Privileged and confidential

IN *AVONWICK V SHLOSBERG* [2017] CH 210, MR JUSTICE ARNOLD REJECTED THE WIDELY HELD ASSUMPTION THAT A TRUSTEE-IN-BANKRUPTCY SIMPLY 'STOOD IN THE SHOES' OF THE BANKRUPT AS REGARDS HIS RIGHTS OF PRIVILEGE.

As the Court of Appeal determined in upholding that decision, the trustee cannot use the bankrupt's documents *"in a way which amounts to a waiver of the privilege"*. In a further decision made in the same proceedings, *Re Webinvest Ltd (In Liquidation)* [2017] EWHC 2446 (Ch), Arnold J has also considered the obligations of confidentiality to which an officeholder is subject. Three significant practical points emerge for officeholders and their advisers from these decisions.

First, trustees will need to exercise greater caution before instructing the petitioning creditor's solicitors. This is because, if they review the bankrupt's privileged documents, it will either amount to a de facto sharing of their contents with the creditor, or place them in a position of conflict of interest or duty insofar as the contents are of assistance to their other client. Instructing the petitioning creditor's solicitors will thus require an election by the petitioner that it is content to be disabled from itself pursuing further action (including against a related third party) with the assistance of those solicitors.

Second, it was confirmed in *Re Webinvest* that an officeholder can in principle take appointments across several related insolvency estates: whilst there is an inherent risk of conflicts of interest at the level of the creditors to the various estates, these can be dealt with as and when they arise. However, other difficulties can also arise. Where officeholders utilise their powers of compulsion to obtain materials, they may only use those materials for the purposes for which the powers were conferred.

The court cautioned that material can only be shared across the estates where the officeholders have considered the particular material and concluded that there is a proper purpose to that sharing. On the facts, the court nonetheless said that no difficulty arose from the position of an officeholder in that case who was common to both the bankruptcy estate and a related liquidation.

As a matter of principle, though, it seems clear that the de facto blanket sharing of compulsorily obtained material through the existence of a common officeholder (and undifferentiated teams) is unlawful and could lead to the court's intervention.

Third, the potential receipt of privileged (as opposed to merely confidential) material calls for more stringent controls where a trustee is also the officeholder of another insolvency estate. No de facto sharing of the bankrupt's privileged material will be permitted. Nonetheless, *Re Webinvest* indicates that, where robust arrangements are implemented, joint office-holding arrangements remain possible.

The court approved a protocol, whereby potentially privileged material would be independently reviewed for privilege and held by a non-overlapping trustee if held to be such. This suggests that, in all instances of overlapping officeholders involving a personal insolvency estate, there will need to be a non-overlapping trustee to receive privileged material in such circumstances.

JAMES MATHER appeared for the applicant in *Avonwick v Shlosberg* led by Philip Marshall QC.

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I am pleased to introduce this new edition of Serlespeak on issues in the law of insolvency. In my and Sophie Holcombe's joint lead article, we discuss the scope of remedies under s.241, Insolvency Act, for transactions at undervalue and preferences. Taking up the theme of transactions at undervalue, Adrian de Froment in his article considers the territorial reach of claims under s.423. Moving on, Ruth den Besten highlights the breadth of potential ramifications of the Supreme Court's judgment in *Lehman*, while Matthew Morrison focuses on the implications of the judgment in the *Carlyle* case for directors' duties when companies are in financial difficulties. Finally, James Mather examines aspects of an officeholder's obligations in relation to privileged or confidential materials.

Hugh Norbury QC

Searching for deep pockets

ONCE IT IS ESTABLISHED THAT AN INSOLVENT COMPANY PREVIOUSLY ENTERED INTO A TRANSACTION AT AN UNDERVALUE (S.238 OF THE INSOLVENCY ACT 1986) OR GAVE A PREFERENCE TO ONE OF ITS CREDITORS (S.239 OF THE 1986 ACT) THE COURT WILL ORDINARILY SEEK TO RESTORE THE INSOLVENT COMPANY TO THE POSITION IT WOULD HAVE BEEN IN HAD THE TRANSACTION OR PREFERENCE NOT TAKEN PLACE (S.238(3) OF THE 1986 ACT).

Often this involves an order that the counterparty to the transaction pay full value for the benefit it received. Where the counterparty is also insolvent, or a man of straw, such order may be of little or no use to the insolvent company's creditors. Section 241 of the 1986 Act, however, allows claimants to be more imaginative in respect of the orders they seek and the persons against whom they claim.

Section 241(1)(d) provides that the court can *"require any person to pay, in respect of benefits received by him from the company, such sums to the office-holder as the court may direct"*. Section 241(2) provides that an order under s.238 or s.239 may impose an obligation on *"any person whether or not he is the person with whom the company in question entered into the transaction..."*. It is, therefore, permissible for claimants to bring claims against persons who were not themselves party to the transaction, but who merely received a benefit from the transaction.

This poses the question: what constitutes a benefit? Some guidance was given in *Re Oxford Pharmaceuticals Ltd* [2009] EWHC 1753 at [84] and [85]. Mark Cawson QC (sitting as a judge of the High Court) said that an order

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“Unless the connected third party can demonstrate good faith the fact that they provided value for the benefit received will not assist…”

against a third party under s.241(1)(d) of the 1986 Act was *not* available unless the third party *“was in possession of assets applied in making the preference or, at least, had otherwise personally benefited in monetary terms from the payment in some direct and tangible way”*. As such, the benefit received by the third party must be both direct and tangible. The court is likely to approach this question taking a realistic and commercial approach (*Damon v Widney Pic* [2002] B.P.I.R. 465).

The practical application of such guidance gives rise to further questions. Could it be said that a shareholder of a company receives a benefit if his/her company is the counterparty to a transaction at an undervalue? More tenuously, could it be said that a beneficiary of a trust receives a benefit if a company wholly owned by the trust is the counterparty to the transaction at an undervalue?

In *Re Oxford Pharmaceuticals* the court refused to make an order pursuant to s.241(2) against the shareholder of the company that received a preference since it was neither necessary nor appropriate to achieve the purpose of restoring the insolvent company to the position it would have been but for the preference. The court remarked that any benefit to the shareholder was merely incidental (at [85]). Of course, had the shareholder received a dividend following payment of the preference the benefit would be direct and the shareholder may be vulnerable to an order under s.241(2). The court further warned against seeking to recover from a third party in circumstances where an order against the counterparty was available.

More problematic is the scenario where, following a preference or transaction at an undervalue, the counterparty to the transaction re-pays one of its creditors (a third party) or enters into a full value transaction with a customer (again, a third party). Could that third party be said to benefit from the transaction? Had the undervalue transaction or preference not taken place the third party would not have been repaid or would not have had the opportunity to enter into a lucrative contract. It is questionable, however, whether such benefit could be characterised as a *direct* benefit from the offending transaction.

A person receiving a benefit from the transaction will be protected if they can demonstrate that they acquired the benefit ‘in good faith and for value’ (s.241(2)). This may assist the categories of third parties considered in the previous scenario, but it will be of less help to persons connected with the company (defined in s.249 of the 1986 Act as including associates of the company or of the directors of the company) since they are presumed to have received the benefit otherwise than in good faith (s.241(2A)). Associates is defined broadly in s.435 of the 1986 Act. If the counterparty to a transaction at an undervalue repaid an outstanding directors loan, and that director was a relative of one of the directors of the insolvent company, it would be presumed that the director who had been repaid received any benefit otherwise than in good faith. The presumption that the third party acted otherwise than in good faith will also arise if the person had *“notice of the relevant surrounding circumstances and of the relevant proceedings”* (s.241(2A)(a)).

Unless the connected third party can demonstrate good faith the fact that they provided value for the benefit received will not assist: an order can still be made against them pursuant to s.241. It is arguable, however, that a third party who provided full value has not received a *direct monetary* benefit since on its face the transaction will be financially neutral. The transaction may have other incidental benefits, such as increasing the third party’s turnover, but arguably following *Re Oxford Pharmaceuticals* such incidental benefit may not be sufficient to justify an order under s.241. Alternatively, the fact that full value was provided may be persuasive evidence that the third party acted in good faith.

It is worth noting that the counterparty to the transaction will not be protected from an order under s.241 because it acted in good faith and for value.

Section 241(2)(b) provides: *“such an order... shall not require a person who received a benefit from the transaction or preference in good faith and for value to pay a sum to the office-holder, except where that person was a party to the transaction...”*. As such, it will always be more straightforward to seek recovery from the counterparty to the transaction. That said, in the search for a defendant with deep pockets, creditors of an insolvent company should not overlook the persons who ultimately took the benefit of the transaction.

HUGH NORBURY QC and SOPHIE HOLCOMBE are acting for a defendant in litigation arising out of the bankruptcy of Mr Shlosberg in which issues similar to those described above are being aired.

Section 423 and defendants outside the jurisdiction

IN THE RECENT CASE OF *OREXIM TRADING LIMITED V MAHAVIR PORT AND TERMINAL PRIVATE LIMITED* [2017] EWHC 2663 (COMM) THE HIGH COURT HAS MADE IT HARDER FOR CREDITORS TO BRING CLAIMS UNDER SECTION 423 OF THE INSOLVENCY ACT 1986 AGAINST DEFENDANTS DOMICILED OUTSIDE THE EU.

Section 423 gives the English court a wide power to unwind transactions entered into at an undervalue for the purpose of putting assets beyond the reach of creditors.

In this case, Orexim (a company incorporated in Malta), brought proceedings against MPT (a company incorporated in India) for breach of a settlement agreement. It also alleged that MPT had sought to put its assets beyond the reach of enforcement by transferring ownership of a ship to another company, and accordingly brought claims seeking to set aside the sale of the ship under s.423 and/or for a declaration that the sale was a sham.

MPT could not challenge jurisdiction in relation to the contractual claim due to an English law and jurisdiction clause in the agreement. However, the defendants challenged the court's jurisdiction in respect of the s.423 and sham claims.

Orexim argued that there was a good arguable case that the s.423 claim fell within PD6B paragraph 3.1(20)(a), which refers to a claim made *"under an enactment which allows proceedings to be brought and those proceedings are not covered by any of the other grounds referred to in this paragraph..."*. It argued that s.423 was such an enactment and there were no limiting words in the provision to suggest that the gateway was not applicable.

The judge, HHJ Waksman QC (sitting as a High Court judge) disagreed. He held that s.423 did not fall within the gateway because it did not expressly confer a right to bring the claim against a person out of the jurisdiction.

There are conflicting first instance decisions on the point, but the judge considered that he was bound by the earlier Court of Appeal authority of *Re Harrods* [1992] Ch. 72. There, the court had decided that an unfair prejudice petition could not be served out of the jurisdiction under the gateway provided for in Order 11, r.1(2) because section 459 of the Companies Act 1985 did not state that it was intended to have extra-territorial effect.

The principle in *Re Harrods* had been applied to s.423 and to the CPR enactment gateway in *Banco Nacional de Cuba* [2001] 1 W.L.R. 2039 by Lightman J, who held that it was *"quite clear"* that such claims did not fall within the predecessor of paragraph 3.1(20)(a). However, in *Jyske Bank (Gibraltar) Ltd v Spjeldnaes (No.2)* [2000] B.C.C. 16, Evans-Lombe J had stated, *obiter,* that s.423 claims did fall within Order 11, r.1(2), and in the later case of *Erste Group Bank v JSC VMZ Red* October [2013] EWHC 2926 (Comm), Flaux J held, without the benefit of detailed argument, that s.423 claims were *"clearly"* within the CPR enactment gateway (HHJ Waksman noted that neither *Re Harrods* nor *Banco Nacional* were cited to the court in *Erste,* and held that the decision was *"clearly wrong"*).

If it is followed, *Orexim* will make it more difficult to bring s.423 claims against defendants domiciled outside the EU. It could also have wider effects: if the same reasoning is applied more broadly, then the enactment gateway may also be closed to claimants under other provisions of the Insolvency Act, and indeed other statutes, that do not expressly provide that they have extra-territorial effect.

Given the conflicting state of the authorities, guidance from the Court of Appeal would be desirable. Permission to appeal has been granted, with the appeal due to be heard in July, so watch this space.

ADRIAN DE FROMENT has a broad commercial chancery practice, with a particular emphasis on civil fraud, company law and insolvency.

Lehman: Unique facts, Universal law

THERE IS A PERCEPTION THAT, INTERESTING THOUGH THE SUPREME COURT'S JUDGMENT IN LEHMAN MAY BE TO INSOLVENCY PRACTITIONERS, ITS IMPACT IS RESTRICTED BY THE EXTREME RARITY OF A SOLVENT INSOLVENCY, AND HOW: AT THE LAST COUNT, THERE EXISTS A SURPLUS AFTER PAYMENT OF SECURED AND UNSUBORDINATED CLAIMS OF SOME £7.7BN IN THE ESTATE OF THE PRINCIPAL LEHMAN TRADING ENTITY, LEHMAN BROTHERS INTERNATIONAL (EUROPE) LIMITED.

To an extent this perception is fair; the number of estates in which competing creditors will be in a position to recover statutory interest accrued during the course of administration is of course limited. Similarly, it will now be a rare estate in which the principal trading company is an unlimited liability company, so as to give rise to the possibility of contribution claims being raised against its shareholders.

However, this is to downplay the key point of universal application arising out of the Lehman judgment, namely that the Supreme Court's findings reflect a very strict application of the Insolvency Act and Rules. This is exemplified by its findings that (i) applying the statutory waterfall, statutory interest and non-provable liabilities take priority over an entitlement to recover subordinated debt; (ii) that, since rule 2.86 mandatorily converts a foreign currency debt into sterling without any accompanying provision for currency conversion claims, it is not open to persons whose claims are denominated in a foreign currency to claim as a non-provable debt currency losses arising as a result of the depreciation in the value of sterling as between the date of the debt's conversion and the date of its payment; and (iii) that the Act does not provide for a contribution claim to be raised against a company's shareholders on a contingent basis and whilst in administration. Rather, the Act provides only for a contribution claim to be made by a liquidator, and a contributory will have no liability until a company is in fact wound up.

In these circumstances, it is clear from the terms of the judgment that there is an ever-decreasing scope for rights that are not expressly countenanced by statute. Indeed, even where Lord Neuberger extended the contributory rule (which precludes members recovering anything from a company as creditor until their liability as member has been discharged) to apply not only in liquidations but in administrations, he expressly stated that is only to occur where not inconsistent with existing legislative provisions.

Accordingly, even if the exact facts and principles at issue in Lehman are unique and do not arise again (or rarely so), the Court's strict approach is likely to be reflected in the approach adopted by other courts when considering claims made against companies in administration, or otherwise under the Act.

RUTH DEN BESTEN appeared as part of the team representing Lehman Brothers Limited (the Lehman service company) in the Supreme Court in *Waterfall I* [2017] UKSC 38, and together with Philip Marshall QC in *Waterfall III*. The question of the ranking of various subordinated debts remains live.

Chambers news

People

After 29 years' service as Serle Court receptionist, we bade farewell to Christine Mitchell who retired in January this year.

We are delighted to announce that Matthew Morrison has been appointed to be a member of the Consultation Board for Practical Law Private Client.

Conferences and seminars

Serle Court sponsored the Private Client Dining (PCD) Club inaugural event in the Cayman Islands in January 2018 and conducted a series of seminars with a number of clients. John Machell QC, James Brightwell and Adrian de Froment spoke on "Sham Trusts" and Richard Wilson QC spoke at the STEP Cayman conference.

In March we also sponsored and co-chaired the Trusts and Estates Litigation Conference in its new venue at Evian. Dakis Hagen QC co-chaired the event and Alan Boyle QC participated in debate on *Caught in the crossfire: Trustees embroiled in divorce proceedings* in which he looked at whether the English Family Court can pierce Colonial Firewalls. Giles Richardson chaired a session, *Meritus Trust Company v Butterfield Trust: Battle of the trusts across several jurisdictions*.

We were very pleased to have Richard Wilson QC and Kathryn Purkis speak at the Private Client Forums in Guernsey and Jersey on *Settlor control in light of the Pugachev decision*. Lance Ashworth QC, Ruth den Besten and James Mather all attended the C5 Fraud, Asset Tracing & Recovery Conference in Geneva.

In April, Serle Court conducted a series of seminars in Dubai, with Rupert Reed QC speaking on *Why the DIFC Court needs a 'necessary and proper party' jurisdiction,* James Weale on *Freezing Injunctions in the DIFC: Key Developments,* Adil Mohamedbhai covering *The DIFC Trust Law: an untapped opportunity?* and Amy Proferes speaking on *State Immunity.* Seminars were delivered to a number of firms and a reception held at the Four Seasons Hotel.

In May, David Blayney QC chaired the first of a series of Islamic Finance Seminars covering *Litigating Disputes from the Gulf States* at Serle Court, with Rupert Reed QC speaking on *Reflections on Dana Gas,* Dr Scott Morrison on *Golden Belt Sukuk and the Duty of Care to Sukuk Investors,* and Amy Proferes speaking on *The Application of Islamic Finance Principles under English law.* The next seminar in this series will cover *Issues of Islamic law arising in trust, succession and family cases* and will be held in Autumn 2018.

A team from Serle Court including Philip Jones QC, Richard Wilson QC and Gareth Tilley delivered seminars to clients in Hong Kong on "Trust Busting" followed by a reception at the Mandarin Oriental Hotel.

We hosted a seminar on property law featuring Christopher Stoner QC, Andrew Bruce and Amy Proferes in chambers which attracted very positive feedback from our clients who attended.

Dates for the diary

Serle Court will be holding its summer client party at the Tate Modern on Wednesday 27th June and the third International Trust and Commercial Litigation Conference in New York on Monday 19th November.

LinkedIn

We have 4 discussion groups on LinkedIn to enable Serle Court members and clients to discuss topical issues in Partnership and LLP Law, Fraud and Asset Tracing, Contentious Trusts and Probate, and Competition Law; please join us. We will also post updates of our upcoming events.

Serlespeak is edited by JONATHAN FOWLES

The changeable duty to act in the best interests of the company

WHILE DIRECTORS REMAIN UNDER A DUTY TO ACT IN THE BEST INTERESTS OF THE COMPANY, NO MATTER HOW DIRE ITS FINANCIAL CIRCUMSTANCES MAY BE, A NOTABLE FEATURE OF THIS FIDUCIARY DUTY IS THE ALCHEMIC WAY IN WHICH THE INTERESTS OF THE COMPANY COME TO BE EQUATED WITH THOSE OF ITS CREDITORS RATHER THAN ITS SHAREHOLDERS AS THE COMPANY'S PROSPECTS WORSEN.

The time at which creditors' interests start to obtrude, and the importance to be attached to them, have been considered in a number of English first-instance authorities in recent years. They were also among the multifarious legal issues considered in the mammoth judgment of the Royal Court of Guernsey in *Carlyle v Conway* (Judgment 38/2017, 4 September 2017).

The question of timing is critically important; if the duty to have regard to creditors' interests arises when the company is too close to insolvency, the horse may already have bolted; however, if it arises too soon, the directors may adopt an overly cautious approach to the opening and closing of the stable door. In *BTI 2014 LLC v Sequana SC* [2016] EWHC 1686 (Ch), Rose J considered the judicial authorities in depth and favoured the view that the company needed to be *"on the verge of insolvency"* for the duty to arise, and that this was a higher threshold than *"a real (as opposed) to remote risk of insolvency"* (as articulated in *HLC Environmental Projects Ltd* [2014] BCC 337). This approach was reiterated by HHJ Cooke in *Dickinson v NAL Realisations* [2017] EWHC 28 and Rose J herself in *Singularis Holdings Ltd (in liq) v Daiwa Capital Markets Europe Ltd* [2017] EWHC 257 (Ch).

In Carlyle, LB Marshall also agreed with Rose J and approved the terminology of *"on the verge"* or *"on the brink"* as conveying the *"appropriate sense of imminence"*. In so doing she rejected the *"zone of insolvency"* language proposed by the liquidator Plaintiffs because it is *"capable of conveying a rather more distant relationship than that which is conveyed by the words "border", "verge" or "brink"."* LB Marshall further stressed that the test is *"rightly flexible and fact-dependent"*.

Where the duty is triggered, some English authorities have suggested that creditors' interests are *"paramount" (e.g. Colin Gwyer & Associates Ltd v London Wharf (Limehouse) Ltd [*2003] 2 BCLC 153). However, the view has also been expressed that directors remain obliged to balance the interests of creditors and shareholders (e.g. *Ultraframe (UK) Limited v Fielding* [2005] EWHC 1638 at [1304]). This difference of approach will be of significance for directors who are faced with the dilemma whether to wind the company up, or to try to turn it around through ongoing trading (a dilemma in which the possibility of wrongful trading ought also carefully to be considered).

In LB Marshall's view, the English authorities suggesting *"creditor paramountcy"* in every case overstate the position. Directors should instead give creditors' interests *"proper regard"*, bearing in mind *"that the creditors will have a priority of interest in the assets of the company over its shareholders if a subsequent winding up takes place"*. The attraction of this test was said to be that it *"imports the possibility of some degree of judgment of appropriateness according to circumstances"*. Adopting this approach, directors are only required to give precedence to creditors' interests where that is necessary in the particular circumstances of the case.

While the emphasis placed by LB Marshall upon the need for insolvency to be imminent, and her view that creditors' interests will not always be paramount, will no doubt be welcomed by those providing directorial services, the fact-sensitive tests suggested by LB Marshall and the ongoing inconsistency between first instance decisions in England and other common law jurisdictions mean that it remains difficult confidently to advise directors as to the duties they owe in times of financial difficulty.

MATTHEW MORRISON, led by Philip Marshall QC, acted for the independent director defendants in the *Carlyle* litigation.

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