Regulations) to allow AIB to relieve parties of failure to comply with those Regulations (but not provisions of the Bankruptcy (Scotland) Act 1985 (B(S)A 1985)).

The Applications and Decisions Regulation, reg 19 (which allows extension or waiver of statutory time limits following reference by AIB to the sheriff) is amended to apply to any reference by the AIB to the Court of Session for directions in replacing a trustee in sequestrations across different sheriffdoms under B(S)A 1985, s 28B(5), (6)(a).

These Regulations add a new s 21A to the Applications and Decisions Regulations to allow the AIB to appoint independent persons, including those with relevant expertise, to assist the AIB in relation to review applications.

The Bankruptcy Fees (Scotland) Regulations 2014

The savings arrangements for the Bankruptcy Fees (Scotland) Regulations 2014, SI 2014/227 are amended to avoid any doubt that a different effect was intended by the provisions of reg 13(1)(a) and (b) in relation to sequestrations and trust deeds. In addition, a change is also made so the revocation of fees for certificates of debtor discharge, certified copies of entries in the register of insolvencies, and certifying other documents and copies of documents, applies to sequestrations and trust deeds begun before 1 April 2015.

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Published by LexisNexis (www.lexisnexis.co.uk)

ISSN 1475-1887
9 771475 188142 08