

The importance of full and frank disclosure in seeking assistance under the CBIRs: a look at *Re Dalnyaya Step LLC (In Liquidation)* [2017] EWHC 3153 (Ch)

KEY POINTS

- This matter concerned a company in liquidation in Russia and a challenge made against the recognition of those proceedings in Great Britain under the Cross-Border Insolvency Regulations 2006 ('the CBIR').
- The company's liquidator (and 'foreign representative' for the purposes of the CBIR) had failed to make full and frank disclosure to the court on his application for recognition, and accordingly the court set aside the order *ab initio*.
- Readers interested in the Magnitsky Act or following recent events in Salisbury and ensuing tensions between UK and Russian governments may find this article of particular interest.

The matter of *Re Dalnyaya Step LLC (In Liquidation)* [2017] EWHC 3153 (Ch), heard before the Chancellor of the High Court, Sir Geoffrey Vos, concerned a recognition order ('the Recognition Order') obtained in Great Britain under the CBIR by Mr Nogotkov, the liquidator and the 'foreign representative' of Dalnyaya Step LLC ('the Company'), a Russian company. The Recognition Order was subsequently challenged by various former officers of the Company and its affiliates ('the Hermitage Parties'), on the basis that the liquidator ought to have disclosed to the court various matters of relevance and importance when making his application.

Readers will recall the article by this firm in (2018) 1 CRI 6 summarising the outcome in *Re Agrokor DD and in the matter of the Cross-Border Insolvency Regulations 2006* [2017] All ER (D) 83 (Nov), another contested case concerning the CBIR. The circumstances in this case were different, in that Mr Nogotkov had applied for the Recognition Order on an *ex-parte* basis. In *Agrokor DD* the parties had agreed a temporary standstill and argued their respective cases for/against a recognition order at the application stage. As with *Agrokor DD* this case serves as a useful reminder of some of

the provisions of the CBIR and the issues that the English court must consider in determining whether to grant recognition (including public policy issues). It also underlines the need to make full and frank disclosure, and is a cautionary tale for persons contemplating making applications on an *ex parte* basis.

CBIR

The CBIR were introduced in Great Britain (that is, England, Scotland and Wales) under the Insolvency Act 2000. This enacted (with some modifications) the model law on cross border insolvency ('the Model Law') drafted by the 30th session of the United Nations Commission on International Trade Law, known as UNCITRAL. The Model Law was devised to resolve issues arising in cross-border insolvencies. Unlike other cross-border insolvency legislation, the Model Law (in unmodified form) does not require reciprocity from the requesting state in order for the enacting state to be obliged to recognise the relevant foreign insolvency procedure. Some states (but not Great Britain) have chosen to enact the Model Law including a reciprocity requirement. Russia has not adopted the Model Law.

Upon the granting of a recognition order

of main proceedings under the CBIR, an automatic stay is imposed in respect of the debtor (Art 20 of Sch 1 to the CBIR), and the foreign representative is entitled to request relief, including the examination of witnesses, the taking of evidence or the delivery of information concerning the debtor's affairs, rights, obligations or liabilities (Art 21(1)(d) of Sch 1 to the CBIR). In *Re Bernard L Madoff Investment Securities LLC (Irving H Picard v FIM Advisers LLP & Ors)* [2010] EWHC 1299 (Ch) ('*Re BLMIS*') the court confirmed that in considering an application made under Art 21(1)(d) of Sch 1 to the CBIR, it should have regard to the principles on which the court would normally exercise its powers under s 236 of the Insolvency Act 1986 ('IA 1986').

Subject to Art 6 of Sch 1 to the CBIR, if the court is satisfied that:

- the proceeding is a foreign proceeding (as defined in Art 2(i) of Sch 1 to the CBIR);
- the application is made by a foreign representative (as defined in Art 2(j) of Sch 1 to the CBIR); and
- certain evidential and procedural requirements are satisfied;

the court is bound to recognise the foreign proceeding (Art 17(1) of Sch 1, CBIR). Article 6 of Sch 1 to the CBIR provides that:

'Nothing in this Law prevents the court from refusing to take an action governed by this Law if the action would be manifestly contrary to the public policy of Great Britain or any part of it.'

The guide to the enactment of the Model

Feature

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Law says that:

'Article 6 allows recognition to be refused when it would be "manifestly contrary to the public policy" of the State in which recognition is sought. This may be a preliminary question to be considered on an application for recognition. No definition of what constitutes public policy is attempted as notions vary from State to State. However, the intention is that the exception be interpreted restrictively and that article 6 be used only in exceptional and limited circumstances (see paras 101-104). Differences in insolvency schemes do not themselves justify a finding that enforcing one State's laws would violate the public policy of another State.'

BACKGROUND

The Hermitage Fund ('Hermitage') was a Guernsey unit trust investing in Russian capital markets. Its manager was HSBC Management (Guernsey) Ltd ('HSBC Guernsey'). Mr William Browder was the founder and CEO of Hermitage Capital Management, which advised HSBC Guernsey. Mr Paul Wrench was the managing director of HSBC Guernsey. Mr Ivan Cherkasov was a member of Hermitage Capital LLP. Messrs Browder, Wrench and Cherkasov are referred to herein as the Hermitage Parties. Hermitage received legal advice from Mr Sergei Magnitsky.

Hermitage's strategy was to acquire shares in large, state-owned or partially state-owned Russian companies (including the Company), and then to expose corruption or mismanagement in those companies by shareholder activism. Typically, that would lead to an increase in the value of the shares in those companies. The Hermitage Parties believed that the Russian state resented these activities, and pursued a malicious campaign against them.

In 2004, the Federal Tax Service of Russia (the FTSR) began an investigation into the Company's affairs. Mr Nogotkov subsequently argued that there was *prima facie* evidence that the Company had been aggressively asset-stripped between 2004

and 2005, primarily at the direction of Mr Cherkasov. In November 2005, Mr Browder was expelled from Russia. In August 2006, the Company entered liquidation in Russia, and in October 2007, the Company was dissolved. In June 2007 Hermitage's offices in Moscow were raided by the Russian Ministry of Internal Affairs ('the MoIA'), and various materials were seized. In late 2007, the Hermitage Parties claimed that Hermitage had been the victim of a USD230m tax fraud, orchestrated by the FTSR and the MoIA.

In November 2008, Mr Magnitsky, who had been engaged by Hermitage to investigate the alleged fraud, was arrested and imprisoned. He was held for 11 months without trial, and developed gallstones, pancreatitis and calculous cholecystitis, for which he was given inadequate medical treatment. He died in prison. His death caused international outrage, and led to the introduction of the Magnitsky Act in the US and the Criminal Finances Act 2017 in the UK, permitting (among other things) the recovery of property that is obtained as a result of conduct which constitutes gross human rights abuses or violations. Similar legislation has been passed in Estonia, Lithuania, Latvia and Canada.

Between 2010 and 2013, Russian authorities made at least 12 requests to the UK for mutual legal assistance in relation to criminal proceedings in Russia against Messrs Browder and Magnitsky. All requests were rejected. The response in several of them read 'the UK is unable to provide any of the assistance requested as the Secretary of State is of the opinion that to do so is likely to prejudice the sovereignty, security, order public, or other essential interests of the UK.'

In March 2013, an email from Mr Andrey Pavlov, a Russian lawyer said to have been instrumental in the alleged fraud, to Mr Nogotkov's solicitors asked whether, if the Company was restored to the register, that would enable a receiver to sue Mr Browder and Mr Cherkasov in London.

In July 2013, the Russian criminal court convicted Mr Browder (in absentia) and Mr Magnitsky (posthumously) of tax evasion. Mr Browder was sentenced to nine years' imprisonment (recently increased to 18 years).

Amnesty International described the verdict as 'the height of absurdity'. In December 2017, Mr Cherkasov (in absentia) was sentenced to eight years' imprisonment.

In August 2015, the Company was restored to the Russian register of companies, and its liquidation reinstated. Mr Nogotkov was made aware of the proceedings against Messrs Browder and Cherkasov, and copied papers relating to those proceedings. The papers included at least two of the requests for information made to the UK Home Office.

RECOGNITION ORDER

In May 2016, Mr Nogotkov applied for the Recognition Order. In his supporting affidavit, he said that he was 'not aware of anything having occurred in relation to [the Company] between the termination of the liquidation proceedings and the events described below'. He also mentioned his intention to apply under s 236 of IA 1986 against former officers of the Company, but did not name them. At the hearing of the application Mr Nogotkov's counsel said 'there are no public policy considerations arising'.

The Recognition Order was granted, and Mr Nogotkov's solicitors swiftly wrote to the Hermitage Parties requesting various documents and information. The Hermitage Parties' lawyers responded, saying that the request was part of a broader fraud perpetuated against the Company and other companies in its group.

In August 2016, Mr Nogotkov filed a further witness statement: 'I did not inform the court of the alleged fraud (or the death of Mr Magnitsky) as part of the Recognition Application because I did not believe that those allegations (whether they are correct as a matter of fact) had any connection to the Company or its liquidation at all.' The court, having seen this witness statement, ordered that the Recognition Order should stand.

In September 2016, Mr Nogotkov issued a s 236 application against the Hermitage Parties. In October 2016, the Hermitage Parties made applications to set aside the Recognition Order, and for security for costs in respect of the s 236 proceedings.

Subsequently the Hermitage Parties were

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awarded security for costs, and Mr Nogotkov obtained a judgment in Russia against HSBC for causing the Company's insolvency by transferring monies out of the Company's accounts in breach of Russian banking regulations. Mr Nogotkov, having obtained the HSBC judgment, quickly applied to terminate the Recognition Order, and to settle the Hermitage Parties' costs (at a discount). The Hermitage Parties declined his offer, saying that it was important that the Recognition Order was set aside *ab initio*, and that they recover their costs on an indemnity basis. Mr Nogotkov improved his offer (offering costs on an indemnity basis), but without success.

In November 2017, the Hermitage Parties' lawyers wrote to Mr Nogotkov's lawyers saying: '... we do not agree that it is acceptable for this matter to be resolved simply by way of a consent order, with no judicial consideration of Mr Nogotkov's conduct.' The Hermitage Parties said that Mr Nogotkov should have disclosed the following when applying for the Recognition Order:

- the existence of the issues relevant to the public policy exception under Art 6 of Sch 1 to the CBIR;
- the involvement in the liquidation of the Company, and in these proceedings, of Mr Pavlov;
- the identify of the Hermitage Parties, and the fact that he intended to make a s 236 application against them; and
- the existence and nature of the criminal proceedings against Mr Browder and Mr Cherkasov.

OGX PETROLEO E GAS SA

Snowden J's judgment in *Re OGX Petróleo e Gas SA* [2016] EWHC 25 CH (reported as a practice note) most recently gave guidance relating to without notice applications for recognition under the CBIR, and was applied in this case.

On OGX's without notice application, a recognition order had been granted in respect of a reorganisation plan under Brazilian law, which had the effect of staying certain arbitration proceedings brought in London by Nordic Trustee ASA and OSX 3 Leasing BV ('Nordic and Leasing'). Nordic and Leasing applied for the order to be set aside on

grounds including material non-disclosure. The parties had agreed a draft consent order under which the automatic stay was to be lifted to permit the arbitration to continue and OGX was to pay Nordic and Leasing's costs. Notwithstanding this agreement, Snowden J gave judgment on the material non-disclosure issue. He said that:

'54. ... the only purpose for which recognition of the Plan was sought... was in order to obtain a stay...

60. I have no doubt that, if he had been properly informed, Mann J would at very least have modified the automatic stay from the outset to permit the arbitration to proceed. Further, and notwithstanding the clear intention that the public policy exception in article 6 should be interpreted restrictively, I consider that it is strongly arguable that the court must have a residual discretion to refuse recognition if satisfied that the applicant is abusing that process for an illegitimate purpose...

64. For the future, however, I think that it must be made clear that foreign representatives and their advisers must ensure that the valuable process for recognition under the Model Law and the CBIR is not misused. When seeking recognition, full and frank disclosure must be made to the court in relation to the consequences that recognition of the foreign proceeding may have on third parties who are not before the court. In particular, the court should be told of any points that could be raised in relation to the modification or termination of the automatic stay and suspension which will come into effect on recognition.'

JUDGMENT

The court held that Mr Nogotkov had been in clear breach of his duty of full and frank disclosure when he applied for and was granted the Recognition Order. Sir Geoffrey Vos stated, in relation to third parties, that not only the specific consequences of the recognition order itself must be disclosed

but also 'the consequences for third parties that are not before the Court that may flow from the recognition of the foreign proceeding, including from intended future applications enabled by the recognition order'. He also said that 'Mr Nogotkov knew that the actions he was taking were highly charged politically', which 'was enough to make it incumbent upon him to tell the English court that political issues involving the Russian State might arise'.

The Recognition Order was therefore declared void *ab initio*, and Mr Nogotkov's termination application dismissed. Sir Geoffrey Vos summarised: 'The setting aside of the Recognition Order would have been an entirely appropriate reaction to Mr Nogotkov's failure to inform the court of the highly political nature of the case that he intended to pursue against the Hermitage Parties, and of the UK public policy issues that it was likely to raise (of which he was or ought to have been aware).'

COMMENT

The breach of duty was, in the authors' opinion, particularly egregious, and the result therefore comes as no surprise. Sir Geoffrey Vos, speculating on whether Mr Nogotkov's failure was innocent, noted that he had 'serious doubt[s] about the mistake being a genuine one'. This matter underlines the importance of making full and frank disclosure in these (and any other) applications, particularly where they are made on an *ex parte* basis. ■

Further reading

- *Re Agrokor DD*: an extraordinary foreign proceeding, but not too extraordinary for recognition under the Cross-Border Insolvency Regulations 2006 (2018) 1 CRI 6
- RANDI Blog, 11 February 2016: Abuse of process and recognition under the UNCITRAL Model Law on Insolvency – *Re OGX Petróleo e Gás SA Nordic Trustee A.S.A*
- LexisPSL Restructuring and Insolvency: Practice notes: Recognition and other applications under the Cross-Border Insolvency Regulations