



AG Home » Stay informed » Publications » Litigation publications » Resolve » Resolve - Autumn 2009 » All Sections - Autumn 2009

## All Sections - Autumn 2009

### Arbitration may continue despite foreign insolvency of respondent

What is the effect on arbitration proceedings when a party to arbitration becomes insolvent in a different EU member state? Which law determines the effect of the insolvency on the arbitration proceedings?

These issues were decided in *Syska v Vivendi*, 2009. Elektrim, a Polish company, was defending arbitration claims brought by Vivendi in London and Geneva when, in 2007, it became insolvent. Syska, the liquidators, challenged the jurisdiction of the London and Geneva tribunals, arguing that under Polish law an arbitration clause loses its effect when a company enters insolvency, and consequently any pending arbitration must be discontinued.

### The EU Insolvency Regulation

The Council Regulation on Insolvency Proceedings ("the Regulation") has governed the law applicable to cross border insolvencies in the European Union since May 2002. It should provide answers to the questions raised above.

The Regulation provides:

"4.1 "save as otherwise provided in this Regulation, **the law applicable to insolvency proceedings** and their effects **shall be that of the Member State within the territory of which such proceedings are opened**, hereafter referred to as the 'State of the opening of proceedings'..."

"4.2 The law of the State of the opening proceedings shall determine the conditions for the opening of those proceedings, their conduct and their closure. It shall determine in particular..."

(e) the effects of insolvency proceedings on current contracts to which the debtor is party;

(f) the effects of insolvency proceedings on proceedings brought by individual creditors, with the exception of lawsuits pending..."

"15 **The effects of insolvency proceedings on a lawsuit pending** concerning an asset or right of which the debtor has been divested **shall be governed solely by the law of the Member State in which that lawsuit is pending...**"

[emphasis added]

So, under article 4.2(e) the effect of insolvency proceedings on contracts to which the debtor is party will be governed by the law of the jurisdiction in which insolvency proceedings have been instituted. But, under articles 4.2(f) and 15, the law of the jurisdiction in which a lawsuit is pending will govern the effect of insolvency on that lawsuit.

Was there a conflict between article 4.2(e), and articles 4.2(f) and 15? Christopher Clarke J, sitting in the Commercial Court, considered that there was, and gave priority to Article 15.

### A more straightforward decision?

Longmore LJ in the Court of Appeal, however, saw no conflict between article 4.2(e), and articles 4.2(f) and 15, reasoning that "*each article has its own sphere of operation and once it is clear that there is a "law suit pending" the question whether that lawsuit should continue or be discontinued by reason of the insolvency is to be determined "solely" by English law as "the law of the Member State in which that lawsuit is pending"*".

The parties accepted for the purposes of the appeal that an arbitration is a "law suit pending" within the meaning of articles 4.2(f) and 15. Longmore LJ therefore dismissed Syska's appeal against Clarke J's first instance decision to uphold the jurisdiction of the arbitral tribunal, although he pointed out that, to the extent that the concept of a conflict between article 4.2(e), and articles 4.2(f) and 15 was critical to Clarke J's Judgment, he considered that reasoning to have been wrong.

### A natural decision

Longmore LJ presents his decision as the natural one, flowing from the rationale between choices of law provided for by the Regulation. He reasoned that, until the validity of a claim is ascertained by way of a lawsuit, it has no relevance to insolvency proceedings at all. It is natural and understandable that it should be the law of that Member State where the legal action has begun or the reference to arbitration is taking place, which should determine whether that action or

that reference should be continued or discontinued. Likewise, he considered that it is "self-evidently" the law of the Member State in which the insolvency proceedings have been instituted which must determine matters such as the amount of the debtor's estate which is available to satisfy creditors and the priority of competing claims on that estate.

The Regulation does not form part of Swiss law, and, interestingly, the Swiss Courts upheld the decision of the Geneva arbitral tribunal to decline jurisdiction, on Syska's challenge.

### **Is the decision academic?**

You might be forgiven for asking what practical result, if any, this decision will have for the conduct of arbitrations. Surely in straightforward debt claims, the insolvency process will allow creditors to prove their debts in a more cost effective way than through litigation and arbitration. And why would a claimant wish to continue to pursue a debtor through litigation or arbitration once the debtor is declared insolvent and is unlikely to be able to pay any damages or costs?

Yet the decision is not only of academic interest. Where a party claims legal or beneficial ownership of an asset, or is seeking some form of non pecuniary relief, that party's objective will not be frustrated by the other party's insolvency so the party claiming will want the arbitration to continue. The same applies where a defendant to an arbitration has the benefit of an insurance policy, which will pay out in the event that the claim is successful.

There will also be cases where the liquidator of the insolvent company wishes to pursue proceedings on behalf of the creditors of a company. In difficult economic times the resolution of this jurisdictional/applicable law question in cross border insolvency is welcome.

[Asana Abu](#)

### **Are mediations always confidential?**

With the growing use of ADR and mediated settlements, the concept of 'mediation privilege' has again been considered by the courts. It came up in a dispute about whether or not a settlement agreement reached following a mediation was valid (*Farm Assist v DEFRA (No.2)* [2009] EWHC1102 TCC). Farm Assist argued that it was put under economic duress when the settlement agreement was signed and the mediator would have valuable evidence as to whether such duress had been exerted by DEFRA at the mediation. The mediator was approached to give a witness statement, refused, and was subsequently served with a witness summons. She applied to set the summons aside by relying on the terms of the mediation agreement, on the confidentiality of the discussions held and by telling the parties that she had no papers or useful recollection of the mediation.

The judge ruled that the summons should stand. The mediator could be compelled to give evidence of alleged economic duress by DEFRA before Farm Assist signed the compromise agreement. There was no 'mediation privilege' that prevented the mediation discussions being disclosed: mediation privilege was little more than normal 'without prejudice' privilege, but with the distinguishing factor that privilege is not waived by disclosure to the mediator. In this case, the parties had waived privilege in the settlement discussions, the privilege being the property of the parties and not the mediator. The mediator could uphold the contractual confidentiality of the mediation agreement but this confidentiality could be ordered or permitted by the court to be set aside, if it was in the interests of justice to do so. The mediator could not rely on drafting in the mediation agreement that excluded the parties' right to compel the mediator to give evidence relating to 'the dispute' because the current dispute between the parties related to the validity of the settlement agreement and not the original dispute.

### **Practical Guidance from the Civil Mediation Council (CMC)**

As a result of the decision in *Farm Assist*, the CMC have produced Guidance for practitioners and mediators on mediation confidentiality. The Guidance includes suggested drafting for mediation agreements to broaden the circumstances in which a mediator may not be compelled to give evidence. The problem in *Farm Assist* was that the mediation agreement confined the situations in which a mediator could be called as a witness to 'the dispute'. The parties wished to call the mediator to give evidence in a separate dispute, about the validity of the settlement agreement, which the mediation agreement did not address. The CMC have suggested that confidentiality provisions in mediation agreements should expressly extend to "any litigation, arbitration or other formal process arising from or in connection with the Dispute and the mediation." The Centre for Dispute Resolution (CEDR) Model Mediation Agreement now reflects this wording. The Guidance also suggests that mediators seek an indemnity from the parties for the time and cost involved if they are called by them to give evidence and/or be paid at their hourly rate when acting as a witness.

Further guidance has been given by CEDR to ensure that mediation agreements make it very clear that what is said or disclosed at a mediation is confidential, as opposed to privileged. "Without prejudice" privilege is a privilege of the parties and not the mediator and therefore may be jointly waived by the parties, without the mediator's consent. Contractual confidentiality is for the benefit of both the mediator and the parties and cannot be waived by the parties alone. Nevertheless, the court may still, exceptionally, override confidentiality provisions, as it can with privilege, if it is in the interests of justice.

## Privileged?

There has been a series of recent cases on privilege including *Oceanbulk Shipping & Trading SA v TMT Asia Limited and Others* [2009] EWHC 1946 (Comm) and *Ofulue v Bossert* [2008] EWCA Civ 7.

In *Oceanbulk*, the parties settled a dispute and then disagreed over the interpretation of a clause in the settlement agreement. As the pre-contractual negotiations were without prejudice, the court had to decide whether or not the content of these negotiations could be revealed to assist the court in deciding the context in which the clause should be interpreted. The court confirmed the existing principle: the rule that without prejudice discussions are not to be revealed to the court is not absolute. In this case, the evidence was admissible on the basis that it was in the interests of justice to assist with the interpretation of the contract.

In *Ofulue*, when the court again looked into the admissibility of without prejudice evidence, the decision was to reinforce the normal position that without prejudice communications cannot be referred to in open court until liability has been decided. Here the judges confirmed that public policy dictates that without prejudice discussions must be inadmissible, unless an exception applies.

## Comment

Given the uncertainty surrounding mediation confidentiality, some might see arbitration as a better method of dispute resolution, given its well established confidential nature. But look at the context in which these decisions have been made. A CEDR 2007 audit showed that 3,400-3,700 mediations took place in 2007, compared with 2,500-2,700 in 2005. The number of mediations is still growing, albeit at a slower rate than in recent years. There has also been unmonitored growth in the number of 'without prejudice' meetings held over the same period. The cases mentioned in this article may simply reflect the growing volume of mediations and without prejudice meetings that are taking place as parties and practitioners embrace ADR and settlement. Given that trend, the number of cases throwing up difficult issues on privilege is relatively low.

As the volume and sophistication of mediation increases, this run of cases, exploring the limits of privilege and confidentiality in mediations, is likely to continue.

[Louise Davison](#) and [Kate Menin](#)

## Brief summaries of key issues for those involved in disputes

### Funding Litigation

#### Notices of Funding

The procedures to be followed if parties want to recover funding costs from their opponents have been reviewed recently by the courts and the Rules Committee.

#### Appeals

It has been decided that no new Notice of Funding is required by a party defending an appeal. A Notice of Funding had been served at the required time in the proceedings before the Judge. The Senior Costs Judge was asked by the Court of Appeal for guidance when the costs claimed were challenged. He confirmed that there is no specific provision for separate notice to be given on an appeal when the funded party is defending and that it was almost standard practice for a CFA to cover first instance costs and any appeal brought against the funded party.

But when a new funding arrangement is signed in respect of an appeal a new Notice will have to be sent. *Beer v BexBes LLP*, Court of Appeal.

#### Details to be provided with Notices of Funding

The court Rules on the contents Notices of Funding (N251) have also changed. For After the Event Insurance policies entered into after 1 October 2009 parties must disclose more details to their opponents. Until now they have had to tell the other side about the fact of the policy, the insurer's name and address, the policy number, the date of the policy and the claims to which it relates. From 1 October, for new policies, as a precondition of recovering the premium from a losing opponent, parties must include on their N251 information about the level of cover, and, where premiums are staged, the points at which an increased premium is payable.

#### Disclosure of ATE policy

In *Barr and others v Biffa Waste Services Limited* [2009] EWHC (TCC), the court held that an after the event ("ATE") insurance policy was disclosable, under both CPR31.14 (which states that a part may inspect a document referred to

in a witness statement) and, more generally, pursuant to the court's case management powers.

In finding the policy to be disclosable, Coulson J noted that the policy had been referred to in witness statements, so unless it was irrelevant or privileged, it should be disclosed. He held that the sufficiency of ATE cover was relevant to the litigation, citing *Hobson v Ashdown Morton Black Solicitors and Others* [2006] EWHC 1134. It was in the defendant's interests to know what exposure it might have if it was successful and thus would seek to recover its costs from the claimants, not least because the successful recovery of its costs would probably depend upon the application of the ATE policy.

Coulson J distinguished between pre-existing liability insurance policies - in respect of which the usual position is that they are a private matter between the insurer and the insured - and ATE policies, which are specifically taken out to enable the claimant to bring the claim and thus may be relevant to the litigation.

He also held that the ATE policy was not covered by litigation privilege, although he noted that information relating to the level of premium would be privileged in so far as it could be said to reflect legal advice as to the prospects of success.

This suggests that a party with an ATE policy in place may have to consider whether it is disclosable as part of standard disclosure. If it is not disclosed, an opposing party may wish to consider applying for specific disclosure. Although in *Barr*, the policy had been referred to in witness statements, the judge said (obiter) that it would have been disclosable under its general case management powers. This suggests that the principle could be of wider application. That said, Coulson J did note that cases are fact sensitive and it is therefore difficult to draw hard and fast principles. Anyway it may be that more detailed mandatory disclosure of ATE details, as required following the 50th Update to the CPR from 1 October in Form N251, will be enough in most circumstances.

### **CFAs and interest on costs**

A party on a CFA can recover interest on costs from the date of judgment. The right to interest is not qualified by consideration of whether a party is itself obliged to pay interest or has been kept out of pocket. Interest is payable on a judgment debt as a whole and the success fee forms part of the costs judgment. *Hanley v Smith*, SCCO, 17 June 2009.

### **Third party funding**

This is a growth area. Third party funding is usually treated as an alternative to using a conditional fee agreement, although the two can be combined, Whilst policy makers have encouraged the emergence of funding for legal disputes, it has not been clear which of the existing regulators, if any, should take responsibility for regulating them. So funders have themselves drafted a voluntary Code of Conduct which they have submitted in response to Lord Justice Jackson's review of civil litigation costs. The draft Code aims to set minimum standards for litigation funding agreements, to promote public awareness and understanding of third party funding and to foster competition between funders. It explains how third party funding works (finance in exchange for a share of damages if the claimant wins), what parties can expect from funders and vice versa. draft Code of Conduct - Third Party Litigation Funders Association - Annex D to Civil Justice Council response to Jackson Costs Review.

[Kate Menin](#) and [Abi Healey](#)

### **The continuing Lehman Brothers administration**

Last Winter's issue of *Resolve* reported on two claims arising out of the collapse of Lehman Brothers. A further application, this time brought by the administrators themselves, was heard by the Court of Appeal on 6 November 2009. Once again, the court's decision does nothing to simplify this long-running administration.

### **Re Lehman Brothers International (Europe) Ltd (in administration) (No 2)**

Prior to its administration, some of the business engaged in by Lehman Brothers International (Europe) Ltd (**LBIE**) meant that it found itself holding assets on trust for its clients (eg assets placed in safe custody). The administrators of LBIE wanted to make a distribution of assets but, since LBIE's own books and records could not be relied on to determine who was entitled to them, there was a risk that LBIE and/or its administrators would be exposing themselves to claims for breach of trust if they made a distribution at that stage.

In March 2009 the High Court granted the administrators permission to prepare a scheme of arrangement. The administrators prepared an outline scheme to be entered into with the beneficial owners of LBIE's trust property. The principal objective would be to compromise all claims of all LBIE's trust clients, and allow the release of billions of dollars' worth of security effectively trapped in LBIE.

In normal circumstances, a scheme of arrangement allows a company to settle its own property amongst creditors. However, in the case of LBIE the property in question was held on trust for third parties.

## Terminology

**Administration** is a procedure under Schedule B1 of the Insolvency Act 1986, under which a company may be reorganised or its assets realised, whilst under the protection of a statutory moratorium.

**A scheme of arrangement** is a compromise or other arrangement between a company and its creditors (or any defined class or classes of its creditors). It is provided for in Part 26 of the Companies Act 2006 (**the Act**), which came into effect on 1 October 2009. Section 899 of the Act provides that the court may sanction a scheme if it has been agreed by at least 75% in value of a company's creditors or class of creditors.

### The application to the High Court for approval of the scheme

The outline scheme attracted the support of LBIE's creditors and the FSA, not to mention LBIE itself. However, s.899 of the Act required the Court to sanction the outline scheme before it could be implemented. Opponents of the scheme (such as the London Investment Banking Association) maintained that it went beyond the scope of the Act.

The High Court considered the administrators' application, and ultimately agreed with their opponents. Blackburne J held that a creditor (for the purposes of the Act) is a person who has a *pecuniary* claim. Since the scheme of arrangement being proposed in this case involved the compromise of *proprietary* claims, it was not a scheme between LBIE and its creditors and the court did not therefore have jurisdiction to sanction it pursuant to the Act.

### The Court of Appeal

The administrators appealed Blackburne J's decision. At a hearing on 6 November 2009 before Lord Neuberger (MR), and Longmore and Patten LJ, Blackburne J's decision was upheld and the appeal dismissed.

The Court of Appeal's decision centred on the meaning of "creditor" for the purpose of the Act. As it is not defined in the Act itself, the court considered that parliament must have intended that the word be used in its literal sense. A person is a creditor of a company only in respect of debts (or similar liabilities) owed to him by the company. A proprietary claim to trust property does not constitute a claim relating to such a debt or liability. The court therefore held that parliament could not have intended that creditors could be compelled to give up not only contractual rights, but also their entitlement to their own property being held by the company on their behalf. The scheme of arrangement being proposed in this case was not a scheme with creditors for the purpose of the Act, and could not be sanctioned.

### What next?

It is not clear at the time of writing whether the administrators will appeal to the House of Lords, rather than abandoning their proposed scheme and making piecemeal applications to the court to permit distributions to parties who can substantiate a proprietary claim. However, litigation sparked by the fall of Lehman Brothers is likely to continue. And this is not the only complex administration in progress at the moment. This decision may not be the last word on what a scheme of arrangement can achieve.

[Rachel Stalker](#)

© 2009 Addleshaw Goddard LLP, all rights reserved