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Cross-Border Insolvency and International Trade (Volume 2)

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Foreword: Cross-Border Insolvency and International Trade

Simon Croall QC, Head of Chambers, Quadrant Chambers, London, UK

Welcome to Quadrant Chambers' second Special Issue of International Corporate Rescue. The analysis provided in the articles in this Special Issue reflects our well-established reputation in the cross-border insolvency market. We have acted for some of the key players in some of the largest recent cross-border insolvencies including those involving OW Bunker, Hanjin Shipping, Arik Airlines, and (very recently) Alpha Insurance. Our long established position in shipping, insurance, commodities and aviation law coupled with our experience in cross-border insolvency gives us a unique insight into complex legal and commercial problems which have arisen, or may arise, when international corporate entities hit troubled times. Those problems frequently arise from the interaction of cross-border insolvency legislation (as interpreted by the courts), on the one hand, and choice of law rules, the law of property, international trade law and international conventions, on the other. This Special Issue provides guidance on how the law has developed and may continue to develop as these issues arise and are addressed by courts. It is the product of the synergy between Chambers' expertise in a wide range of commercials sectors and its ever growing expertise in insolvency and related areas.

I hope you enjoy this Special Edition. We look forward to working with you in the future in this fast-moving and challenging area.

Proving for Foreign Currency Debts in an Insolvency

Michael Howard QC, Quadrant Chambers, London, UK

Lehman Brothers International (Europe) ('Lehman Brothers') was an unlimited company, with two members, Lehman Brothers Holdings Intermediate 2 Ltd ('LBHI2') and Lehman Brothers Ltd ('LBL'), both of which were unsecured creditors of Lehman Brothers. In 2008 Lehman Brothers went into administration, as did LBHI2 and LBL. LBHI2 had made subordinated loans to Lehman Brothers, repayment of which was conditional on Lehman Brothers being able to pay its 'liabilities'. Obligations which were 'not payable or capable of being established in the insolvency [of Lehman Brothers]' were to be disregarded. Lehman Brothers also had many other creditors owed unsecured debts payable in foreign currencies. Although, rather unexpectedly, Lehman Brothers had a surplus in its administration, LBHI2 and LBL were unlikely to be able to repay their creditors. The Court was required to determine certain issues concerning the validity and ranking of various claims on the surplus for the purposes of the distribution to creditors in the administration. The Supreme Court[1] allowed a number of appeals and cross-appeals from the decision of the Court of Appeal[2] (which had for the most part upheld the decisions of David Richards J at first instance[3]).

The Supreme Court held:

(1) That LBHI2's claim as holder of subordinated loans was subordinate (a) to statutory interest and (b) to non-provable liabilities.

(2) If statutory interest was not paid during an administration, it could not be claimed in a subsequent liquidation.

(3) Lehman Brothers were entitled to seek contributions from members under section 74(1) of the Insolvency Act 1986 for non-provable liabilities but not for statutory interest.

(4) Lehman Brothers could not prove in the administrations of its members for a potential contribution claim under section 150 of the Insolvency Act 1986.

(5) Likewise, the members' potential liabilities under section 150 as contributories could not be set off against their claims as subordinated creditors.

(6) Lehman Brothers could rely on the contributory rule to resist paying the members on their proofs until they met their liabilities as contributories.

(7) Creditors who had suffered a loss due to the depreciation of sterling between the administration date and the payment date were not entitled to claim it as a non-provable debt.

This note is concerned only with the last of these holdings. It involves consideration of the way in which foreign currency debts are to be treated, both in the case of existing debts and in the case of debts which would accrue in the future. The Court of Appeal, by a majority, had upheld the decision of David Richards J that exchange losses were recoverable on foreign currency debts arising out of the conversion of the debt into sterling at the rate prevailing at the date of the order for administration. The Supreme Court, Lord Clarke of Stone-cum-Ebony dissenting, reversed the decision of the lower courts on this point.

Currency conversion claims

Rule 2.86 of the Insolvency Rules 1986 deals with the case of the company which goes into administration. It provides that:

> 'For the purpose of proving a debt incurred or payable in a currency other than sterling, the amount of the debt shall be converted into sterling at the official exchange rate prevailing on the date when the company entered administration ...'[4]

This is so even if the company subsequently goes into liquidation, though if the liquidation is not preceded by a period of administration, the relevant date is the date on which the company goes into liquidation.[5] The

Notes

1 [2017] 2 W.L.R. 1497.
2 [2016] Ch 50.
3 [2015] Ch 1.
4 The equivalent rule for liquidations is Rule 4.91 and is in identical terms, *mutatis mutandis*.
5 Insolvency Rules, r 4.91. Conversely if the administration is preceded by a liquidation, the date of the liquidation governs.

issue in *re Lehman Brothers*[6] was whether creditors who had suffered a loss due to the depreciation of sterling between the administration date and the payment date were entitled to claim that loss as a non-provable debt. The majority of the Supreme Court held that no such recovery was possible. The leading judgment was given by Lord Neuberger of Abbotsbury PSC, with whose judgment Lord Kerr of Tonaghmore and Lord Reed JJSC agreed. Lord Clarke dissented and Lord Sumption expressed certain reservations considered below.

The effect of a liquidation on foreign debts had been considered in *Miliangos v George Frank (Textiles) Ltd*,[7] in which English law for the first time accepted the possibility of foreign debts being recovered in foreign currencies. Lord Wilberforce (with whom Lord Cross of Chelsea agreed) expressed the view that the exchange of the foreign debt into sterling should be effected at the date when the claim was admitted to the liquidation. That case was concerned with a simple claim for the recovery of a contractual debt, and Lord Wilberforce's observations about insolvency were *obiter*. However, the matter arose for decision in two subsequent cases, *Re Dynamics Corp of America (In Liquidation) (No 2)*[8] and *Re Lines Bros (In Liquidation)*.[9] In those two cases, the courts refused to follow the guidance given by Lord Wilberforce and instead laid down a rule that the date for conversion was the one on which the order for liquidation or administration was made. The Supreme Court ignored the radical difference between the two approaches and ruled that the dicta in these cases did not provide any useful guidance. The reasoning was as follows. The provisions of the 1986 insolvency legislation and the rules made under it were a new scheme. These cases were concerned with an earlier insolvency code, and the legislation constituted a radical change in the law. The treatment of foreign currency creditors was expressly dealt with for the first time in the 1986 Rules. The new insolvency legislation and rules followed on the publication of the Cork Report[10] and two Law Commission working papers, *Private International Law: Foreign Money Matters*[11] and Final Report on Private International Law Foreign Money Liabilities,[12] all of which argued for the date of the order for administration as being the conversion date. Even so, one would have thought that the considered reasoning of eminent judges in the context of the law as it formerly stood should not have been simply ignored. They involved the consideration of the underlying problems with which the Rules were supposed to deal.

There were two principle arguments put forward to support the Supreme Court's conclusion that no recovery was possible.

The narrower issue. What the Supreme Court called 'the narrower issue' was whether the wording of the rules was such that the claim in respect of exchange losses was one which was barred by the wording of the rules. Lord Neuberger considered that it should be inferred that the new r.2.86 was intended to spell out the full extent of a foreign currency creditor's rights, especially as the purpose of the 1986 legislation was to simplify and clarify the law. He thought that if it were otherwise, r.2.86 would operate as a one-way option on the currency markets in a foreign currency creditor's favour. He noted[13] that the rules expressly provided for adjustments to a proof of a contingent debt and that there was no equivalent provision for a foreign currency debt. This approach is supported by *Mann on Money*,[14] broadly on the ground that it is necessary for there to be a single date taken for the ascertainment of claims but challenged by *Howard, Knott and Kimbell on Foreign Currency*[15] on the ground that Lord Wilberforce's approach still resulted in a single date being taken for the assessment but involved the deferment to the latest possible date for the conversion. (Neither of these works appears to have been cited to the Supreme Court.) The wording of the Rules is such as to require there to be a conversion where there are foreign currency debts.

The narrow argument is therefore that (a) on their true construction, the Rules provide for the payment to be limited to the sterling equivalent of the debt at the date of the order; (b) this construction is supported by contrasting the express provision for adjustment of contingent debts with the silence in relation to foreign currency debts; and (c) the foreign currency creditor would benefit if sterling appreciated after the date of administration but, on the other view, would not lose if sterling depreciated. The narrow view results in the claim of the creditor being satisfied if he receives payment in full of the proved sterling sum.

It is not possible therefore for a liquidation or administration to be carried out in a foreign currency, even though all the liabilities are properly expressed in the same foreign currency. Where any foreign debt is

Notes

6 *Ante*, note 1.
7 [1976] AC 443 (HL).
8 [1976] 1 WLR 757
9 [1983] Ch 1 (CA).
10 Report of the Review Committee on Insolvency Law and Practice, 1982 Cmnd 8558.
11 (1981) Working Paper No. 80.
12 (1983) Law Com No 124 (Cmnd 9064).
13 Judgment, §93.
14 C. Proctor (ed.), *Mann, the Legal Aspect of Money* (7th edn, Oxford, Oxford University Press, 2012) §8.27.
15 Michael Howard QC, John Knott and John Kimbell QC, *Foreign Currency: Claims, Judgments, Damages* (Informa 2016) §§10.5-10.17.

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involved it seems that there must be a conversion as a result of the wording of the new rules. In this respect, the Rules must be taken to have overruled the decision of Harman J in *Re Scandinavian Group PLC*[16] where it had been held that liquidation could be carried on in a foreign currency. That would have been possible in practice only in the exceptional case where all the liabilities were in a single foreign currency,[17] which would be a very rare event in an English liquidation (and was not the situation in *Re Lehman Brothers*).

The wider issue. When the case was before the Court of Appeal,[18] Lewison LJ would have held that the foreign currency debt was in effect merged with the sterling sum proved in the administration, and the dividend established by reference to the date of the order for administration was substituted for the contractual liability, which thereupon ceased to exist.[19] This reasoning failed to find favour with the majority in the Court of Appeal. Briggs LJ (as he then was) expressly held that the contractual liability continued, and the assessment as at the date of the order of the sterling value of the debt was a matter merely of procedure.[20] The debt remained in being and unsatisfied, and if there turned out to be funds available to satisfy the balance of the debt, assessed by reference to exchange rates prevailing at the date of payment, there was no reason why the claimant should not recover the surplus over the sum for which he had proved. Moore-Bick LJ came to the same conclusion.[21] Essentially, he held that the words of the Insolvency Rules did not have the effect that the order for administration substituted a right to a sterling sum in the administration for the contractual right to a foreign currency debt.

Lewison LJ's approach was therefore consonant with the result reached in the Supreme Court; but was based on a conclusion about the wider issue. In essence, the difference between the two is that between substance and procedure. If as a matter of construction Rule 2.86 bars any inquiry as to the state of the debt after the date of the order for administration, the creditor has lost his right to pursue the debt, even though it may still exist. This is purely a matter of procedure. If, however, it is not merely that his remedy has been barred: the debt has become the sum fixed by the compulsory conversion and there has been a substantive change in the obligation.

In view of the Supreme Court's holding in relation to the construction of Rule 2.86, it was thought unnecessary for the Supreme Court to go on to decide the wider issue, but all the judges expressed their opinion about it. The majority view was that the conversion did indeed take place.[22] 'It would be inconsistent with the general thrust of Chapt.10 of Pt 2 … of the 1986 Rules that a debt, which has been the subject of a proof which has been met in full, nonetheless includes a component which is somehow capable of resurrection.'[23] The point is so fully argued out that it has the general character of an alternative *ratio decidendi*. It seems however that it has been expressly left open, because Lord Neuberger states that his reasoning is the basis only for his 'current inclination';[24] and he expressly says that his 'Conclusion' is founded on 'the narrower contention'.[25]

The views of the minority are instructive. Lord Sumption supported the general rule which prevents upward variation of foreign currency debts to take account of currency fluctuations by reference to the argument (for which he cited the judgment of Brightman LJ in *re Lines Bros*[26]) that this was not consistent with a *pari passu* distribution. It is not clear that this is so, because the recovery of the exchange loss would simply mean that the correct figure was entered as the claim. The same would apply to contingent liabilities, for which, as Lord Neuberger pointed out, special provision is made in the Rules. There would be something to be said for the view that all future debts in foreign currencies (as opposed to debts in foreign currencies already accrued) should be treated as contingent debts, as the exact quantum of such debts in sterling terms cannot be known until after the date of the order for administration or liquidation. That would have been consistent with Lord Wilberforce's approach in *Miliangos v George Frank (Textiles) Ltd,*[27] though not, as mentioned earlier, with the later decisions in *Re Dynamics Corp of America (In Liquidation) (No 2)* and *Re Lines Bros (In Liquidation)*.[28] The wording of Rules 2.86 and 4.91 appear to prevent this conclusion because they refer to debts 'incurred *or payable*'. And it is for that reason that Lord Sumption agrees with the first ground of the decision, namely

Notes

16 [1987] 1 Ch 87 at 107-8.

17 There may be room for argument about this, for example in the case where 90% of the debts are in US dollars and 10% in Euros. But this debate cannot take place while the Rules are as they are now.

18 [2016] Ch 50.

19 *Ibid.*, §§64-101.

20 *Ibid.*, §§142-166.

21 *Ibid.*, §§247-259.

22 The Courts reasoning is set out at §§97-112.

23 *Ibid.*, §94.

24 *Ibid.*, §98.

25 *Ibid.*, §112.

26 [1983] Ch 1 at 16.

27 [1976] AC 443 at 467.

28 *Supra.* See the discussion in *Howard, Knott and Kimbell* (n. 15) at §§10.5-10.17.

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that the words of the statutory scheme are clear and cannot be circumvented.

It is perhaps worth noting that Lord Sumption expresses some doubt as to the validity of the reasoning of the Committees whose recommendations led to the Rules being formulated so as to make the cut-off date for conversion that of the order for administration.[29] He went on to express a preference for the view of the courts below on the wider argument as to the effect of the winding up order, though, like Lord Neuberger's contrary opinion, his words were *obiter* only.[30] Lord Sumption's analysis was however underpinned by a substantial body of authority (to which David Richards J and the majority of the Court of Appeal had also referred). In particular in *Wight v Eckhardt Marine GmbH,*[31] Lord Hoffmann said that 'the winding up leaves the debts of the creditors untouched. It only affects the way in which they can be enforced' and that 'the winding up does not either create new substantive rights in the creditors or destroy the old ones'. Again, in *Parmalat Capital Finance Ltd v Food Holdings Ltd (in liquidation),*[32] he said that 'a winding up order does not affect the legal rights of the creditors or the company'. These are clear expressions of principle, stated well after the Insolvency Act 1996 and its associated Rules came into effect. It is thought, with respect, that Lord Neuberger's attempts to qualify or escape from these dicta are unconvincing.

Lord Clarke dissented on both points. He agreed with Lord Sumption and the courts below that the effect of making a winding up order had a purely procedural effect, so that the contractual debt survived. But he went on to hold that, as that was so, in the case where there was a surplus, there was no need to confine the creditor's recovery to the sum which was identified at the time of the order. In effect he held that the Rules governed the amount recoverable only in so far as there was a distribution to the creditors on an insolvency. Insofar as there was no insolvency, there was nothing on which the rules could bite so far as the funds exceeded those claims which were crystallised at the time of the order. As the underlying contractual right survived, there was no reason why the creditor should not make a full recovery as at the date of payment. There is, with respect, much to be said for this view. First, as Lord Clarke pointed out, the other conclusion would mean that the shareholders of the company would benefit at the expense of the general creditors.[33] Lord Neuberger took in effect the converse point.[34] He was concerned at the possibility that the foreign currency claimants would have a one-way bet if recovery for exchange losses were permissible. Creditors would be able to claim for losses if sterling depreciated against the currency of the claim, while they would not suffer any diminution in their recovery if sterling appreciated. It is thought, with respect, that this is to confuse recovery for exchange losses and recovery for losses crystallised at a date when a different exchange rate prevails.

Secondly, the reasons behind the Rules are not very satisfactory. The Committees on whose recommendations the Rules were based were considering the problems of foreign currency insolvency at a time when the decision in the *Miliangos* case[35] was still quite recent and its ramifications had not been explored fully in practice. And their remit was an extremely wide one, so that particular areas of insolvency practice could not of necessity have the intensive focus which would have been present had they been the only topic under consideration, rather than a small corner of a huge canvas which was to be painted in reforming legislation. Thirdly, while it is possible to agree that the construction of rules 2.86 and 4.91 leads inexorably to certain results in the distribution of funds which are insufficient to satisfy all the debts of a particular insolvent company, that does not dispose of the question. If it is decided, in accordance with the arguments which found favour with the trial judge and Lords Sumption and Clarke (for what are, with respect, good reasons), that the status of the debt was not necessarily touched by the Rules because they were to be regarded as governing a matter of procedure only, it is difficult to see how that procedure can affect the underlying rights of the parties except to the extent that the execution of that procedure is relevant. That being so, it is respectfully submitted that Lord Clarke's view makes better practical sense and does not violate the terms of the Rules.

It might be thought that the decision of the Supreme Court proceeds on the assumption that there is a potential cause of action for exchange losses. This would be a large assumption to make without argument.[36] In reality, however, the courts never became involved in this question. Their concern was whether the original

Notes

29 See [2017] 2 WLR 1497 at §194. Lord Clarke agreed: see *ibid.* §222. I respectfully agree with those doubts.
30 *Ibid.*, §§195-6.
31 [2004] 1 AC 147 (PC), §§26, 27.
32 [2008] BCC 371 (PC), §8.
33 Judgment §§218-9.
34 Judgment §91, and see §§84-87.
35 *Ante.*
36 It is a question on which the authors of *Howard, Knott and Kimbell* (n. 15) are divided. See Chapter 13 where the majority view is embodied in the first part of the chapter, treated as representing the Orthodox View (§§13.1-13.43) and the minority view in a Note of Dissent (§§13.44-13.55). Reviewers of this book have been greatly interested by the conflict of views among the authors, but none has actually offered an opinion as to which set of arguments is the more persuasive.

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debt survived the order for administration and, if so whether it was enforceable. No new cause of action was involved. If there had been, there would have been a good argument that the cause of action arose *after* the order for administration, so that Rule 2.86 was never engaged. Nonetheless, the fact that none of the courts gave any consideration to the possibility that there was a separate cause of action for a reduction of recovery due to fluctuations in exchange rates gives some support for the view that there is no general right to claim for such losses.[37]

Notes

37 Thus supporting the Note of Dissent in *Howard, Knott and Kimbell* (n. 15).

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The Collapse of Hanjin Shipping: An English Lawyer's Perspective

Robert Thomas QC and Jeremy Richmond, Barristers, Quadrant Chambers, London, UK

Introduction

The Korean container shipper, Hanjin Shipping Co., Ltd. ('Hanjin') is one of the world's top ten container carriers in terms of capacity with a fleet that includes 61 container ships and 18 bulk carriers, with a presence in 60 countries and 6,000 employees. By way of example of its importance to world trade, it reportedly accounts for about 8% of trans-Pacific trade volume for the United States. On 31 August 2016 Hanjin filed for bankruptcy in South Korea. It is one of the largest, if not the largest, container shipping insolvencies in history. It follows on from a series of shipping bankruptcies in recent years including Korean Line Corporation, STX Pan Ocean, Samsun Logix and Sanko Steamship. As Hanjin's bankruptcy, and possible rehabilitation, in South Korea proceeds, the international effects of the bankruptcy continue to be felt. Stories in the international press abound about significant container build up at port facilities, Hanjin vessels not putting into port so as to avoid arrest attempts and freight forwarders desperately seeking to access cargo in Hanjin containers.

The bankruptcy has been recognised in multiple jurisdictions under the UNCITRAL Model Law. In Great Britain, Hanjin's bankruptcy was recognised by an order of Nugee J dated 6 September 2016 ('the Recognition Order') pursuant to the UNCITRAL Model Law as implemented by the GB Cross-Border Insolvency Regulations 2006 ('CBIR'). The Recognition Order was in the usual 'extended form'. That is to say that not only is Hanjin treated in Great Britain as if it has been wound up by a creditor's petition but also enjoys the moratorium afforded to companies that have entered into administration in England pursuant to paragraph 43, Schedule B1 to the Insolvency Act 1986.

Hanjin's bankruptcy has thrown up a plethora of complex issues concerning the interaction of insolvency law, maritime law, property law and conflicts of law (among other things). In this article we address just some of the very many issues arising and outline the potential approaches that the English courts may take going forward, regarding: (a) the bases on which English courts are likely to modify the Recognition Order to allow a claim to be commenced or continued against Hanjin; (b) the enforceability of sub-freight liens and claims for freight under a bill of lading in light of the moratorium in England pursuant to the Recognition Order; (c) detention of cargo at ports; and (d) potential submission of Hanjin's creditors' claims to the jurisdiction of the Korean insolvency.

Our aim is to identify the English courts' likely approaches rather than attempt to give definitive answers to the issues arising. This is partly because the interaction and interplay between these diverse areas of law is still developing; and partly because the practical issues arising are typically intensely fact-sensitive.

Modification of recognition orders under CBIR

The basic provisions of CBIR are well known but merit a brief summary here. Article 20(1) of CBIR provides that upon recognition of a foreign proceeding that is a foreign main proceeding, subject to Article 20(2), (a) commencement or continuation of individual actions, or individual proceedings concerning the debtor's assets, rights, obligations or liabilities is stayed; (b) execution against the debtor's assets is stayed; and (c) the right to transfer, encumber or otherwise dispose of any assets of the debtor is suspended. Article 20(2) provides relevantly that the stay and suspension referred to in Article 20(1) shall be the same in scope and effect as if the debtor had been made subject to a winding up order under the Insolvency Act 1986; and subject to the same powers of the court and the same prohibitions, limitations and exceptions and conditions as would apply under the law of Great Britain. Article 20(3) expressly excludes from the scope of Article 20(2) the right to take steps to enforce security over the debtor's property or to take steps to repossess goods in the debtor's possession under a hire-purchase agreement. It is common, at least in maritime insolvency cases, for the English courts to grant additional relief to the debtor under Article 21 so as to prevent the steps referred to in Article 20(3) without the written consent of the court or the consent of the foreign representative where the purpose of the foreign main proceedings is in the nature of a restructuring rather than a liquidation:

Transfield ER Cape Limited.[1] As noted above, the Recognition Order in the Hanjin bankruptcy contained such additional relief.

Articles 20(6) and 22 in short provide that a person affected by the stay or suspension under Article 20(1) or the additional relief under Article 21 may apply to modify or terminate the recognition order. It is to the application of these two provisions that we now turn.

The English court has recently considered the correct approach in considering such applications in *Ronelph Marine Ltd et. al. v STX Offshore & Shipbuilding Co Ltd and Jang*.[2] The case sets out conveniently some of the principles that the English court is likely to apply in applications to modify recognition orders.

In *Ronelph Marine*, each of the applicants (referred to herein for convenience as 'Ronelph Marine') entered into shipbuilding contracts with Dalian, a wholly owned subsidiary of STX. STX entered into performance bonds with Ronelph Marine, which bonds were governed by English law and contained non-exclusive 'English court' jurisdiction clauses. Dalian entered into a Chinese insolvency process in which it was made clear that the ship building contracts would not proceed. Ronelph Marine said that such notice was a renunciation and/or anticipatory breach of the shipbuilding contracts and sought to claim damages in the Chinese insolvency proceeding against Dalian.

The Dalian administrator rejected Ronelph Marine's claim. Consequently, Ronelph Marine then sought to sue STX in the English Commercial Court under the performance bonds. Those proceedings reached the stage of disclosure of documents after which STX entered into rehabilitation proceedings in South Korea, which proceedings were subsequently recognised in Great Britain under CBIR. Ronelph Marine then sought to claim under the performance bonds in the Korean rehabilitation proceedings. The Korean administrator rejected those claims. In Korean rehabilitation proceedings, the administrator prepares a list of all claims by creditors. If the creditor does not agree with that list, then it must submit a proof of claim within a limited period, which will either be accepted or rejected by the administrator (in this case the administrator rejected Ronelph Marine's claims). If rejected, then the creditor may commence 'confirmatory proceedings' in the Korean Rehabilitation Court within a limited time period. If not satisfied with the outcome of the confirmatory proceedings, the creditor may file an objection and the case is transferred to the Korean civil courts as an 'objection proceeding'. It was accepted by the Judge (Norris J) that if he modified the recognition order so as to allow the English court proceedings to continue it was likely that the Korean Courts would suspend the Korean confirmatory proceedings pending the outcome of the English court proceedings. Moreover, Norris J appeared to accept that the decision of the English court proceedings would likely be accepted in the Korean insolvency proceedings. So, Ronelph Marine had in effect two options: (a) to seek to continue its claim in Korean confirmatory proceedings; or (b) to seek to have its claims adjudicated in the on-going English court proceedings. Ronelph Marine chose the latter of the two options, namely to seek to have its claims adjudicated in the on-going English court proceedings. Consequently, Ronelph Marine applied to modify the recognition order so that it could continue the English court proceedings for the purposes of obtaining an adjudication of its claim with a view to presenting the outcome in the Korean confirmatory proceedings. Ronelph Marine accepted that it could not enforce any English judgment against STX, but it argued it could rely on the judgment for its unsecured claim in the Korean Rehabilitation Court, which could either adopt or reject such claim.

Norris J acceded to the application to modify the recognition order and in so doing conveniently re-stated some of the guiding principles that the English courts apply in determining applications to modify 'extended' recognition orders. Firstly, the applicant bears the burden of making out his case to modify the recognition order. Secondly, the applicant must identify the nature of the interests that he wishes to promote by obtaining that relief. Thirdly, the court will consider the question of whether the grant of such relief is likely to impede the achievement of the purpose of the insolvency proceeding. Fourthly, the applicant must enable the Court to balance his legitimate interests against the interests of other creditors, having regard to the nature and the probability of prejudice to the other side. In the context of money claims Norris J considered the well-known rule in England that the court will only exceptionally give a creditor the right to override and pre-empt the statutory machinery (in this case the Korean confirmatory proceedings). However, he considered that the 'exceptional' test was '*protean*' and stated that the true test was whether 'the applicant creditor [can] demonstrate a circumstance or combination of circumstances of sufficient weight to overcome the strong imperative to have all the claims dealt with in the same way'.[3] Norris J found that Ronelph Marine had discharged that burden since (a) the case gave rise to complex matters of English law; (b) the English Commercial Court proceedings were reasonably well advanced; (c) the English Commercial Court would adjudicate and

Notes

1 [2010] EWHC 2851.
2 [2016] EWHC 2228 (Ch).
3 Paragraph 31 of the judgment.

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quantify the claim under the performance bonds more speedily; (d) the English Court adjudication would assist rather than hinder rehabilitation proceedings in Korea; and (e) the interest of the other creditors in the Korean rehabilitation were not said to be prejudiced on STX foreign representative's evidence in the event the English Commercial Court proceedings were allowed to continue.

Although Norris J emphasised that the factors he had indicated were not exhaustive, advisors should consider each of the factors identified by Norris J when preparing any application to modify the Recognition Order in the Hanjin insolvency.

The enforceability of sub-freight/sub-hire liens and claims for freight under a bill of lading in light of the moratorium in England pursuant to the Hanjin's Recognition Order

Hanjin not only owns its own vessels but is understood to have chartered (ie hired) a significant part of its fleet from other owners. Many (if not all) of those charters are likely to be on standard form time charterparties and, as a result, many will be subject to English law and jurisdiction (most probably arbitration). The owners of such chartered vessels will, therefore, be looking on nervously and considering the implications of the Hanjin insolvency from an English law perspective.

There will, of course, be substantial claims against Hanjin for early termination/repudiation of the charters (although the recent Court of Appeal decision in *Spar Shipping*[4] may arguably complicate matters). There will also probably be claims arising from the arrest/detention of those vessels which are unlucky enough to be arrested but, given the size of the insolvency, it seems perhaps unlikely that proving in the insolvency will not yield much return and certainly not for a considerable period of time. Owners will, therefore, be looking at other ways to secure payment which are not subject to the Recognition Order and the stay imposed by it.

Arguably the most straightforward situation is where the Owners have issued bills of lading to shippers to which they (i.e. the Owners, as opposed to Hanjin as charterers) are a party. How widely this is the case with vessels chartered by Hanjin is presently unclear but where it is, then the Owners have a contract directly with the shipper (or bill of lading holder). The writers do not see why such a contractual claim between Owners and shippers/bill of lading holders should be subject to or affected by the Recognition Order.

If this is right then the following observations can be offered. It is generally accepted that where the bill of lading contract is with the Owners, the right to freight is vested in those Owners and that the shipper/bill of lading holder will not obtain a good discharge by paying Charterers unless the bill provides by express terms or by incorporation that payment may be so made. The consequences of this are twofold. First, it means that to the extent that the Charterers (ie Hanjin) have not paid freight or hire due to the Owners, then the Owners may maintain their claim against shippers/bill of lading holders (although they may have to account for any sums recovered above that owing to them under the relevant Charterparty with Hanjin). The second consequence is that the shipper/bill of lading holder may be exposed to paying twice. To that extent, there is the risk (as with the recent collapse of OW Bunkers) that entirely innocent parties will end up in an invidious position, facing claims from two parties and in the end having to satisfy both.

The second question that calls for consideration is whether Owners can successfully avoid the consequences of the Recognition Order by relying upon what are commonly called liens on sub-freight (or sub-hire) against parties who may have chartered the vessel from Hanjin (or indeed sub- or even sub-sub-chartered her).

Plainly such liens are not possessory nor do they fit easily into any of the generally recognised types of liens. As a result and until recently (and arguably still) their nature has been the subject of debate.

In 2011, in *Cosco Bulk Carriers Co Ltd v Armada Shipping SA*,[5] the juridical nature of a lien on sub-freight/hire came before Briggs J sitting in the Chancery Division. Following the bankruptcy of Armada in Switzerland and a Recognition Order made in Great Britain under CBIR, Cosco sought to argue that a London arbitration that it had brought against Armada's sub-charterers by which it sought to enforce its lien over sub-hire, was not subject of the automatic stay because the lien operated as an equitable charge and that the Recognition Order did not prevent a secured creditor from enforcing his security. The Judge considered that the issue was 'ripe for consideration at least by the Court of Appeal' but declined to express his own views on the question, finding instead that he would permit the arbitration to proceed as a matter of discretion in any event.

Just a year later, the matter arose again in the Commercial Court in *The Western Moscow.*[6] This time the

Notes

4 [2016] EWCA 982, in which, after several years of uncertainty, the Court of Appeal determined that a charterers' failure to pay an instalment of hire punctually in advance under the familiar form NYPE timecharter was not a breach of condition, entitling the shipowner to terminate and claim damages for that reason alone.

5 [2011] EWHC 216 (Ch).

6 [2012] 2 Ll Rep 163.

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dispute was over jurisdiction. In a masterful analysis of the competing views, Christopher Clarke J (as he then was) reviewed the relevant authorities and concluded that the lien clause created an assignment by way of charge, rather than conferring a *sui generis* personal contractual right of interception. In so doing, he adopted the views expressed by a series of Judges at first instance in preference to views expressed by Lord Millett in *Agnew v Commissioners of Inland Revenue*[7] (and propounded by Professor Oditah[8]). As such, his judgment cannot as yet be regarded as the last word on the subject but it has been cited with approval by various leading textbook and was accepted as correct in *The Bulk Chile.*[9]

The judgment in *The Western Moscow* leaves a number of questions unresolved but assuming that it does indeed properly identify the nature of the lien, it leads to the conclusion that proceedings in relation to such a lien fall outside the scope of a standard Recognition Order, as foreshadowed in the judgment of Briggs J in *Cosco v Armada* and that they fall within the exception found in Article 20(3) of CBIR which expressly states that the automatic stay under Article 20 does not affect any right to take any steps to enforce security over the debtor's property.

Whilst this may be the cause for some optimism on the part of Owners, it is important to bear in mind that the Court has the discretion under Article 21 of CBIR to extend the scope of the stay to other proceedings or actions where it is necessary to protect the assets of the debtor or the interests of the creditors. In cases in the UK relating to maritime insolvencies, (as noted above) this has commonly been the case and Orders have been extended so as to prevent parties enforcing charges etc without the Court's permission or the foreign representative's consent. Consistent with this approach, the Order made in the Hanjin insolvency has been extended in several respects including a prohibition on any steps to enforce any mortgage, charge or lien or other security over the company's property and a blanket prohibition on any legal process (defined to include arbitrations) against the Company or its property without the permission of the Court. Whilst a brave lawyer might seek to argue that the right to freight or hire does not constitute property within the meaning of the Order, one suspects that this will receive short shrift.

As a result, the apparent security offered by the lien on sub-freight/hire may be less appealing than many might think and the prospects of Owners avoiding the clutches of the Recognition Order (at least in its present form) appear slim. That said, it is yet to be seen whether the Court may look favourably on a variation order permitting the underlying claims to be resolved in English arbitration (and according to English law) in much the same way as the Judge permitted in *Cosco v Armada*. And therein lies the rub. As Professor Baughen has noted,[10] the evidence given to the English Court in *The Bulk Chile* suggests that under South Korean insolvency law the lien on sub-freight/hire may not, in fact, be affected by the rehabilitation proceedings. It is fair to say that the evidence before the Judge was conflicting and, although the Judge expressed a clear preference for the evidence of one of the experts, this cannot, of course, preclude the possibility of the matter being resolved differently in South Korea in due course. Nevertheless, this part of the Judgment raises the possibility of arguing before the English Court that whatever stay is in place pursuant to the Recognition Order should be lifted or varied in the case of the liens on subfreight/hire in view of the generally favourably approach that English courts adopt to the enforcement of property/security rights in the context of English administrations provided such enforcement is unlikely to impede the achievement of the purpose for which the administration/rehabilitation was being pursued.

What this analysis also brings into sharp focus is the need carefully to consider the particular circumstances of any particular case. Various assumptions are made in what is said above and they may or may not apply in any individual case.

Detention of cargo at ports

It is estimated that 90% of Hanjin vessels should finish offloading their cargoes by the end of October 2016.[11] However, the collapse has led to a significant delay in goods coming to market and a disruption to the supply chain. There are a number of potential causes for delay. They include some GB ports' assertion of a contractual lien or common law lien over the Hanjin shipped containers (and their contents) at port in respect of unpaid port fees.

Leaving aside the question of the effect of the Recognition Order, whether a port can assert a contractual lien over the containers (and their contents) is obviously a question of contract and as such intensely fact-sensitive. Common issues that arise are whether (a) the lien provisions in the port's terms and conditions are capable of covering both containers and their contents, and (b) the cargo owner has authorised Hanjin

Notes

7 [2001] 2 AC 710.
8 The juridical nature of a lien on subfreight [1989] LMCLQ 191.
9 [2012] 2 Ll Rep 594.
10 See his short but insightful piece in the online publication on Maricom law dated 24 September 2016.
11 See the British International Freight Association's general information memorandum dated October 2016.

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to contract on terms with the port operator so that the cargo can be said to fall subject to the port operators' contractual lien (applying the analysis in *Jarl Tra AB v Convoys Ltd*).[12] In addition it is possible that port operators may seek to assert (a) common law liens including a warehouseman lien and the ancient wharfingers liens (e.g. *R v Humphrey*)[13] over the containers and their contents, or (b) a statutory lien or right of distraint under the Harbours, Piers and Docks Clauses Act 1847 or related subsequent legislation.

Certain common law liens raise particularly complex issues since they *prima facie* give rise to a general (all-monies) lien such that the debt that must be discharged to terminate the lien includes not only the port charges in respect of the particular container in question but also *all* debts owing by Hanjin to the port.

One additional and particularly difficult area of the law is the effect of the Recognition Order on the potential perfection of a lien. In brief outline, in order to perfect a common law lien as a matter of English law the person asserting the lien must show that (a) the debt in question is due for immediate payment; and (b) the lienee is in lawful possession of the goods in question. As such, it might be said that the recognition order 'suspends' the right to perfect a lien pursuant to CBIR, Arts.20(1)(c) and 20(2)(a) so that if the lien is not perfected by the time of the recognition order the potential lien is lost.[14] However, in the context of the appointment of a receiver and 'the perfection' of a contractual lien, it would seem that it is possible to perfect a lien after the appointment of the receiver (see e.g. *George Barker (Transport) Ltd v Enyon,* where a contractual lien was not defeated by the later crystallisation of a floating charge in circumstances where the creditor (the lienor) came into possession of the goods only *after* the floating charge's crystallisation).[15] It has been doubted, however, whether this case would be followed in the case of a liquidation,[16] which doubt, it could be argued, may extend to the context of a recognition order in GB.

Submitting to the jurisdiction of the Korean insolvency proceedings

As a matter of English law, there is a real risk that a creditor proving in a foreign insolvency proceeding will, by that action alone, subject his claim to the jurisdiction of the foreign insolvency proceedings. Where the creditor has a monetary claim arising from a contract with an English jurisdiction clause the risk may be of no consequence since it is likely that the English court will take the view that the claim *prima facie* should be determined by the foreign insolvency proceeding in any event (see *Ronelph Marine, supra*). However, if the creditor has a proprietary claim in England against Hanjin (e.g. a common law lien claim) the position may well be more nuanced. Moreover, submitting such proprietary claims presents something of a dilemma for a creditor. This is because failure to lodge a claim in the Korean insolvency proceedings in time potentially means that the claim cannot be advanced at all in the Korean insolvency proceedings. However, on other hand, submitting a proprietary claim arising in England in the Korean insolvency proceedings runs the risk of the creditor submitting his claim to the jurisdiction of the Korean insolvency proceedings. The Korean insolvency proceedings may or may not treat such claims as favourably as the English courts.

There have been a number of recent cases that touch upon the question of submission to the jurisdiction of the foreign insolvency proceedings including *Rubin v Eurofinance*;[17] *Stichting Shell Pensioenfunds v Krys*[18] and *Erste Group Bank v VMZ Red October*.[19] Reasons of space preclude a detailed factual analysis of these cases. However, the following principles set out in these cases may well impact on the issue as a matter of English law.

Firstly, a 'foreign' creditor submits to the jurisdiction of the court supervising a company's insolvency by proving in that insolvency. That by itself is sufficient without more (and irrespective of whether the proof has been accepted or a dividend has been received): *Erste Group* at [51].

Secondly, a submission may consist in any procedural step consistent only with the acceptance of the rule under which the court operates. These rules may expose the party submitting to consequences, which extend well beyond the matters with which the relevant procedural step is concerned: *Stichting Shell* at [31].

Thirdly, the characterisation of whether there has been a submission for the purpose of the enforcement of a foreign judgment in England depends on English law. The court will not simply consider whether the steps

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12 [2003] 2 CLC 1072

13 1 McClel & Y 173, 14

14 As a matter of domestic English insolvency law, a company subject to liquidation proceedings remains the legal owner of its property, so that a creditor may claim a lien, where applicable, over any property passed to it after the commencement of winding-up (generally the date of the presentation of the petition) but not once the actual winding up order is made: *Re Wiltshire Iron Co, ex parte Pearson* (1867-1868) LR 3 Ch App 443.

15 [1974] 1 WLR 462.

16 See e.g. Totty, Moss & Segal *Laws of Insolvency* (looseleaf) at D3-08.

17 [2013] 1 AC 236.

18 [2015] AC 616.

19 [2015] 1 CLC 706 (CA).

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taken abroad would have amounted to a submission in English proceedings. The international context requires a much broader approach. Nor does it follow from the fact that the foreign court would have regarded steps taken in the foreign proceedings as a submission that the English court would so regard them. Conversely, it does not necessarily follow that because the foreign court would not regard the steps as a submission that they will not be so regarded by the English court as a submission for the purpose of the enforcement of a foreign judgment. The question of whether there has been a submission is to be inferred from all the facts: *Rubin* at [161].

Fourthly, as a general rule, however, there can be no objection in principle to a creditor invoking the purely adjudicatory jurisdiction of a foreign court, provided that it is an appropriate jurisdiction and that litigation is not vexatious or oppressive to the liquidator or other interested parties: *Stichting Shell* at [40].

While determining the position as a matter of English law in extreme cases (e.g. complete participation or total non participation in the foreign insolvency) is reasonably straightforward the position is less so where a party seeks to reserve its position regarding jurisdiction when filing its claim in the Korean insolvency proceedings. Sheldon *Cross-Border Insolvency* (4th ed.) at 13.25 suggests (we tentatively suggest correctly) that the position is as follows:

> '…
>
> It is suggested that, in each case, the answer will turn on a precise and careful analysis of whether the step that a creditor has taken in the insolvency process is consistent with ignoring the consequences of that process that are in issue, and the degree of any inconsistency in the creditors' approach.
>
> …'

One possible solution to a creditor's dilemma is for it to apply to court to modify the English recognition order as appropriate or ask the foreign representative for an undertaking to similar effect. For example, in *D/S Norden v Samsun Logix Corporation*[20] D/S Norden sought permission to enforce its English security (a sub-freight lien) against Samsun's sub-charterer notwithstanding a stay on proceedings against Samsun imposed pursuant to CBIR. This on the basis that typically English courts would normally give leave to exercise a proprietary right provided it was unlikely to impede the achievement of the purpose for which the administration/rehabilitation was being pursued. It was common ground between the parties that the sub-freight lien would not be vulnerable to challenge as a matter of English domestic law. The Korean receiver had rejected in the Korean insolvency proceedings the sub-freight lien claim in part. D/S Norden subsequently submitted the part of the claim that had been rejected to confirmatory proceedings in Korea. D/S Norden argued that if it pursued its claim in the Korean insolvency proceedings then it would run the risk of the Korean receiver arguing that it (D/S Norden) would be bound by whatever the Korean court might decide. Conversely, if it did not participate in the Korean proceedings it would run the risk of the Korean court making an adverse decision against its sub-freight lien claim without having regard to arguments that it could have otherwise advanced in the Korean proceedings. The Judge rejected D/S Norden's application for permission to enforce the sub-freight lien. However, the Judge ordered that the recognition order be modified so that it was a condition of its continuation that the Korean receiver should not be permitted to argue in subsequent English proceedings that D/S Norden was estopped from denying that the decision of the Korean court should be given effect.

Conclusion

Hanjin's bankruptcy has given rise to a number of complex and vexed English law issues involving the interaction of insolvency law, maritime law, property law and conflicts of law. The position as regards the Hanjin rehabilitation and the Recognition Order in GB remains fast moving and fluid. For legal advisors involved in the fall out interesting times no doubt lie ahead.

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20 [2009] EWHC 2304 (Ch).

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If a Tree Falls in the Forest … Shouldn't the Saplings in the Clearing Benefit?

Thomas Macey-Dare QC, Barrister, Quadrant Chambers, London, UK

Synopsis

In an important judgment delivered in November 2017,[1] the English Court of Appeal has decided that an airline's right to be allocated take-off and landing slots at UK airports under the EU Slots Regulation survives as a valuable asset which can be realised for the benefit of the airline's creditors after it ceases to operate and enters administration. The judgment is significant in that it prioritises the interests of creditors, ahead of the stated goal of the Slots Regulation of promoting competition within the airline industry, by allowing a failed airline to receive an allotment of slots and sell them to the highest bidder, rather than requiring those slots to be reallocated fairly among other airlines, including new market entrants who would otherwise be entitled to receive half of the slots. The judgment turns on the construction of the Slots Regulation and is therefore significant, not only in the UK, but throughout the whole of the EU.

Background

At the beginning of October 2017, Monarch Airlines collapsed with debts of £630 million, of which £466 million was unsecured. At the time, Monarch was the UK's 5th largest airline, and the 26th biggest in Europe, operating a fleet of 35 aircraft, serving 43 destinations and carrying many millions of passengers each year. Its failure came after years of mounting financial pressures, caused by competition from other low cost carriers, the long-term decline of the traditional package holiday, increasing operating costs, terrorist attacks and the depreciating value of Sterling. Some 3,500 people lost their jobs. Around 110,000 holidaymakers were stranded overseas, and had to be brought home in what was dubbed Britain's biggest ever peacetime repatriation. A further 750,000 customers were reported to have paid for flights which they were not able to take.

Monarch's collapse was by no means unique. Over 250 global airlines have failed in the last decade alone.

Administrators were appointed on 2 October 2017, not with a view to running Monarch's airline business or selling it as a going concern, but in order to realise the value of the company's assets in the optimal way for the benefit of its creditors. Specifically, they intended to complete a series of transactions with other airlines, whereby Monarch's take-off and landing slots at airports including Gatwick and Luton would be exchanged for less valuable slots plus significant payments. By the time Monarch entered administration, these Gatwick and Luton slots were its most valuable assets, and were reported by the press to be worth around £60 million.

On the same day that Monarch entered administration, the Civil Aviation Authority (CAA) provisionally suspended Monarch's Air Operator Certificate (AOC) and commenced the procedure for revoking it. It also commenced the procedure for revoking or suspending Monarch's Operating License.

Slots and slot trading

Slots are an important class of assets for commercial airlines. They are not route-specific. There is great competition among the airlines for the most valuable slots. Within the EU slots are allocated in accordance with the Slots Regulation: Council Regulation (EEC) No. 95/98 on Common Rules for the Allocation of Slots at Community Airports, as amended. A slot is defined in the regulation as the permission given by a public body, the 'coordinator', to an air carrier to use the full range of airport infrastructure necessary to operate an air service at a 'coordinated airport' on a specific date and time for the purpose of landing and take-off. All major airports in the EU are 'coordinated' airports. In the UK, the designated 'coordinator' is Airport Coordination Ltd ('ACL').

Under the Slots Regulation, for the purpose of allocating slots, each year is divided into two 6-month scheduling periods: winter and summer. Slots are allocated semi-annually, a number of months before the start of each scheduling period.

Notes

1 *R. (on the application of Monarch Airlines Ltd (in Administration)) v Airport Coordination Ltd* [2017] EWCA Civ 1892.

Article 8(2) of the Slots Regulation – the 'grandfather rights' or 'historic precedence' provision – states that an air carrier who has been allocated a particular series of slots in one scheduling period, and has utilised them to a sufficient extent, is entitled to be awarded the same series of slots again in the equivalent scheduling period of the following year. Article 8a, entitled 'Slot mobility', permits air carriers to exchange slots with each other on a one-for-one basis, subject to the approval of the slot coordinator.

Monarch's administrators intended to rely on these provisions in order to renew the valuable slots which Monarch had previously been operating at Gatwick and Luton Airports, for the summer 2018 scheduling period, and then exchange them with other airlines in return for other, less valuable slots, plus substantial cash payments. Monarch had applied to renew their slots a few days before it went into administration. Monarch's administrators had no intention, and no means, of operating the slots they were to receive under these exchange transactions.

ACL was due to allocate slots for summer 2018 by 26 October 2017. On 24 October it informed Monarch's administrators that it considered that it had no obligation to allocate any slots to Monarch; but that it intended to reserve its decision pending the outcome of the CAA's procedure to revoke or suspend Monarch's Operating License. Two days later Monarch's administrators applied for judicial review of ACL's decision, seeking an order requiring ACL to allocate it slots for summer 2018 in accordance with its grandfather rights under the Slots Regulation.

R v ACL ex parte The States of Guernsey Transport Board

The kind of slot trading envisaged by Monarch's administrators is perfectly permissible, at least outside an insolvency situation, and is an accepted and important part of the international airline business. The International Air Transport Association ('IATA') has for many years operated a semi-annual Schedule Coordinating Conference, following each slot allocation process, in order to facilitate such transactions; and ACL itself sometimes acts to facilitate slot exchanges between carriers, by issuing 'dummy slots' with no utility save as an item of exchange. This reflects the fact that, under the Slots Regulation, bilateral exchange of slots is permitted but unilateral transfer is not.

The practice of exchanging slots in this manner was approved by the English High Court in the earlier case of *R v ACL ex parte The States of Guernsey Transport Board* [1999] Eu. L. R. 745, which was decided under the original, unamended, Slots Regulation.

In that case, Air UK wished to terminate its unprofitable service between Heathrow and Guernsey. It agreed to exchange its valuable Heathrow slots with British Airways, in return for an equal number of much less attractive slots at Heathrow, plus (as was 'at least highly probable' according to the judge) a cash payment. BA did not intend to use the Air UK slots for a Guernsey service, but for other, more profitable, routes. Air UK did not intend to use the BA slots at all. It intended to return them, unused, to the 'pool' so that they could be re-allocated to other airlines under the Slots Regulation.

ACL, the slot coordinator for Heathrow, confirmed the exchange. The Guernsey Tourist Board, anxious to preserve direct flights between Heathrow and Guernsey, challenged ACL's decision by way of judicial review, arguing that the transaction was, in reality, not an exchange of slots, but a disguised transfer of slots by Air UK to BA, which was not permitted under the Slots Regulation.

Maurice Kay J dismissed the Guernsey Tourist Board's claim. He held that the exchange of slots was valid and lawful within the Slots Regulation, notwithstanding the accompanying payment, and notwithstanding that Air UK did not intend to utilise the slots it received. In so deciding, he observed (*obiter*) that the role of the slot coordinator under the Slots Regulation did not extend to conducting investigations into matters such as the value of the slots exchanged, whether monetary consideration had been passed, and whether the recipient of the slots actually intended to utilise them. He noted that imposing such a duty on the coordinator would be unworkable and undesirable, in that it would frustrate the rapid and efficient exchange of slots, and risk 'the fossilising of schedules to the detriment of customers and others.'

This reasoning in the *Guernsey Tourist Board* case emphasises the benefits to consumers and competition of maintaining a highly liquid secondary market for allocated slots. Promoting competition and removing barriers to market entry is, indeed, one of the central aims of the Slots Regulation. The recitals to the regulation state that it is 'Community policy to facilitate competition and to encourage entrance into the market', and that 'these objectives require strong support for carriers who intend to start operations on intra-Community routes.' Article 10 provides that all new slots, and all slots over which 'grandfather' rights are not asserted, are to be placed in a 'pool' and distributed among applicant air carriers, with 50% of them being first allocated to 'new entrants' as defined in Article 2.

It is easy to see how, under normal conditions, a liberal slot trading régime tends to further these goals, by preventing ossification in the market. But where an airline has collapsed, and has no realistic prospect of utilising its own slots, or anyone else's, these objectives are best served by returning the airline's slots to the pool, from where the coordinator can redistribute them fairly to new entrants or other airlines, and not necessarily to the highest bidder with the strongest market position.

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This consideration lay at the heart of the ACL's refusal to renew Monarch's slots for the summer 2018 scheduling period.

The key legal question

The key legal question in *Monarch* was whether, at the time that ACL came to decide on the allocation of slots for summer 2018, Monarch was still an 'air carrier' within the meaning of the Slots Regulation. Only an 'air carrier' is entitled to be allocated slots under the Slots Regulation. An 'air carrier' is defined by Article 2(f)(i) of the Slots Regulation as 'an air transport undertaking holding a valid operating license or equivalent at the latest on 31 January for the following summer season ...'

Operating license and AOC

Within the EU, the grant of an Operating Licence is governed by the Licensing Regulation, (EC) No. 1008/2008, Article 4 of which provides that an undertaking shall be granted an Operating License by the competent licensing authority of a Member State provided that it meets certain conditions, including that (a) its principal business is located in that Member State, (b) it holds a valid (AOC) issued by the national authority of that Member State, (c) it has one or more aircraft at its disposal, (d) its main occupation is to operate air services, and (g) it meets certain specified financial conditions. An AOC is defined in Article 2(8) of the Licensing Regulation as a certificate confirming that the operator has the professional ability and organisation to ensure the safety of the operations specified in the certificate.

The Licensing Regulation contains provisions which allow the competent licensing authority to suspend or revoke an air carrier's Operating License in the event of, among other things, financial difficulties. In particular Article 9(2) requires the competent licensing authority, in the event of clear indications of financial distress or insolvency proceedings, to proceed without delay to make an in-depth assessment of the financial situation and on the basis of its findings to review the status of the Operating License within a time period of three months. Article 9(5) of the Licensing Regulation requires the competent licensing authority to suspend or revoke an Operating License immediately if an air carrier's AOC is suspended or withdrawn.

The competent licensing authority in the UK, where Monarch had its principal place of business, is the CAA. It is responsible for issuing AOCs as well as Operating Licenses. Within the UK, the Operation of Air Services in the Community Regulations, SI 2009/41, contains detailed procedural rules governing the process by which the CAA may revoke or suspend an Operating License, including rules as to hearings and appeals.

The rival arguments

Monarch argued that it was still an 'air carrier' within the meaning of the Slots Regulation because, despite being in administration and no longer operating any aircraft, it still held an Operating License, albeit the CAA was in the process of considering whether to suspend or revoke that license.

ACL argued that this was unrealistic: Monarch was not an air carrier as it had ceased to be a functioning airline and any suggestion that it could resume the operation of air transport services was no more than a theoretical possibility. According to ACL, the test could not simply be whether Monarch held a current Operating License: that would make a failed airline's entitlement to slots depend on how quickly the competent licensing authority concluded the process of deciding whether to suspend or revoke it, which might vary from one Member State to the next in an arbitrary way; and it would go against the aim of encouraging competition, which required slots which were no longer needed to be redistributed among other airlines in a fair manner.

At first instance, the Divisional Court (Gross LJ and Lewis J) accepted ACL's arguments. That decision was unanimously reversed, however, by the Court of Appeal (Floyd, Newey and Asplin LLJ).

The decision of the Court of Appeal

The Court of Appeal noted that an undertaking does not inevitably cease to be an air carrier for the purposes of the Slots Regulation whenever it becomes unable to operate air transport services. For example, a temporary inability to operate would not have that effect.

That being so, where was the line to be drawn, between a temporary inability to operate and one which was sufficiently final to justify the conclusion that the undertaking was no longer an air carrier? The Slots Regulation provided no guidance on that question.

Moreover, assuming that an appropriate test could be identified, the slot coordinator was hardly in a position to apply it. For example, there might be a question mark over whether an airline in financial difficulties had a realistic prospect of being sold as a going concern or emerging from restructuring and resuming trading. The slot coordinator did not have the powers or the procedural framework to carry out the kind of investigation that might be required to resolve that kind of issue, and the Slot Regulation gave no indication that he should undertake that role.

Matters relating to an airline's financial circumstances were best left to the licensing process, where the competent licensing authority (the CAA in the UK) would have the resources to undertake the necessary investigations within the appropriate procedural framework.

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The Court of Appeal concluded that Monarch remained an 'air carrier' within the Slots Regulation, notwithstanding that it had no real prospect of ever resuming air transport services. That conclusion left no room for any argument that Monarch should be denied an allocation of slots on the basis that that would be inconsistent with the purpose of the Slots Regulation. The court also rejected a submission that it should refuse to grant Monarch the relief it sought as a matter of discretion.

Monarch's slots

ACL decided not to pursue a further appeal to the UK Supreme Court. In due course, Monarch received its allocation of slots for summer 2018. It proceeded to exchange the most valuable Gatwick slots with IAG, and the Luton slots with Wiz, in each case for undisclosed sums.

Discussion

The Court of Appeal in *Monarch* construed the Slots Regulation in a manner which reflects the anti-deprivation principle, a rule of UK public policy according to which an insolvent entity (and, by extension, its creditors) ought not to be deprived of property by reason of having become insolvent: *Belmont Park Investments Pty Ltd v BNY Corporate Trustee Services Ltd* [2011] UKSC 38 per Lord Collins of Mapesbury at [1-5]. In so doing, it rejected the construction preferred by the Divisional Court, which reflected and gave effect to the stated aim of the Slots Regulation of improving competition and market access.

The Court of Appeal based its decision, however, not on the competing policy considerations, but on the language of the Slots Regulation and on practical considerations. In particular, it was concerned that the Regulation should be given a construction which was consistent with the functions and resources which the relevant parts of the Community acquis allocate to the different regulatory bodies in the aviation field, and which was both clear and workable. The effect of that construction is, however, is to deprive slot coordinators like ACL of an important power and, with it, the chance for new market entrants to obtain highly sought-after slots in the event of an airline collapse. These slots will now inevitably tend to come to into the hands of the biggest and most established players. That is surely not what the framers of the Slots Regulation intended.

This is an issue which will need to be rectified by legislation. Such legislation is long overdue. As the Court of Appeal observed in *Monarch*, when the Slots Regulation was being amended for the third and final time, in 2004, the European Commission proposed that Article 8a(1)(d), which permits exchange of slots, should be amended to provide that slots may be exchanged only 'where both air carriers involved undertake to use the slots received in the exchange.' Had this proposal been adopted, it would have abolished the practice of exchanging slots which one party does not intend to use altogether. This proposal was not, however, adopted. The reason given was that the Council was concerned that the whole issue of market access should be considered in the wider context of a more thorough review of the slot allocation rules which could be the subject of separate Commission proposals in the future (see Common Position (EC) No. 22/2004). Fourteen years later, these new proposals are still awaited. The Court of Appeal's decision in *Monarch* might provide the nudge which the Commission requires.

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Insolvencies in the Supply Chain: Recourse against the Owner of the Goods

Matthew Reeve, Barrister, Quadrant Chambers, London, UK

Introduction

The collapse of Hanjin Shipping Co. Ltd. at the end of 2016 continues to present a wide range of lingering legal challenges in maritime jurisdictions around the world, many to be resolved applying the principles of English Law. An overview was given in the article in volume 13, issue 6 of *International Corporate Rescue*; 'The Collapse of Hanjin Shipping: An English Lawyers Perspective'. In particular, that article drew attention to the potential difficulties for creditors caused by the restriction, often contained in foreign insolvency recognition orders, prohibiting the taking of steps to enforce security over the debtor's property. The recognition order made by Nugee J in the United Kingdom in respect of Hanjin on 6 September 2016 contained such a restriction. And as the article explained, that represents a potential obstacle to the shipowner's traditional remedy of a lien over sub-freights owed to the debtor.

The present article focusses on the other remedies (apart from the enforcement of security over the debtor's property) available to creditor carriers and wharfingers in the logistical supply chain when their contracting counterparty fails but they remain in possession of the goods; so, where A (a carrier or warehouse) contracts with B to carry or look after the goods of C and B (through insolvency) fails to pay A, what recourse will A have against C if he terminates the contract? The answers to this question have been most carefully refined in the area of carriage by sea, but much of the reasoning can be carried over into cases of carriage by air and road and storage contracts. The consequent rights and liabilities must be carefully analysed in the particular case before A attempts to terminate his contract with B.

Contract with the owner of the goods?

The first step is to ask whether there is a direct contract with the owner of the goods. So, in the shipping context, a shipowner (A) may, in addition to his contract by way of a charterparty with the charterer (B), enter into a carriage contract with the cargo owner/shipper (C). The latter contract, if it exists, will typically be contained in or evidenced by the bills of lading issued by B. Much depends on whether the bills of lading are 'owners' bills', in the sense of having been issued on behalf of the shipowner, or 'charterers' bills'. Only the former can usually be relied upon as representing a direct contract between the shipowner and cargo owner/shipper.

If a direct contract is identified, there are two main consequences. First, even if the shipowner terminates the charterparty for non-payment, he may remain obliged under the bill of lading contract to carry the cargo to the scheduled destination. The shipowner is not at liberty to abandon the carriage. Second, the good news for shipowners is that they may have a direct claim against the cargo owners for the payment of unpaid freight under the bills of lading together with a lien allowing them to withhold delivery of the cargo until payment is made. The direct claim for freight rests on the analysis that the freight is usually collected from the shippers by the charterers acting as agent for the shipowners, and shipowners can, by giving written notice, terminate that agency (confirmed recently in *The Bulk Chile* [2013] 2 Ll Rep 38). The basis of the lien is slightly different. It relies on an analogy with wharfingers who, under the common law, have a lien for their storage charges. In explaining the lien in *The Lehmann Timber* [2013] ll Rep 541, Sir Bernard Rix stated:

> 'Shipping is performed on the basis that time is money and that a ship is a floating and travelling warehouse for which cargo must pay either in the form of agreed freight or by way of damages for breach of contract … A shipowner should not be required to abandon his lien because the only other choices facing him are disastrous ones of turning his ship into a floating warehouse for an indefinite period, or throwing them into the sea, or storing them on land at his own expense.'

This reasoning may apply far beyond the specific context of carriage by sea. The common law lien may well be available to other participants in the international supply chain including road and air carriers, distributors and warehouses.

No direct contract?

In other cases where A terminates its carriage or storage contract with B, there may be no continuing contact between A and C, the owner of the goods.

So where cargo is shipped aboard a vessel under charterers' bills of lading and, before the completion of the voyage, the shipowner withdraws the vessel from the charterer for non-payment of hire, the shipowner has no continuing contract with any party on which it can rely. It has no contractual basis for charging for carrying the cargo any further or for storing it before its collection by the true owners. But the vacuum is filled by a number of overlapping liability regimes to which the shipowner and its advisers can turn:

– Agency of necessity
– Bailment/sub-bailment
– Unjust enrichment
– Quantum meruit/contract implied from cargo owners' post-termination conduct

The applicable principles are less precise than the provisions of the standard charter and carriage contracts they replace, but they are in some respects favourable to the shipowner. Some aspects remain to be fully worked out, such as the precise basis upon which a shipowner can charge for its services after termination.

The principal way in which English law mediates between the shipowner/carrier and the owner of the cargo is by treating them as having a non-contractual bailment (or sub-bailment) relationship.

In *The Kos [2012]* Ll Rep 292, there were claims in bailment and unjust enrichment, but the focus was on the former. After the withdrawal of the vessel, it was detained for 2.64 days in port whilst the charterers arranged for the discharge of their cargo. The Supreme Court allowed the shipowner's claims for the cost at the market rate of the fuel consumed and of the detention of the vessel during the period after the withdrawal of the vessel and before the discharge was completed. Critical was the conclusion that, following the termination of the contractual relationship, the shipowner was a *non-contractual bailee* with the consent of the cargo owners, impliedly given at the time the cargo was originally shipped. As such, the shipowner owed a duty to cargo owners to take care of the cargo and had a 'correlative right' to charge the cargo owners for the cost incurred in doing so. The right undoubtedly includes expenses paid by the shipowner, but there was an important question as to whether the shipowners can charge for their own services in caring or carrying the goods and, in particular, whether they can charge the market rate (including a profit element). In *The KOS*, Lord Sumption ventured the view that the claim for detention at the market rate could be characterised as an 'opportunity cost' and a 'true cost'; but the distinction between expenses and remuneration was, ultimately, not argued. He also recognised that the unjust enrichment claim might result in a different measure of recovery but left the 'larger issues' raised by such a claim to be decided in another case 'possibly in a less specialised context than a dispute about carriage by sea'.

The Court did not have to wait long for such a case.

In *Benedetti v Sarawis* [2014] A.C. 938, the claimant acted as broker in introducing the defendant to the purchase of the equity in a large Asian mobile network supplier. His claim for a share of the business based on an alleged contract failed. His alternative (non-contractual) claim in unjust enrichment for a commission at the market rate for his services in introducing the deal succeeded. The Supreme Court accepted that the defendant was liable to pay remuneration on the grounds that he had accepted the claimant's services in introducing the transaction and had been enriched by them at the expense of the claimant in circumstances in which it would be unjust if he did not pay. Although the case could have been fitted within the established category of 'free acceptance' as a basis for restitution, Lord Clarke expressed the principles more expansively:

> 'It is now well established that a court must first ask itself four questions when faced with a claim for unjust enrichment as follows. (1) Has the defendant been enriched? (2) Was the enrichment at the claimant's expense? (3) Was the enrichment unjust? (4) Are there any defences available to the defendant?'

The measure of recovery was stated to be the value of what the defendant received, not the cost to the claimant, and the starting point is the market price for the services rendered. In that case the market value of the services was EUR 36.3 million.

It remains to be seen whether *Bendetti* opens the door to carriers or wharfingers to charge a market rate for their services in carrying or caring for goods after the termination of the relevant contract, on the basis of unjust enrichment. Much may depend upon a deeper analysis of the *implied consent* given by the goods owners, at beginning of the commercial adventure, to the bailment/sub-bailment of the goods. But there is a considerable incentive for them to take the point, particularly if the market rate has risen since the price for their services was originally fixed.

The last question is whether the non-contractual claims for post-termination carriage and care of goods can be enforced by way of a lien over the goods themselves. The point has not been squarely addressed but, in *The Lehmann Timber*, Sir Bernard Rix expressed the view that the logical conclusion of his analysis in that case was that such a lien does exist.

Conclusion

There is a relentless search by creditors in international insolvencies for remedies other than enforcement of

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security against the property of the debtor. Where that insolvency occurs in the logisitical supply chain, carriers and wharfingers have a choice of alternative potential remedies, including claims against the original goods owners for freight and for post-termination services, often secured by a possessory lien over the goods. The shipping cases have led the way but some of the principles expressed in them have a much wider application.

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Bakhshiyeva v Sberbank of Russia et al. [2018] EWHC 59 (Ch): Permanent Stays under the Cross-Border Insolvency Regulations 2006

Jeremy Richmond, Barrister, Quadrant Chambers, London, UK

Introduction

In *Bakhshiyeva v Sberbank of Russia et. al.* [2018] EWHC 59 (Ch), the English Court held that it did not have the power under the GB Cross-Border Insolvency Regulations 2006 ('the CBIR') to grant a permanent stay to prevent creditors exercising their rights under a contract governed by English law contrary to the terms of the foreign insolvency proceedings which intended to bind all creditors. It was accepted by both parties that the Court was bound by 'the rule' in *Antony Gibbs & Sons v La Société Industrielle et Commerciale des Métaux* (1890) 25 QBD 399 (which is Court of Appeal authority) that held that a debt governed by English law cannot, without more, be discharged or compromised by foreign insolvency proceedings. So the issues before the Court were (a) whether it had the power to order a permanent stay to prevent the creditors enforcing their rights under a contract governed by English law contrary to the terms of the foreign insolvency proceedings; and (b) if so, whether the Court should exercise such power.

Background facts in brief

OJSC International Bank ('IBA') is the largest bank in Azerbaijan. Its largest shareholder is the government of Azerbaijan. It entered into restructuring proceedings under Azeri law the purpose of which was to enable IBA to propose a plan to restructure its debts ('the Restructuring Proceedings'). As its name suggests, the Restructuring Proceedings had the aim of facilitating the rehabilitation of IBA, and the resumption of trading rather than the collection of assets and their distribution among its creditors. On 6 June 2017 the Restructuring Proceedings were recognised in England as 'foreign main proceedings' under the CBIR and the usual extended order made in such cases imposing a moratorium similar in scope to that which would arise in an English administration proceeding ('the Moratorium'). As such, the Moratorium prevented creditors from commencing or continuing any action against IBA or its property in England without the permission of the Court or the consent of IBA's foreign representative.

On 18 July 2017 the IBA restructuring plan ('the Plan') was approved by a substantial majority at a meeting of creditors in Azerbaijan and was subsequently on 17 August 2017 approved by the Azeri Court. The Plan as a matter of Azeri law bound all affected creditors, including those who did not vote and those who voted against the Plan. Under the Plan each creditor's indebtedness would be discharged in its entirety and exchanged for various 'entitlements', that consisted of new debt securities (including sovereign bonds and bonds issued by IBA itself).

Sberbank of Russia and Franklin were the two Respondents in the case. Both were creditors of IBA. Sberbank had loaned USD 20m under a facility agreement. Franklin was the beneficial owner of USD 500m 5.62% notes. The facility agreement and the notes were both governed by English law. The Respondents did not vote or participate in any way in the meeting in which the Plan was approved. It was common ground in the case that the Respondents had not acquiesced in the Plan.

IBA's foreign representative applied to the English Court for an extension of the Moratorium. It would have lapsed upon the termination of the Restructuring Proceedings, which was due to terminate on 30 January 2018 and, as things then stood,[1] as a matter of Azeri law could not be extended. More specifically, the foreign representative sought a continuation of the Moratorium in terms that notwithstanding the termination of the Restructuring Proceedings, the Moratorium would continue and that it should not be lifted so as to permit Sberbank or Franklin to enforce

Notes

1 Since the time of the hearing there was a substantial emergency amendment to the Azeri Law on Banks that enabled the Plan to be extended for a further six-months to 30 June 2018. This gave rise to new issues concerning the extension of the moratorium under the CBIR, which were addressed in the Judge's supplemental decision reported at [2018] EWHC 792 (Ch).

their loans. In effect, the Moratorium, if granted, would discharge the debts (at least in England). Both Respondents opposed the application on the basis that under 'the rule' in *Gibbs* their claims against IBA could not be discharged by the Plan. They argued that they retained the right to enforce their English-law based claim, subject only to the Moratorium in force and that the continuation of the Moratorium would prevent them exercising and vindicating their continuing rights. The respondents respectively cross-applied for the lifting of the Moratorium for permission from the Court to commence proceedings against IBA.[2]

The 'rule' in *Gibbs*

Hildyard J summarised the rule as follows at [44]-[46] of his Judgment:

> '[44] ... a debt governed by English law cannot be discharged or compromised by a foreign insolvency proceeding. Indeed, the proposition goes further: discharge of a debt under the insolvency law of a foreign country is only treated as a discharge therefrom in England if it is a discharge under the law applicable to the contract ...
>
> [46] There is an exception: if the relevant creditor submits to the foreign insolvency proceeding, the Antony Gibbs rule does not apply. The rationale is simple: the creditor will be taken to have accepted that the law governing that foreign insolvency proceeding should determine the contractual rights he has elected to vindicate in that proceeding ...'

The Judge noted some of the extensive criticism of the 'rule' in *Gibbs* not least that the rule sat uneasily against the principle of 'modified universalism' (as expressed in the common law and the CBIR), that tended towards granting greater recognition and effect to foreign insolvency proceedings. Notwithstanding such criticism the Judge observed that the 'rule' in *Gibbs* continued to be applied in England and in any event bound the Judge as a matter of *stare decisis*. Therefore, the applications proceeded on the basis that the 'rule' in *Gibbs* bound the Judge so that the real question that the Judge had to decide was whether: '[such principles of modified universalism] [enabled] the Court to grant relief calculated to advance those principles without upsetting the "rule" in the Antony Gibbs case when properly understood and confined:' [58].

The parties' arguments

The foreign representative's argument in summary

The foreign representative sought a permanent stay (subject to the right of the Respondents to apply to lift the stay upon the subsequent demonstration of a good reason) notwithstanding that the Restructuring Plan would shortly terminate. The foreign representative argued (among other things) that Article 21(1)(a) and (b), Sch.1 to the CBIR, gave the Court sufficiently wide powers to grant such a stay or moratorium after the Restructuring Proceedings had terminated in Azerbaijan. Article 21(1)(a) provides the Court, upon recognition of the foreign proceedings, with the discretionary power to stay the commencement or continuation of individual proceedings concerning the debtor's assets, rights and obligations or liabilities to the extent not stayed under the automatic stay provisions found in Article 20(1)(a). Similarly, Article 21(1)(b) provides the Court with the discretionary power to stay execution against the debtor's assets again to the extent not stayed under the automatic stay provisions found in Article 20(1)(a). In short, the foreign representative argued that upon recognition of the Restructuring Proceedings, the Court had a wide arrange of powers that were not circumscribed temporally by the duration of the Restructuring Proceedings. The foreign representative mainly relied on two earlier authorities in support of her submission, namely *Re BTA Bank JSC* [2012] EWHC 4457 (Ch) and *Atlas Bulk Shipping A/S Larsen and others v Navios International Inc.* [2012] Bus L R 1124. In *Re BTA Bank JSC* the Court granted a permanent stay (subject to an application by any affected creditor) under Article 21(1)(a) regarding debts that were subject to English law so as to avoid the potential disruption of a negotiated restructuring plan in Kazakhstan approved by a large majority of creditors. In *the Atlas Bulk*, on complex facts, the Court made an order restraining a creditor from relying on alleged set-offs in English Commercial Court litigation under Article 21(1)(g)[3] of Sch.1, CBIR. It was common ground in that case that as a matter of Danish insolvency law the creditor was not entitled to invoke its set-off against the company because non-mutual set-offs and set-offs arising from post-bankruptcy assignments are not permitted in a Danish bankruptcy. The creditor argued that the English Court could not apply Danish law. The Judge found that both English law and Danish law provided that non-mutual set-offs and post-insolvency set-offs did not hold good against the general body of creditors. In the circumstances,

Notes

2 Those applications were considered in a consequential hearing reported at [2018] EWHC 792 (Ch).

3 Which provides the Court with the discretionary power upon recognition: '[to grant] any additional relief that may be available to a British insolvency officeholder under the laws of Great Britain...'

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the Judge in that case therefore granted the restraining order sought.

The Respondents' arguments

The Respondents opposed the continuation of the Moratorium. The Respondents' principal argument was that Article 21 did not extend to granting the Courts power to provide relief beyond the duration of the foreign proceedings and in so doing affect a party's substantive rights. The Court's jurisdiction under Article 21 was to provide a 'breathing space' for the foreign representative in implementing the Restructuring Proceedings. As such once the Restructuring Proceedings had terminated the Court no longer had jurisdiction to grant relief under Article 21. Since the Restructuring Proceedings did not affect the Respondents' claim (per 'the rule' in *Gibbs*) even if the Court did have the jurisdiction to extend the Moratorium permanently, it should not do so since a permanent moratorium would in effect circumvent 'the rule' in *Gibbs*.

The Respondents also relied on *Fibria Celulose S/A v Pan Ocean Co Ltd* [2014] EWHC 2124 (Ch). In that case the Court had rejected a submission that it had the power under Article 21(1)(a) and (g) to prevent one party (Celulose) to a long-term contract of affreightment from sending a notice terminating such contract on the basis of the insolvency of the other party (Pan Ocean). Pan Ocean was in rehabilitation proceedings in South Korea, which proceedings had been recognised in Great Britain as foreign main proceedings under the CBIR. Pan Ocean's foreign representative argued that in South Korea, clauses permitting termination of contracts upon insolvency were unenforceable and that the Court should restrain Cellulose from exercising such right under Articles 21(1)(a) or (g). The Judge in *Pan Ocean* held, relying on the UK Supreme Court case, *Rubin v Eurofinance SA* [2013] AC 236, that as a matter of construction Article 21(1)(a) applied to the commencement or continuation of an action or proceeding but did not extend to the service of a notice of termination. Further, the Judge found that Article 21(1)(g) did not permit the Court to apply foreign insolvency law (in this case Korean law) so as to affect the substance of the parties' rights and obligations under the contract. As the Judge in *Pan Ocean* remarked at [111]:

> 'Rubin ... supports the view that the relief available under Article 21 is of a procedural nature and that the article should be given a wide interpretation in relation to matters of procedure. There is considerable scope for argument as to whether relief sought in a particular case is of a procedural nature. I will not attempt to define which matters are procedural and which are substantive. However, having explained the difference between [the Applicants] being entitled to terminate the contract and not being so entitled, it seems to me that this difference goes well beyond matters of procedure and affects the substance of the parties' rights and obligations under the contract.'

The decision

In short, the Judge applied the passage in *Pan Ocean* set out immediately above, and found that the foreign representative was impermissibly seeking to use Article 21 to constrain the extant substantive rights of the Respondents. The Judge noted his reluctance to offer any general definition of what matters are procedural and what matters are substantive (per *Pan Ocean*). The Judge found, however, that there was no material distinction between the exercise of an express right of termination (per *Pan Ocean*) and a general right of enforcement (as in the case before him). As such, the Judge found that there was strictly speaking no jurisdiction to make the order for the permanent stay sought by the foreign representative. The Judge also noted that even if the Court had jurisdiction to extend the moratorium permanently it would never appropriately be exercised so as to achieve the application of foreign law to the discharge or variation of an English law right. Such a step would contravene 'the rule' in *Gibbs*.

The Judge also briefly considered whether as a matter of jurisdiction relief under the CBIR *must* end when the foreign proceedings did. The Judge considered that where the foreign proceedings in question were analogous to an English administration it would make 'sound sense' that relief under the CBIR could not last beyond the duration of the foreign proceedings being assisted. The Judge also noted that different considerations may apply if the foreign proceedings were concerned with the universal collection of debt and distribution of the insolvent company's property and which could be characterised as '*in rem*' in nature. However, the Judge did stress that his remarks were not intended to be a definitive determination of the matter so that the question must, for the time being, remain an open one as far as English law is concerned. In any event, the Judge considered that, consistent with his main ruling, if there were jurisdiction to extend the moratorium beyond the duration of the foreign proceedings, he would have been reluctant to exercise the jurisdiction in this case since (a) it would not be appropriate in effect to side-step the rule in *Gibbs*; (b) the CBIR, if applied in this manner, would require the substantive alteration of English contractual rights; (c) there were good policy reasons to protect the expectations of parties that had chosen to adopt English law to have English law applied to their substantive contractual rights, the recognition of the foreign proceedings in Great Britain notwithstanding, at least where the foreign proceedings concerned the restructuring of existing debt; and (d) IBA could have sought a scheme of arrangement in England so as to bind the Respondents and in effect overcome 'the rule' in *Gibbs* but did not do so.

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Conclusion

At least for the time being,[4] the contractual substantive rights of a party to an English law contract that does not participate in the foreign proceedings recognised in Great Britain remain unaffected by the foreign proceedings per the rule in *Gibbs*. Currently, attempts to circumvent the rule in *Gibbs* by seeking a permanent stay beyond the duration of the foreign proceedings, which stay would affect such contractual rights, are unlikely to succeed at least where the foreign proceedings concern a debt restructuring.

Notes

4 It is understood that the decision is currently under appeal.

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Subrogation Based on Unjust Enrichment: *Menelaou v Bank of Cyprus Plc*

Claudia Wilmot-Smith, Barrister, Quadrant Chambers, London, UK

In many cases a claimant's money might have been used to discharge another party's debt. For example, a company director may misappropriate company assets and use them to pay his own creditors. In such a case the director has been enriched at the expense of the company. The law of unjust enrichment may give the company a direct personal restitutionary remedy against the director. However, in the case of an insolvent debtor, this remedy may be of little use.

In some circumstances, however, the claimant may have the right to be subrogated to the creditor's extinguished rights. If the creditor's debt was secured, or the creditor had a preferential ranking in the debtor's insolvency, this remedy will offer a significant advantage to a personal claim: by stepping into the shoes of the creditor, the disenriched company will acquire its more valuable rights.

The starting point for an understanding of the law in this area is Lord Hoffmann's speech in *Banque Financière de la Cité v Parc* [1999] 1 AC 221 (HL). Leaving to one side the insurance case:

> 'one is here concerned with a restitutionary remedy and that the appropriate questions are therefore, first, whether the defendant would be enriched at the plaintiff's expense; secondly, whether such enrichment would be unjust; and, thirdly, whether there are nevertheless reasons of policy for denying a remedy.'

Lord Hoffmann recognised that the secured creditor's rights have been discharged by the payment of the debt. They cannot, therefore, be 'kept alive' for the benefit of the subrogated claimant (the wording employed in previous authorities):

> '[S]ubrogation is ... an equitable remedy against a party who would otherwise be unjustly enriched. It is a means by which the court regulates the legal relationships between a plaintiff and a defendant or defendants in order to prevent unjust enrichment. When judges say that [a] charge is 'kept alive' for the benefit of the plaintiff, what they mean is that his legal relations with a defendant who would otherwise be unjustly enriched are regulated as if the benefit of the charge had been assigned to him. It does not by any means follow that the plaintiff must for all purposes be treated as an actual assignee of the benefit of the charge and, in particular, that he would be so treated in relation to someone who would not [otherwise] be unjustly enriched.'

The courts will treat the claimant *as if* he has acquired the discharged creditor's rights, in order to prevent the debtor from being unjustly enriched at the claimant's expense. To be able to claim this kind of subrogation as a remedy, a claimant must first make out a good claim in unjust enrichment.

A party wishing to be certain his claim is good before making it may be disappointed to hear that unjust enrichment has been described as 'a vague principle of justice with no practical value.'[1] However, to some extent this is an outdated criticism. It is now established accepted that the law will respond in circumstances denoted by Lord Hoffmann in the passage cited above, namely if (1) the defendant has been enriched; (2) at the claimant's expense; and (3) the enrichment was unjust; (4) if there are no defences available to the defendant.[2]

As to these:

- Whether the defendant has been enriched is a question of evidence: has the defendant obtained a pecuniary benefit?
- The requirement that the enrichment be 'unjust' sounds the most vague, as if the courts are being referred to some abstract notion of 'justice'. This calls to mind outdated principles of 'equity' in the broad sense, 'the vague jurisprudence which is sometimes attractively styled "justice as between man and man", characterised by 'well-meaning sloppiness

Notes

1 Charles Mitchell, Paul Mitchell, Stephen Watterson, *Goff & Jones: The Law of Unjust Enrichment* (8th ed., Sweet & Maxwell, 2011) at 1-07, referring to a criticism which the authors of *Goff & Jones* do not endorse.

2 Adopting Lord Clarke's formulation in *Benedetti v Sawiris* [2014] AC 938 at [10].

of thought'[3] However, the 'unjust' factor of the law of unjust enrichment is better understood as a word denoting a number of recognized bases which the law sees to call for restitution (each the subject of a separate chapter in *Goff & Jones*: see the chapter headings in part 5 for a handy list).

- More problematic, however, is the idea that the defendant must have been enriched 'at the expense of' the claimant. What connection must there be between a claimant's loss and a defendant's gain, such that the law will confer upon the claimant a remedy? Unfortunately for a prospective litigant, 'clear criteria have yet to emerge from the cases, and there is no consensus among scholars as to the theoretical basis of the requirement.'[4]

In practice this uncertainty may not matter much in the two-party case, with a single transfer of value. The connection between the parties will be sufficiently close to satisfy most tests. However, subrogation claims involve more than two parties, and more than one transfer of value. In these circumstances, determining whether the defendant has been enriched 'at the expense of' the claimant should require an understanding of what it means to say that one party's enrichment has been at another's expense.

In order to do so 'we must first ask what the point of the "at the expense of" requirement is. Why would the law require that an enrichment come at the claimant's expense?'[5] It is only through this analysis of the circumstances that justify a party being stripped of its gains that the requirement can be properly understood.

The Supreme Court was afforded the opportunity to engage in this analysis and bring clarity to this area of law in *Menelaou v Bank of Cyprus UK Limited* [2015] UKSC 66. The basic facts of that case were as follows:

- Mr and Mrs Menelaou had jointly owned a property called Rush Green Hall, subject to two legal charges in favour of the Bank of Cyprus. These charges secured debts of GBP 2.2m, more than the property was worth.
- Mr and Mrs Menelaou decided to sell Rush Green Hall, and apply some of the proceeds towards the purchase of a smaller property. Rush Green Hall was duly sold for GBP 1.9m.
- The Menelaous found a new family home, Great Oak Court. Mr and Mrs Menelaou wanted to gift this property to their daughter, Melissa (to hold for the benefit of herself and her younger siblings).
- In order for the Rush Green Hall sale to go through, it was necessary for the bank to release its charges. The bank agreed to do so upon receipt of GBP 750,000, and subject to a 3rd party legal charge over Great Oak Court.
- The Menelaous's solicitors confirmed to the Bank that they would comply with its instructions. The legal charge drawn up by the solicitors was purportedly signed by Melissa.
- On 12 September 2008 completion took place on both Rush Green Hall and Great Oak Court. The solicitors received the balance of the price from the purchasers of Rush Green Hall. GBP 750,000 was remitted to the bank, GBP 785,000 was sent to the vendors of Great Oak Court to meet the balance of the purchase price. They also sent the bank deeds authorising the cancelling of the registered charges over Rush Green Hall, which were not returned until 13 October 2008.
- The Menelaou family moved to Great Oak Court. About two years later, they proposed it be sold. The conveyancers pointed out the registered charge over the property, securing Mr and Mrs Menelaou's debts. Upon discovering this, Melissa commenced proceedings, claiming rectification of the charges register.

Before the trial commenced, it was accepted that the charge was not enforceable: Melissa had not signed it (and had no notice of it). The solicitors accepted that they were liable to the bank for the losses suffered in consequence. The questions that remained for determination were whether

- Great Oak Court was held on trust for the bank; alternatively
- the bank was entitled to an equitable charge arising as the result of:
    - subrogation to an unpaid vendor's lien over Great Oak Court; alternatively
    - based on a wider principle of unjust enrichment.

The bank's submissions were premised on the contention that the purchase price of GBP 875,000 was paid with or from funds provided by the bank, being moneys received by the solicitors from the purchasers of Rush Green Hall.

The Court was therefore required to determine:

Notes

3 Criticisms levelled at the history of the action for money had and received to the plaintiffs' used by Scrutton LJ in *Holt v Markham* [1923] 1 KB 504 at 513-4.

4 *Goff & Jones* at 6-02.

5 F. Wilmot-Smith 'Taxing Questions' (2015) LQR 131.

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- whether Melissa had been enriched at the bank's expense;
- whether such enrichment was unjust; and
- whether the bank was therefore entitled to the proprietary remedy of subrogation.

The benefit to Melissa was the gratuitous acquisition of Great Oak Court, free of any charge. The detriment to the Bank was the release of its charges, without gaining any charge over Great Oak Court. But, as recognized by the trial judge 'The existence of both detriment and benefit does not however establish the further element that the latter should have been *at the expense of the Bank*. Whether a causal link between detriment and benefit is required or sufficient, and of what nature, remains little explored by both courts and academic commentators, and even less resolved' (emphasis supplied) ([2012] EWHC 1991 (Ch) at paragraph 22).

On the facts 'the claimant's benefit enured and was complete on 12 September 2008, while the Bank's detriment through the mistaken release of its charges over Rush Green Hall occurred over a month later.' In other words, whatever the nature of the connection between the bank's loss and Melissa's gain, it was not a causal one: cause must precede effect. The bank lost at first instance.

The decision was overturned by the Court of Appeal. However, its answer to the question 'was the enrichment at the expense of the bank?' was circular. Floyd L.J. said that there must be a 'sufficiently close causal connection' between the claimant's detriment and the defendant's benefit ([2013] EWCA Civ 1960; [2014] 1 WLR 854 at [30]) 'But it is a tautology to say the link must be sufficient: the question remains what connection *is* sufficient. Before we can answer that, we need to know what *kind* of connection we seek.'[6]

The appeal to the Supreme Court focused on the unjust enrichment issue. However those hoping that this would require the Supreme Court to grapple with the question as to what connection between a gain and a loss would justify liability will be disappointed. There was no real attempt to engage with this issue.

Lord Clarke saw it to be a 'question in each case … whether there is a sufficient causal connection, in the sense of a sufficient nexus or link, between the loss to the bank and the benefit received by the defendant.' (at [27]) That is partially true (it may be that a non-causal connection will suffice: note that there was in fact no causal connection in *Menelaou* itself). However, as previously noted, a principled answer to that question requires one to first answer the prior question: what kind of connection will suffice? Whilst Lord Clarke recognised that '[t]here has been much debate both among academic and judges as to the correct test' (at [28]), he concluded that 'it is not to my mind necessary to consider the issue further in this case because, as the Court of Appeal made clear, the position is clear on the facts of the instant case.' (at [32])

According to Lord Clarke, Melissa was enriched at the expense of the bank 'because the value of the property to Melissa was considerably greater than it would have been for the avoidance of the charge and the Bank was left without the security which was central to the whole arrangement.' (at [24])

In other words, the two connecting factors between gain and loss were:

- the fact that the value of the uncharged property was greater than it would have been if the property had been charged; and
- the bank did not have security.

However, these are not reasons at all. The first is a statement was to why Melissa can be said to have been enriched. The second is a statement as to why the bank can be said to have been disenriched. This combination, 'enrichment + disenrichment', was in itself said to be the 'reason' why the former was 'at the expense of' the latter. Lord Clarke's judgment is marked by its lack of analysis as to nature of the connection between the two, or why this connection would justify the court's stripping Melissa of her gains.

Nor is there much further guidance to be found in Lord Neuberger's judgment. It has already been noted that there was not in fact a causal link between Melissa's enrichment and the bank's loss. However, Lord Neuberger appears have approached the question of causation much more broadly. He saw it to be significant that it was the Bank's agreement to release the purchase moneys for the freehold of Great Oak Court, subject to receiving a charge, which allowed Melissa to acquire the freehold. The Bank was in this sense causatively responsible for Melissa's enrichment. However, it has been pointed out that, in this context, causation of gain by itself is insufficient for liability.[7]

For Lord Neuberger, this causal connection was significant because 'the Bank could have prevented the purchase proceeding until it had been granted a Charge. Accordingly, again deriving support from the passage quoted from *Abbey National*, looking at the arrangements in relation to the purchase and charging of Great Oak Court, it seems to me plain that Melissa's enrichment was at the expense of the Bank.' (at [66])

This conclusion (and in particular the use of the word 'accordingly') raises more questions than it answers. Quite why it is that the Bank's power to prevent the purchase until it obtained the charge meant that

Notes

6 F. Wilmot-Smith, note 3 above.
7 See F. Wilmot-Smith, note 3 above, and the examples he gives to illustrate this.

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Melissa's enrichment was 'at the expense of' the Bank is not explained: we are told that is 'plain'. It may be that Lord Neuberger took the view that the Bank retained an interest in the purchase moneys, because it had imposed a condition on their release; and that this interest connected Melissa's enrichment with the Bank's loss. However, this was not expressly stated. Moreover, this reasoning leans rather closer to the issue as to whether the bank had a proprietary claim than it does to the issue as to whether Melissa's enrichment was at the Bank's expense; and, a claim in unjust enrichment is different in principle to a claim to vindicate property rights.[8]

Lord Neuberger's judgment is likely to provide fertile ground for unjust enrichment scholars to explain the basis of the decision as they see it, but it is of little practical help to a prospective litigant who wants to know whether he has a good claim.

A potential litigant may, however, take advantage of this uncertainty: by failing to define the kinds of connections that are sufficient to justify a remedy, the Supreme Court has left it open to the individual litigant to rely on *any* kind of connection that it feels may justify the use of 'at the expense of' language when pleading its claim. The Supreme Court will have the opportunity to consider the matter afresh when the appeal to *Investment Trust Companies (In Liquidation) v Revenue & Customers Commissioners* [2015] EWCA Civ 82 is heard. Until then, a party who perceives that his loss can in some sense be linked to the discharge of another party's security interest may plead his case broadly. Where the only alternative is a personal claim against an insolvent, the value of such an interest may justify the cost of such a claim.

Notes

8 *Foskett v McKeown*[2001] 1 AC 102, 108F, 129E-F, per Lord Browne-Wilkinson and Lord Millett, and cited in *Menelaou* itself at [37].

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Unjust Enrichment and the Direct Transfer Rule: *Investment Trust Companies v Revenue and Customs Commissioners*

Claudia Wilmot-Smith, Barrister, Quadrant Chambers, London, UK

On 11 April 2017 the Supreme Court handed down judgment in *Investment Trust Companies v Revenue and Customs Commissioners* [2017] UKSC 29 [2017] 2 WLR 1200. This judgment, given by Lord Reed, provides a welcome analysis of the requirement that a defendant must have been unjustly enriched 'at the expense of' a claimant if he is to claim restitution from him.

The basic requirements of a claim in restitution are well established. A claimant must establish that: (1) the defendant has been enriched; (2) at the claimant's expense; and (3) the enrichment was unjust. If these factors can be made out, and the defendant has not been able to rely on any defences, his claim will succeed.[1] Where the claimant directly conferred the benefit on the defendant, the application of this test is, in principle, straightforward.

Complications arise, however, where the claimant has not dealt with the defendant directly. In these circumstances, a question arises as to what it means to say that a defendant's enrichment has been 'at the expense of' the claimant. Recovery in these circumstances was recently allowed by the Supreme Court in *Menelaou v Bank of Cyrpus UK Ltd* [2015] UKSC 66.

In that case the defendant bank had lent the appellant's parents money, secured by a charge over their home. They decided to sell and purchase another property, which they wanted to (and in the event did) gift to the appellant (Melissa). The bank agreed to release its charges on their property so that the sale could go through, on the condition (inter alia) that they have a legal charge over the new property. The solicitors confirmed that these conditions would be complied with. A legal charge was drawn up, purportedly signed by the appellant.

The charge had not been signed by Melissa and, so, was not enforceable against her. She was thus better off than she would have been if her parents had complied with the terms of their agreement with the bank. The issue was whether she was required to make restitution to the bank in respect of this gain. The gain was a result of two separate transfers:

- First, from the bank to the appellant's parents. This transfer was defective: the Menelaous subsequently failed to comply with its conditions.
- Second, from Melissa's parents to her. This transfer was not defective. The property was gifted to her, and it was accepted that she had no knowledge of her parents' dealings with their bank.

In these circumstances the Supreme Court found that the bank had been unjustly enriched at her expense.

Commenting on the Supreme Court's judgment in *Menelaou* in an earlier edition of this publication, the present writer noted that the basis upon which the Supreme Court had made this finding was unclear; and lamented the lack of guidance as to what it meant to say that the defendant's enrichment has been '*at the expense of*' a claimant with whom he has had no direct dealing.[2]

Happily, the Supreme Court has since had the opportunity to consider the matter afresh. Lord Reed's judgment in *ITC v Revenue and Customs Commissioners* directly engages with the issue, with a rigour which earlier case law has lacked.

ITC: the facts

Varies investment companies (the 'Managers') had made supplies of investment management services. These supplies were treated as taxable, as a result of the incorrect transposition of an EU VAT directive into UK law Their customers (the 'Companies') paid the amounts charged,

The Managers received these amounts, and in turn accounted to the Commissioners in respect of the same. In carrying out this accounting process, the Managers deducted from the tax chargeable on its supplies (known as 'input tax') the tax which it had itself paid on taxable supplies received for the purposes of its business (known as 'output tax'). It paid to the Commissioners the remaining surplus, if any.

Notes

1 Adopting Lord Clarke's formulation in *Benedetti v Sawiris* [2014] AC 938 at [10].
2 Subrogation based on Unjust Enrichment: *Menelaou v Bank of Cyprus Plc* Int. C.R. 2016, 13(3), 211-214.

Thus, for example, if the Managers made supplies to an ITC, and charged £100 VAT, but had purchased taxable supplies during the relevant period on which the VAT was £25, the Manager would apply the £25 against the £100, and pay the Commissioners the balance (£75).

The Managers' obligation to account for VAT was triggered by the supply of the relevant services, rather than the VAT being charged to, or paid by, the Customer. The Customers' liability was contractual.

The Managers had statutory claims against the Commissioners for repayment of the VAT which they had accounted for, under the Value Added Tax Act 1994. They successfully claimed back the VAT they had accounted for in respect of the amounts paid by them to the Customers, with two exceptions:

– They were unable to claim in respect of accounting periods ending on or after 4 December 1996, which were time-barred under s.80 of the Value Added Tax Act 1994;
– The amounts repaid to the Managers were calculated on the basis that, under s.80(2A), it was necessary to set the amount of input tax which they had deducted against the output tax for which they had accounted. Taking the notional figures set out above, the Managers were entitled to repayment of the £75 which they had actually paid to the Commissioners, but not the £25.

The Managers passed on the amounts they were repaid to the Customers, with the result that they obtained a refund of the amounts they had paid, subject to these two exceptions.

The customers' claims against the commissioners

The Customers brought proceedings against the Commissioners, claiming restitution of the amounts covered by the two sections above – i.e., they claimed:

– the full £100 in respect of payments made during periods which were subject to the statutory time bar; and
– the £25 which they had paid to the Managers, but which the Managers had not paid over the to the Commissioners because of the accounting process referred to above.

The 3 key questions before the Supreme Court were identified by Lord Reed as follows:

– Did the claimants have a common law claim against the Commissions in principle (subject to any statutory exclusion)?
– If so, did s.80 of the 1994 VAT Act bar such a claim?
– If there was no claim, or any such claim was barred, was this result compatible with EU law?

This casenote addresses the first of these questions, which raises the issue outlined above.

Recovery of the £25

It was accepted that the Commissioners were enriched by the notional £75 which they received from the Managers. Both heads of claim required the Court to consider whether they were also enriched by the notional £25. It held that they were not. This conclusion turned on the way in which VAT is accounted for and since the question is unlikely to arise in other cases, it will not be covered here. Suffice to say, the Supreme Court held that any argument that the Commissioners were enriched by moneys which they did not actually receive depending on establishing that the Managers were entitled to factor the VAT received on the relevant supplies into their input and output tax calculations. This was inconsistent with the claim to recover the £75 on the basis that it was not due. If the Commissioners were required to repay the notional £25, they would in fact be £25 worse off.

Recovery of the £75

Of broader interest is the question as to whether the Commissioners' receipt of the £75 enriched them at the expense of the Claimants. The relevant facts were as follows:

The Managers accounted to the Commissioners for their output tax liability in respect of the relevant periods.

When doing so, they took into account the £100 that they had received from the Claimants.

The net result, therefore, was that the Commissioners were better off as a result of the Claimants' payments to the Managers (and the Claimants were, of course worse off).

However, the Claimants had not directly paid anything to the Commissioners.

Moreover, the Managers liability to account for the £100 arose because they had charged the Claimants this amount in respect of the services, not because the Claimants had actually paid it.

Enrichment 'at the expense of' a claimant

When considering whether a defendant has been enriched 'at the expense of' a claimant with whom he has not directly dealt, Lord Clarke, in *Menelaou,* stated that 'the question in each case is whether there is a sufficient causal connection, in the sense of a sufficient

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nexus or link, between the loss caused and the benefit received by the defendant.' (at [27])

However, this does not tell us what type of nexus or link will be considered sufficient. Lord Reed criticised the 'test' in *Menelaou* as being 'too vague to provide clarity ... [it] leaves unanswered the critical question, namely, what connection, nexus, or link is sufficient[to justify such a remedy]?' (at [37])[3]

When considering a claim in unjust enrichment, the Court must determine whether it can justify compelling the defendant to pay his gains over to the claimant. The requirement that the defendant's enrichment be 'at the expense of' the claimant is directed at this question: it is designed to ensure that such disgorgement can be justified.

Further, he noted:

> 'the questions [e.g. whether the enrichment is at the expense of the claimant] are not themselves legal tests, but are signposts towards areas of inquiry involving a number of distinct legal requirements. In particular, the words 'at the expense of' do not express a legal test, and a test cannot be derived by exegesis of those words, as if they were words of a statute.' (at [41])[4]

Lord Reed underlined the necessity for a careful legal analysis of individual cases, by reference to the purpose of the law of unjust enrichment, namely, to correct normatively defective transfers, usually by restoring the parties to their pre-transfer positions (at [42]). To this end, the requirement that the enrichment be 'at the expense of' the claimant is designed to ensure that there is a transfer of value from the claimant to the defendant, with the claimant having suffered a loss, which loss has benefitted the defendant (at [43]).

If the law of restitution is about reversing defective transfers, it is not immediately obvious that the remedy should be allowed in a three party case, especially if only one of the transfers is defective (as in *Menelaou*).

Lord Reed recognised that 'it has often been suggested that there is a general rule, possibly subject to exceptions, that the claimant must have directly provided a benefit to the defendant' if he is to claim that the latter has been unjustly enriched at his expense (at [50]).

He set out the following examples of cases in which a claimant will have a remedy in unjust enrichment, despite not having dealt directly with the defendant:

– Where one or both parties have dealt through an agent. Here, the series of transactions is legally equivalent to a direct transaction between the claimant and defendant. (at [48])
– Where the right to restitution has been assigned, the claimant assignee stands in the shoes of the assignor. He is, therefore, treated as if he had been a party to the relevant transaction, and the transaction is treated as if it were a direct one (at [48]).
– An intervening transaction may be created in order to conceal the connection between the claimant and the defendant. If it is found to be a sham, the arrangements may be treated as 'equivalent to a direct payment' (as in *Relfo Ltd v Varsani (No 2)* [2014] EWCA Civ 360, see that case at [103] and [115]).
– If the property received by the defendant is one into which the claimant can trace an interest, the law will treat the property as if it were the claimant's. Thus 'the defendant is therefore treated as if he had received the claimant's property'. ([48])
– Where a claimant discharges a debt owed by the defendant to a third party, the defendant is directly enriched – not by the payment, but by the discharge of his debt. If the transfer of value is defective, the law reverses it, so far as possible, by subrogating the claimant to the rights formerly held by the third party. ([49])
– There are also cases in which a series of transactions are treated as if they formed a single scheme or transaction, 'on the basis that to consider each individual transaction separately would be unrealistic' ([48])

Taking Lord Reed's 5 categories of case:

– The first three encompass circumstances in which there is in truth a single transfer of value from the claimant to defendant. They are cases which, on analysis, do not fall foul of any general principle that the law of restitution provides a remedy only where the defendant's gain was the direct result of his dealing with the claimant.
– In the fourth, the 'at the expense of' requirement is satisfied by dint of the fact that the claimant's property can be traced directly into the defendant's hands. Lord Reed sees this situation as one which can be reconciled with the 'direct benefit rule' on the basis that the defendant is treated as if he were the recipient of the claimant's property. If the claimant had an interest in the property at the time it was transferred to the defendant, such a transfer is normatively equivalent to a direct transfer from claimant to defendant.

Notes

3 See also F. Wilmot-Smith 'Taxing Questions' (2015) 131 LQR 521, commenting on the Court of Appeal's decision in the ITC case, 'it is a tautology to say the link must be sufficient: the question remains what connection *is* sufficient. Before we can answer that, we need to know what *kind* of connection we seek.'

4 See also F. Wilmot-Smith 'A dream case' (2016) 132 LQR 196, especially comments on *Menelaou* at p. 99.

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– In cases where a claimant discharges a defendant's debt owed to a third party creditor, the defendant is directly enriched. Thus, on Lord Reed's analysis, the claimant has directly provided a benefit to the defendant.
– The last, however, is problematic.

Lord Reed acknowledged that, where the defendant has not received a benefit directly from the claimant, and in circumstances falling outwith the first four categories listed above, it is 'generally difficult to maintain that the defendant has been enriched at the claimant's expense.' (at [51]) He clarified that:

– A 'but for' causal connection between the claimant being worse off and the defendant being better off is not sufficient to constitute a transfer of value from one to the other.
– Nor is the 'at the expense of' requirement satisfied by a connection between the benefit and loss that exists merely as a matter of economic or commercial reality. 'Economic reality' is not a criterion that can be applied with any rigour or certainty – especially where there have been chains of suppliers or consumers. As has been recognised in other jurisdictions, it can be extremely difficult to ascertain whether the economic burden of an unjust enrichment has been passed on. Moreover, as Lord Reed highlighted, since unjust enrichment is not concerned with compensation for loss, an approach which seeks to identify the party who ultimately bears a particular loss is not one which accords with the purpose of restitution law (at [60]).

Despite these difficulties, there are cases where the courts have allowed unjust enrichment claims brought by claimants who have not dealt directly with the defendant (whether through agents, or because any intervening transactions were shams), and who cannot trace their property into the defendant's hands.

Lord Reed explains these as cases in which recovery is allowed because the relevant transactions are 'co-ordinated', such that it is 'unrealistic' to consider them individually. They are instead considered to form part of a single scheme or transaction – to which both claimant and defendant are parties.

Unfortunately, he did not provide any guidance as to the circumstances in which the courts will hold that it is 'unrealistic' to treat each individual transaction in a series as separate transactions. This was treated as a separate category of case from those where the intervening transaction is a found to be a sham.

The two examples Lord Reed gave of this category of case were *Banque Financiere de la Cite SA v Parc (Battersea) Ltd* [1991] 1 AC 221, and *Menelaou*.

– *Banque Financiere* is a complicated case, and this case note is not the place to engage in an analysis thereof. Suffice to say, however, that it has been subject to academic criticism – notably by Professor Peter Watts, who described the result as 'problematic'.[5] It is not clear that Lord Reed's 'co-ordinated transactions' test sheds any further light on the analytical basis for the decision in that case.
– Lord Reed's judgment does not help make sense of the result in *Menelaou*. In particular, there was no explanation as to why the transactions in *Menelaou* should be treated differently from those in *ITC*, i.e. why it was 'unrealistic' to treat the transactions in one case as if they were a single transfer, but not in the other.

Without any guidance as to what it means to say that a series of (non-sham) transactions cannot 'realistically' be considered to be separate, the breadth of this exception to a general rule that a claimant must have directly provided a benefit to a defendant if the court is to strip the defendant of his gains is unclear.

This is perhaps unsurprising: Lord Reed thought that it would be 'unwise to attempt in this appeal to arrive at a definitive statement of the circumstances in which the enrichment of a defendant can be said to be at the expense of the claimant' (at [38]) and 'unwise at this stage of the law's development to exclude the possibility of genuine exceptions [to the direct transfer rule], or to rule out other possible approaches.' (at [50])

He was, however, clear that it could not be said that the Commissioners had been enriched at the expense of the Customers. This was based on his rejection of the notion that there had been a transfer of value from the Claimants to the Commissioners.

– There was a transfer of value from the Claimants to the Managers (the notional £100).
– There was a further transfer of value from the Managers to the Commissions (the £75).

Both transfers were defective (the former, because it was made in performance of a contractual obligation which was mistakenly believed to be owed; the latter because it was made in compliance with a statutory obligation which was incompatible with EU law). However, 'These two transfers cannot be collapsed into a single transfer of value.' (at [71])

Given Lord Reed's warning that he was not seeking to lay down a definitive test, this conclusion should perhaps not be understood as requiring a claimant

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5 LQR 1998, 114(Jul) 341-345.

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in an indirect transfer case to show that a number of transfers can be 'collapsed' into a single transfer of value from himself to the defendant if he is to recover. Given the lack of clarity as to the circumstances in which transfers can be so collapsed, this is probably good.

The scope of the exception will have to be worked out in later cases. However, Lord Reed's judgment provides valuable guidance to practitioners when considering how to analyse cases involving multiple transfers.

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Thomas v Frogmore: COMI Factors and Improper Motive Reviewed

Liisa Lahti, Barrister, Quadrant Chambers, London, UK

The recent case of *Thomas & another v Frogmore Real Estate Partners & others* [2017] EWHC 25 (Ch) provides useful guidance for analysing the centre of main interests ('COMI') of a company not registered in the UK or other EEA state and therefore of the circumstances in which UK courts will allow insolvency proceedings to be instigated within the jurisdiction in the relating to such a company.

Further the judgment is one of only a few cases to comment on the scope of the 'improper motive' provision, contained in paragraph 81 of Schedule B1 to the Insolvency Act 1986 (the 'Act'), which provides that the court may terminate an administration where the appointor had an 'improper motive' for making the appointment.

The facts

The case involved three companies, FREP (Knowle) Limited, FREP (Ellesmere Port) Limited and FREP (Belle Vale) Limited (the 'Companies'). The Companies form part of Frogmore group, which specialises in real estate investment and management in the UK.

The Companies were special purpose vehicles, formed for the acquisition of three shopping centres. Each of the Companies owns a shopping centre located in England ('the Shopping Centres'). The Companies were registered in Jersey (which is not a EEA state). However, they did not carry on any trading operations in Jersey, did not have employees of their own, their principal assets (namely the Shopping Centres) were situated in England and the sole shareholder of the Companies, Frogmore Real Estate Partners GP1 Limited (the 'Shareholder'), was an English company. Further each of the Shopping Centres was managed by Frogmore Real Estate Investment Managers Limited ('FREPIM'), an English company with its registered office and base in London

Nationwide Building Society ('Nationwide') had advanced substantial sums to the Companies under a facility agreement (the 'Facility Agreement'). Security in respect of this loan had been provided by the Companies by a combination of debentures (the 'Nationwide Debentures'). Pursuant to these arrangements, the Companies owed and were required to repay over £106 million to Nationwide on 1 October 2016. They failed to do so. Therefore in November 2016 administrators were appointed by Nationwide under floating charges granted in its favour. There had also been on-going proceedings since December 2014 between the Companies and FREPIM against Nationwide, after Nationwide decided to transfer its economic interest in the loans to another company (the '2014 Litigation').

The issues

It was common ground that for the administrators to be validly appointed the Companies had to have their COMI in England and Wales. The administrators applied for a declaration as to the location of the Companies' COMI.

Further, the Companies applied for an order terminating the administrators' appointment arguing that Nationwide had had acted with an improper motive in that the purpose of appointing the administrators had been to stifle the progress of the December 2014 litigation.

Therefore the issues were (1) the location of the Companies' COMI and (2) whether the administrators' appointment should be terminated on the basis of an improper motive on Nationwide's part.

Issue 1: COMI

The starting point is that a company's COMI is where its registered office is located. Paragraph 111(1B) of the Act and Article 3 of the EC Regulation together create a *rebuttable* presumption that the location of the registered office of a company will be its COMI.

Existing case law, in particular the decisions of the European Court of Justice, in *Re Eurofood IFSC Ltd* (Case 341/04) [2006] Ch 508 and *Interedil Srl v Fallimento Interedil Srl* (Case C-396/09) [2012] Bus LR 1582 provide guidance as to what might rebut the presumption.

In *Eurofood* the European Court of Justice explained that the COMI must be identified by reference to criteria that are both objective and ascertainable by third parties.

> '[The] presumption in the second sentence of article 3(1) of the Regulation may be rebutted, however,

> where, from the viewpoint of third parties, the place in which a company's central administration is located is not the same as that of its registered office. As the court held in In re Eurofood IFSC (Case C-341/04) [2006] Ch 508, para 34, the simple presumption laid down by the European Union legislature in favour of the registered office of that company can be rebutted if factors which are both objective and ascertainable by third parties enable it to be established that an actual situation exists which is different from that which locating it at that registered office is deemed to reflect' (*Interedil*, para. 51).

Further

> '[t]he factors to be taken into account include, in particular, all the places in which the debtor company pursues economic activities and all those in which it holds assets, in so far as those places are ascertainable by third parties' (*Interedil*, para. 52).

Applying the existing case law and guidance the court held that the COMI of all three of the Companies was in England rather than in Jersey where the Companies were registered.

The day-to-day conduct of the business was in the hands of an agent (namely FREPIM) that was an English company, appointed in England, pursuant to an English law governed agreement. The actions of FREPIM were not just limited commercial activities but included the types of function that one would expect a head office to discharge, including working on investment strategy and business plans for the Companies, instructing lawyers, surveyors and consultants for them, negotiating the purchase and sale of properties on their behalf and so on. Similarly, the day-to-day dealings with third parties were carried out from the offices of FREPIM in London. For example the companies' VAT returns stated that the FREPIM London office was the business address for the Companies.

Further the Facility Agreement and Nationwide Debentures were governed by English law and made reference to Nationwide's ability to appoint administrators under the Act. Nationwide was the Companies' largest creditor, and therefore its views were important when deciding the issue of the Companies' COMI.

The Companies sought to establish that their COMI was in Jersey and relied on the fact that Board meetings were held in Jersey. However the court did not find this persuasive. A third party would not know where Board meetings are taking place. In any event the location of the board was of limited importance in circumstances where the day-to-day conduct and business dealings of the Companies were carried out through FREPIM in London.

This aspect of the decision serves as an important reminder, for debtors and creditors alike, of the court's objective approach in ascertaining the COMI of a company not registered in the EEA but operating in the UK. Though the starting point is to look at a company's registered address that is not the end of the matter. A case and fact specific analysis needs to be carried out.

Issue 2: Improper motive

In respect of the second issue, the Companies submitted that Nationwide had acted with an improper motive in that the purpose of appointing the administrators had been to stifle the progress of the December 2014 litigation.

Paragraph 81 of Schedule B1 of the Act provides:

> '(1) On the application of a creditor of a company the court may provide for the appointment of an administrator of the company to cease to have effect at a specified time.
>
> (2) An application under this paragraph must allege an improper motive (a) in the case of an administrator appointed by administration order, on the part of the applicant for the order, or (b) in any other case, on the part of the person who appointed the administrator.
>
> (3) On an application under this paragraph the court may –
> (a) adjourn the hearing conditionally or unconditionally;
> (b) dismiss the application;
> (c) make an interim order;
> (d) make any order it thinks appropriate (whether in addition to, in consequence of or instead of the order applied for).'

This provision was introduced as an amendment to the 1986 Act the by the Enterprise Act 2002, Schedule 16, paragraph 1. The court observed that there was little in the way of explanation as to what lay behind this amendment. No guidance was to be found in the material published by the relevant government departments and agencies which sponsored the amendment nor was there any debate on the provision recorded in Hansard.

The court held that it was invidious to attempt to pinpoint precisely what form the motivation must take for the statutory jurisdiction to be invoked. The test is whether there is a motive that is not in harmony with the statutory purpose of administration and that is causative of the decision to appoint. If there is no disharmony it is difficult to see why the motive should be treated as a material matter militating towards termination of the administration.

Further, following the reasoning in the Northern Irish case of *Cursitan v Keenan* [2011] NICh 23, the court held that even where there is a finding of an improper motive, the court has a wide discretion as to whether to terminate an administration.

> 'If the statutory purpose of administration would be likely to be achieved, notwithstanding the motives of

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> the appointor, like McCloskey J. in Cursitan it seems to me that this would normally be the main touchstone for the court. The existence of an improper motive may become of relative insignificance in such circumstances, particularly where the appointor's improper objective was not actually achieved.' (para. 47 of the Judgment).

The court did not find a improper motive on the facts of the case. The date of repayment for Nationwide's loans had been set as October 2016 for some years, Nationwide had offered to extend the date for repayment by six months and the deadlines set had not been unreasonable. Further, even if there had been an improper motive, there was no satisfactory evidence that the statutory purposes of the administration were not likely to be achieved. Therefore the court did not interfere with the administrators' appointment.

This aspect of the decision is likely to be welcomed by administrators and potential appointors alike because it provides certainty. Essentially as long as the statutory purpose of administration is reasonably likely to be achieved, the motivation for the appointment is irrelevant. Therefore it appears that courts will only interfere with appointments in limited and somewhat extreme circumstances.

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Ronelp Marine Ltd & Others v STX Offshore & Shipbuilding Co. Ltd [2016] EWHC 2228 (Ch)

Joseph England, Barrister, Quadrant Chambers, London, UK

Introduction

This case is an example of the Court lifting the automatic stay on proceedings under the Cross-Border Insolvency Regulations 2006 ('CBIR'), and allowing an English Commercial Court action, i.e. an unsecured claim, to continue on the basis of exceptional factors.

Background

Where foreign insolvency proceedings are recognised by the English Court under the CBIR as foreign main proceedings, there is an automatic stay on other proceedings against the insolvent company (article 20(1)(a), schedule 1, CIBR). The Court can, however, modify or terminate this stay under article 20(6), Schedule 1, CBIR.

In an earlier recent decision, *Seawolf Tankers Inc and another v Pan Ocean Co. Ltd* [2015] EWHC 1500 (Ch), the Court held that the test it had to apply when deciding whether to lift the automatic stay under the CBIR was the test applicable to the lifting of a stay in administration proceedings. Although, oddly, that decision is not referred to in the instant case (which also concerned Korean insolvency processes).

Facts

STX Offshore & Shipbuilding Co. Ltd ('STX') was a Korean shipbuilding company with a registered office in London. It had given an English law governed (performance bond) guarantee in respect of its wholly-owned Chinese subsidiary, also a shipbuilder, in relation to the construction of five ships that the subsidiary had contracted to build. The shipbuilding contracts were also governed by English law. The subsidiary entered into Chinese insolvency proceedings and the ships were not built.

The various buyers of the ships ('the Buyers') commenced proceedings in Commercial Court in London against STX under the guarantee in January 2015. STX filed a defence which included that the shipbuilding contracts were illegal and unenforceable. The illegality argument was based on a sideletter between the parties to the shipbuilding contracts which had the effect of reducing the price by $6 million for each ship from the price stated in the contracts. STX argued that this was intended to mislead third parties as to the true price payable for the ships.

The Commercial Court gave directions for the conduct of the litigation but, some 14 months after the litigation commenced, STX itself entered into rehabilitation proceedings in Korea. The effect was to stay litigation against STX, as the Korean administrator duly obtained recognition of the Korean rehabilitation proceedings under CBIR, and the Court granted an automatic stay that no legal process could be continued against STX except with the consent of the Korean administrator or the permission of the Court. The Buyers applied to the English Court to lift the stay in order to continue the Commercial Court proceedings against STX.

Decision and reasoning

Norris J lifted the stay. In doing so, he held that the creditor applying for permission to continue existing proceedings bore the burden of making out its case for relief. To discharge this burden, it was held that [29]:

(1) The applicant must identify the nature of the interest that it wished to promote by obtaining the relief.

(2) The applicant must address the question of whether the grant of such relief is likely to impede the achievement of the purpose of the insolvency proceedings.

(3) The applicant must enable the Court to balance the applicant's legitimate interests against the interests of other creditors, having regard to the nature and probability of prejudice on either.

(4) The applicant must, in addressing the above questions, bear in mind that it is seeking to persuade the domestic court to interfere in the processes of the foreign insolvency court.

The Court emphasised that such considerations were not an exhaustive list.

The Court held that, in the context of unsecured money claims such as the instant case, it will only be in exceptional cases that the Court gives a creditor a right, by the taking of proceedings, to override and pre-empt the statutory machinery. Although noting the necessarily protean nature of the term 'exceptional', Norris J held it to mean: a circumstance or combination of circumstances of sufficient weight to overcome the strong imperative to have all claims dealt with in the same way. [31]

In the instant case, the following factors persuaded the Court to lift the stay:

(1) Although a money claim, it was a particularly complex one. Particular complications arose from whether the underlying contracts were unenforceable on the ground of illegality. The fact that English law is engaged by a jurisdictional clause is not sufficient of itself. The facts of this case, as applied to the uncertain and complex state of the law of illegality (recognised by the Supreme Court in a number of recent decisions on illegality), made this unsuitable for expert evidence via a summary review procedure in the Korean Rehabilitation Court. Further complexities arose as to whether, upon construction of the contracts, common law remedies were excluded, the interaction of which has also been expressed to be complex in reported decisions.

(2) The proceedings in the Commercial Court were already at a relatively advanced stage and considerable costs had been spent on preparation for a trial in December 2016. Although not decisive in of itself, it is was a factor, and the nearer the outcome of the proceedings, the greater weight to be attached.

(3) The Buyers wanted an adjudication and quantification of their claim under the guarantees to be determined more speedily than would be likely under the confirmatory review and objection proceeding process in Korean.

(4) Rather than impede the achievement of the Korean Rehabilitation Plan, lifting the stay would assist it. It would enable the Korean Rehabilitation Court to suspend the Buyers' confirmatory action, and would provide a quicker adjudication on the issues, which the Korean Court could adopt, promote or ignore, if dissatisfied. The steps left to take in the English proceedings would not interfere in any material way with the formulation and prosecution of the Rehabilitation Plan, not least given the size of STX's insolvency. The fact that the Korean Court gave permission for the administrators to defend the instant application was not evidence of interference, and the Korean Rehabilitation Court no doubt wanted the application properly tested before the domestic Court.

Finally, the Court moved to balancing the interests of the Buyers (to obtain a verification and quantification of their claim as quickly and economically as possible to play a part in the Rehabilitation Plan) and of other creditors of STX (ensuring the same rules applied to all claims, that the Rehabilitation Plan proceeded efficiently, and that the administrator was not put to undue expense causing a reduction in the amounts then available to creditors). The Court held that resolving a difficult issue of foreign law would assist, and not impede, the insolvency process and that treating the Buyers' claim differently was justified because of the nature of the dispute and extant nature of the proceedings in the Commercial Court, where a trial was imminent. Although the costs of the Commercial Court action would be slightly higher, it was not significant in the scheme of a Rehabilitation Plan involving approximately US$6.7 billion, and the English proceedings would be shorter, especially if the confirmatory proceedings in Korea were followed by objections. Further, there was (i) no disorder to the administration; (ii) no basis in evidence for suggesting other creditors would follow suit if the Buyers were given this relief; (iii) a judgment in respect of the illegality defence may in fact assist other cases; and (iv) there was no question of piecemeal/unequal distribution which would undermine the objective of having a single insolvency estate. [45]

Commentary

This is a clear and well-reasoned decision on both the facts and the law, and it is also a very pragmatic decision.

Although the wider context of this case is increasingly familiar to the English Courts – the fall-out from Korean insolvencies in the shipping market – the facts were of course unique and the decision to find 'exceptional' factors rested very squarely on those facts.

However, there is useful guidance as to what the creditor applying for permission to continue existing proceedings should do to discharge its burden. Further, at the end of his judgment, in granting the relief sought, Norris J encapsulated the four key reasons for his decision [43]: (i) the complexity of the foreign law issue (illegality here); (ii) proceedings already being at an advanced stage; (iii) continuing the proceedings would not impede the administration; and (iv) it did not advance the interests of the applying creditor over others. These may be useful indicators for future cases.

It is also a highly practical decision, not least in view of the Courts increased focus on proportionality, noting the advanced stage of the Commercial Court process and the costs/time of continuing , as opposed to not continuing.

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It further shows that, when subject to scrutiny, it is far from impossible to lift a stay in this context, and that many of the perceived obstacles, such as the potential prejudice to the foreign insolvency process and other creditors, are often more forensic than they are real. The factors that persuaded Norris J may also not be as unusual or uncommon as they may seem (i.e. difficult points of English law, a litigation at an advanced stage, and no real prejudice to other creditors/the foreign insolvency process). I would, however, caution that in many cases where the rehabilitation plan is not as sizeable as it was in the instant case, the costs and speed of the English Court process (including an appeal, which may be likely if it involves a complex issue of English law) may not be as advantageous, compared with the foreign insolvency jurisdiction, as was the case here.

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gary.ventura@quadrantchambers.com

Simon Slattery, Senior Clerk
simon.slattery@quadrantchambers.com

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