serle speak
ISSUE NO.3

Welcome to the latest edition of Serle Speak. The extraordinary financial developments of recent times have resulted in a marked growth in insolvency events and this edition addresses topical issues arising in the insolvency arena. Topics covered include the importance of asserting proprietary claims in asset recovery, difficulties faced in realising foreign assets in bankruptcy and the significance of intellectual property rights in the insolvency estate. Other articles concern the need for full and frank disclosure in insolvency applications and the role of indemnities in corporate insolvencies. **PHILIP MARSHALL QC**

Proprietary claims matter

THE PROCEEDINGS BROUGHT BY *LEXI HOLDINGS PLC (IN ADMINISTRATION) V SHAID LUQMAN* CONCERN A FRAUD DESCRIBED BY BRIGGS J. AS "TRULY SHOCKING IN ITS SCALE AND AUDACITY" ([2007], EWHC 2653 (CH.)).

Lexi, a company engaged in the business of providing unregulated bridging loans, went into administration in October 2006. Its administrators, KPMG LLP (appointed by Barclays as floating charge holders) shortly discovered, notwithstanding the wholesale destruction of company documentation shortly before their appointment, that the company's guiding officer, Shaid Luqman, had misappropriated over £50m from the company by a series of payments to himself and various connected persons. Further unlawful loans had been advanced and properties transferred away in breach of the provisions of the Companies Act.

In November 2006 Lexi brought proceedings in the Chancery Division to recover these monies and on 13 November 2006 obtained a freezing order, with ancillary asset and tracing disclosure and evidence preservation orders, in support. In July 2007 Shaid was sentenced to 18 months' imprisonment for breaching these orders, a sentence subsequently increased to the maximum term of 2 years. Judgment in default in a sum in excess of £75m was obtained against Shaid in December 2007.

One of Lexi's claims was brought against Ian McGarry, a surveyor who received £625,000 from Lexi in January/February 2006 (at about the same as he valued property to be offered to ABN Amro as security for lending to another of Shaid's companies). Lexi claimed that these monies had been paid to Mr McGarry in breach of trust and were held by him on constructive trust for the company. A claim was also made for monies had and received.

Mr McGarry failed to comply with the courts for disclosure and, following his failure to comply with an Unless Order, Lexi obtained judgment against Mr McGarry on 19 March 2008. The judgment was entered into upon request of the company, for the sum of £625,250 plus compound interest.

In order to enforce its judgment, Lexi obtained an interim charging order over Mr McGarry's home, and a third party debt order against his bank accounts. However, payment of the judgment debt was arguably restricted by a criminal restraint order made against Mr McGarry in April 2006 upon the application of the SFO, who were also investigating his affairs. Accordingly, in June 2007 Lexi applied to the Crown Court pursuant to section 42 Proceeds of Crime Act 2002 ('POCA') as a person affected by the restraint order for its variation to permit payment of the judgment debt.

The variation was opposed by the SFO. However, HHJ Hone QC held that this variation should be allowed on two grounds. First, he held that Lexi had a proprietary claim to the monies received by Mr McGarry; second, he concluded that (as under the pre-2002 statutory regimes contained in the Criminal Justice Act 1988 and Drug Trafficking Act 1994) the court had a "reasonably wide discretion" to do justice under POCA, and thus to sanction the payment of third party unsecured judgment creditors.

> This judgment demonstrates the importance of asserting, where possible, a proprietary claim

The SFO applied for permission to appeal, which was granted upon its renewed application having regard to the public importance of the matters raised.

The Court of Appeal (Keene LJ, Davis J and His Honour Diehl QC, Recorder of Swansea) first considered whether HHJ Hone QC had been correct to find that Lexi held a proprietary claim to the restrained monies. It concluded that although there had not been a judgment, or even a finding, to this effect in the civil proceedings, Lexi's decision to enter judgment for a monetary sum did not amount to an abandonment of any further claim that it might have for an equitable charge over Mr McGarry's property and which might be recognised by further legal proceedings. In the circumstances, and applying ***Tang Man Sit v Capacious Investments Ltd*** [1996] 1 AC 514, per Lord Nicholls at 521-522, no question of double recovery arose: the equitable charge was invoked simply to repay monies held on trust for the company. However, the Court of Appeal reduced the sum by which the restraint order was to be varied to the identifiable proceeds held in Mr McGarry's bank accounts (in December 2006, some £437,258.31).

Second, the Court of Appeal considered the legislative steer provided by section 69 of POCA, that the powers to make or vary a restraint order are to be exercised with a view to ensuring that any realisable property is available for the purpose of satisfying any confiscation order made, without taking into account any conflicting obligations of the defendant. The Court held that the payment of third party creditors at the restraint stage did conflict with this object, and therefore determined that the court had no discretion to vary a restraint order to make payment to an unsecured creditor.

This judgment demonstrates the importance of asserting, where possible, a proprietary claim in fraud proceedings where a restraint order has been or may be made against a defendant. Absent such right a restraint order cannot be varied in respect of a prior debt, and a victim will be required either to seek compensation in criminal proceedings (if these are successfully pursued), or at least to await the abandonment or determination of these, if it is ever to recover the monies it has lost. It is notable that this also gives rise to an oddity that whilst a restraint order may, pursuant to section 41(3) POCA, be varied to permit payment of an ordinary or business debt incurred whilst the restraint order is in place, no such variation may be made in respect of ordinary or business debts incurred before the restraint order is made.

Philip Marshall QC and Ruth Holtham appeared for Lexi.

- PHILIP MARSHALL QC
- RUTH HOLTHAM

IPRs and insolvency

IN INSOLVENCY MATTERS, THE POSITION OF ANY INTELLECTUAL PROPERTY RIGHTS (IPRS) IS OFTEN OVERLOOKED BY ALL CONCERNED. THIS IS UNFORTUNATE, AND CAN LEAD TO GREAT PROBLEMS.

Given that actual money is always short in such situations, it is sensible to see if there are any other assets, such as IPRs, that are not already mortgaged and that can be used to raise money or make the other assets more attractive to potential buyers.

Many things need to be considered. First, ownership must be established. This can be difficult, as IPRs are often held by a non-trading holding company and merely licensed to the trading entity. Also, in smaller concerns, the directors often purport to hold the rights personally. Secondly, licensing terms must be considered, especially automatic break clauses on the company becoming insolvent, and run-off provisions dealing with the future conduct of articles already made but not yet sold. Thirdly, even though the existence and subsistence of registered rights are usually easier to ascertain, the existence of various unregistered rights such as goodwill, copyright, design right and confidential information must not be overlooked, otherwise valuable assets might be wasted. Fourthly, the validity of rights is important to determine if

> '... IPRs are often held by a non-trading holding company and merely licensed to the trading entity'

they are to be used as the basis for any financial instrument, or used either defensively or aggressively in any litigation. Fifthly, the issue of infringement ought to be examined, both infringement by others of the company's own IPRs, and infringement by the company of third parties' IPRs.

Those are the principal matters. However, there are other issues that can arise in certain circumstances, such as for example the assignment of rights needs to be handled with great care, as often the assignor will then be dissolved, and so any errors might become very difficult (if not impossible) to rectify subsequently.

In all, it is unwise in the extreme not to consider fully the position of the IPRs in insolvency matters.

Michael Edenborough has extensive experience in intellectual property matters.

MICHAEL EDENBOROUGH

Full and frank disclosure on insolvency applications

AN APPLICANT FOR THE APPOINTMENT OF A PROVISIONAL LIQUIDATOR OWES DUTIES OF FULL AND FRANK DISCLOSURE, HELD CHRISTOPHER CLARKE J IN *MILLHOUSE CAPITAL UK LTD AND ROMAN ABRAMOVICH -V- SIBIR ENERGY PLC* [2008] EWHC 2614 (CH).

Yugraneft, a Russian company in liquidation in Russia, claimed to have been the victim of a fraud directed by Roman Abramovich by which its interest in a company, Sibneft-Yugra, was diluted from 50% to under 1%. Yugraneft claimed losses of billions of dollars.

Yugraneft, having failed to overturn the dilution in Russia and the BVI, claimed against Mr Abramovich and Millhouse in knowing receipt and dishonest assistance. It sought to realise this asset by suing through an English liquidator. So its parent company petitioned to wind up Yugraneft as an unregistered company (sections 220-221 Insolvency Act 1986), and secured the appointment of a Provisional Liquidator, who commenced Commercial Court proceedings forthwith, well before hearing of the winding up petition.

Mr Abramovich complained that the appointment of the Provisional Liquidator had been obtained by non-disclosures to the Court about the facts and strength of the claim. For example, the Petitioners asserted that Mr Abramovich was "certainly resident here", and did not disclose that, in the BVI, Mr Abramovich had stated on oath (and the BVI Courts accepted), that he was resident in Russia, not England. The Russian criminal investigations into the dilution (instigated by a complaint by the Russian liquidator) were misleadingly portrayed, and it was not disclosed that the Russian liquidator had not exercised his right of appeal against the no-criminality finding. Mr Abramovich applied for reverse summary judgment at the same time.

> 'The defaulting party is deprived of any advantage that the order may have given him'

Christopher Clarke J held that the non-disclosures were serious: even had he found that the Commercial Court claims against Mr Abramovich were viable, he would have set aside the Order appointing the Provisional Liquidator and dismissed the Commercial Court claims. He held that the obligation of full disclosure exists to secure the integrity of the Court's process and to protect the interests of those potentially affected by the order. The Court's ability to set aside the Order and to refuse to renew it is the sanction by which that obligation is enforced: it deters others from breaking it. The defaulting party is deprived of any advantage that the order may have given him.

Alan Boyle QC and Richard Walford acted for Mr Abramovich and Millhouse on the Companies Court claims, and Richard Walford was a member of the counsel team which successfully obtained reverse summary judgment in, and the dismissal of the Commercial Court proceedings.

RICHARD WALFORD

Claims against indemnified defendants

UPON LIQUIDATION THE CREDITORS OR SHAREHOLDERS WILL WANT INTERIM DISTRIBUTIONS TO BE MADE AS SOON AS POSSIBLE. THEY WILL ALSO WISH THE CONDUCT OF DIRECTORS, AUDITORS AND OTHER AGENTS OR ADVISERS ('SERVICE PROVIDERS') TO BE INVESTIGATED AND PROCEEDINGS FOR RECOVERY COMMENCED. MANY MAY ALSO WISH TO BRING DIRECT CLAIMS AGAINST THESE SERVICE PROVIDERS. BUT SUCH SERVICE PROVIDERS USUALLY HAVE AGREEMENTS PROVIDING FOR INDEMNIFICATION BY THE COMPANY FOR LOSSES OR EXPENSES INCURRED WHILE ACTING FOR OR ADVISING THE COMPANY.

If the indemnity is for all acts other than fraudulent or negligent ones and the claim is a claim in negligence by the company, the maximum sum claimable by the indemnified will only be the costs incurred in successfully defending the proceedings. If the indemnity covers all acts other than fraudulent ones (not lawful in the case of directors or auditors), and the company (or third parties) are bringing proceedings alleging fraud or negligence, the claim in fraud may not succeed but the claim in negligence might. Although this will cancel itself out in the case of the company making such a claim, this will not be the case where it is a third party claiming.

As soon as a claim is intimated or made the service provider will, or ought to, lodge a proof of debt in the liquidation. Uncertain, contingent or future debts are all debts for which proofs can be lodged. Subject to a *de novo* appeal to the court, it is for the liquidator to place a value on such a debt. This provision exists to enable liquidations to be closed early, without waiting for the amount of the debt to be crystallised. However, as the liquidation cannot close until the proceedings conclude, the liquidator should defer adjudicating on the proof until then. If the proceedings are brought by third parties, the claimants will usually have claims against the company as well, so the claims will affect their own proofs of debt, so here the liquidator also ought to delay his adjudication. If he does not, it is likely that the court will adjourn the appeal from his decision until the proceedings are concluded.

This delay does not prevent interim distributions being made, but rule 4.182 Insolvency Rules 1986 provides that the liquidator must make provision for disputed proofs and claims. Although so far unconsidered, it must be the case that a provision should be made for the amount payable the maximum amount potentially claimable under the indemnity unless the whole or part of the claim has no realistic prospect of succeeding. If this is not done the defendants may be ultimately unfairly prejudiced.

> "If this is not done the defendants may be ultimately unfairly prejudiced"

Thus, the consequence of proceedings against indemnified defendants is that interim distributions may be delayed. This puts pressure on liquidators, creditors and shareholders to accept a less favourable deal than they might otherwise have agreed.

Philip Jones QC acts for a party in the liquidation of the Sphinx Group of Companies in the Cayman Islands where these issues arise.

PHILIP JONES QC

Foreign assets in a bankruptcy

ASSETS OUTSIDE THE JURISDICTION FALL WITHIN A BANKRUPT'S ESTATE, BUT THE POTENTIAL DIFFICULTY OF REALIZING IMMOVEABLE ASSETS ABROAD IS ILLUSTRATED BY THE CONTINUING *AL MIDANI* CASE. THE BANKRUPT WAS ENTITLED TO A VILLA IN SPAIN AND A SHARE OF CERTAIN REAL PROPERTY IN LEBANON, BOTH OF WHICH HAD BELONGED TO, AND REMAINED REGISTERED IN, HIS LATE FATHER'S NAME.

In Spain, the Trustee in Bankruptcy obtained registration under the EU Regulation and thus became the proprietor of the villa, as permitted by Spanish law. The bankrupt brought Spanish proceedings challenging the Trustee's rights so to do, despite an order of the High Court requiring him to cease such interference ([2006] BPIR 123).

The challenge was dismissed, but a third party then claimed rights over the villa pursuant to a post-bankruptcy agreement allegedly entered into with the bankrupt. When that party declined to progress proceedings to assert its claim (by removing the file from a lower Court), the Spanish Court intimated that it would direct a sale of the villa on receipt of a letter rogatory from the English Court requesting it so to do. Warren J ordered the issue of the letter (27.08.08, unreported), only for the Spanish Court to indicate that it would not direct sale of the villa after all, because it opined that the Trustee had sufficient rights and power so to do. Reconsideration of that decision is being sought.

In Lebanon, registration in the Trustee's name was again required to realize the bankrupt's share. However, the Land Registry refused to allow registration, or to register any disposition, unless the Trustee provided a Declaratory Order from the English Court reconfirming his right to claim title and to sell (which the Trustee duly did).

> "...despite an order of the High Court requiring him to cease such interference"

These instances indicate the importance to a Trustee of detailed local advice as to the method of realization of immoveables, and the need to consider the procedures and (sometimes unforeseen) costs of so doing.

Victor Joffe QC acts for the trustee in bankruptcy of Mr Al Midani.

VICTOR JOFFE QC

‘This ‘first class’ set offers a much wider scope of work than just pure insolvency’

Chambers & Partners 2009

Chambers news

People

We are delighted to announce that Michael Edenborough, a specialist in Intellectual Property has joined Serle Court. His practice covers all areas of intellectual property law and technical commercial disputes, including issues before the UK and European patent and trade mark offices. Michael has appeared in over 55 reported cases during the last eight years, of which over half were appeals or judicial reviews. Chambers and Partners 2008 comments ‘Michael is “always on the right wavelength”, he has the “knack of mastering the law and applying it” and his “hardcore technical knowledge astounds and impresses those around him as does the way he churns out top quality work.”’

James Corbett QC and Geraldine Clark have both been admitted as advocates before the courts of the Dubai International Financial Centre.

We are also pleased to announce that on 1 December Andrew Bruce was appointed a Deputy Adjudicator to Her Majesty’s Land Registry.

Legal Directories

Serle Court has continued its improvement in the Legal 500 2008 directory, attracting 7 more individual entries and adding Media, entertainment and sport as a set recommendation. The total individual barrister recommendations now stands at 85 and as a set we are recommended in 10 practice areas.

We continued to feature strongly in Chambers & Partners 2009. We now have 92 individual recommendations placing us 4th in the ‘recommendations per member’ table. Individual highlights include Philip Jones QC and Philip Marshall QC who are both ranked as ‘stars at the bar’. Only 10 other barristers are included in this prestigious category. As a set we are recommended in 11 practice areas and only 4 other sets are recommended in more.

We continue to be extremely grateful to all our clients who continue to recommend us so highly.

Award Nominations

We have been nominated for a number of awards in 2008 including: Chambers of the Year at the STEP Private Client Awards 2008; 3 nominations for the Chambers & Partners Bar Awards – Chancery set of the year, Chancery junior of the year and for the 4th year running Client Service set of the year; Chambers of the Year at the British Legal Awards and most recently we are the only Chancery Commercial set nominated in the inaugural Chambers of the Year category at the Legal Business awards.

We are delighted that for the second year running a member of Serle Court, William Henderson, has been named Chancery Junior of the year at the Chambers & Partners Bar Awards.

Edited by Tim Collingwood

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