CHAPTER 2

THE COMPANY IN FINANCIAL TROUBLE

2-001 When a company falls into financial difficulties, control of the company and its undertaking may pass from the board of directors to an administrator or a liquidator and indeed successively from one to the other. During the period of an administration, control may be shared between the administrator and the board of directors, though in this case the board will have a limited role and be very much the junior partner. (Similar questions can arise in connection with receivership but, following the qualified prohibition of administrative receivership,[1] those tensions will now only rarely be encountered in practice.) In view of the overlapping functions and responsibilities of the board of directors, administrators and liquidators, an overview of their respective roles and legal duties in the context of insolvency is called for (in particular, as regards the continuation of the company's business).

1. THE RESPONSIBILITIES OF MANAGEMENT AT A TIME OF FINANCIAL DIFFICULTY

2-002 Directors confronting solvency issues still have all the general duties of directors specified in ss.170–177 of the Companies Act 2006,[2] but their duty to promote the success of the company is expressed to be subject to any enactment or rule of law requiring directors to consider or act in the interests of creditors.[3] Directors do not have a duty to ensure that the company does not trade at a loss (in the sense of a duty which is enforceable as such and without more),[4] but continuing to trade without due consideration for the consequences involves the risk of challenge, if the company does not survive, on the grounds of fraudulent or wrongful trading or in disqualification proceedings brought by the Secretary of State. In considering all

1 Insolvency Act 1986 s.72A.

2 The duty of a director under s.172(1) to act in good faith in the interests of the company is a duty to act in what the director believes, not what the court believes, to be the interests of the company. The test is a subjective one. See: *Re Smith & Fawcett* [1942] Ch. 304, 306 (CA); *Madoff Securities International Ltd (In Liquidation) v Raven* [2014] Lloyd's Rep. F.C. 95 at [190]; and *Re HLC Environmental Products Ltd* [2014] B.C.C. 337 at [91] and [92]. As to shadow directors, see *Vivendi SA v Richards* [2013] B.C.C. 771.

3 Companies Act 2006 s.172(3).

4 *Secretary of State for Trade and Industry v Taylor* [1997] 1 W.L.R. 407, 414. (Note also *E-Clear (UK) Plc (In Liquidation) v Elia* [2013] 2 B.C.L.C. 455 (CA), per Patten LJ at [30]: "an excess of liabilities over assets is not a bar to a company continuing to trade provided that it can meet its liabilities as they fall due".) For public companies, consider also Companies Act 2006 s.656 (duty of directors to call meeting on serious loss of capital) and also the FCA Listing Rules and Disclosure Guidance and Transparency Rules sourcebook, Regulation (EU) No.596/2014 of the European Parliament and of the Council of 16 April 2014 on market abuse. See also the Financial Services Act 2012 Pt 7 (offences relating to financial services).

these questions it is important to remember that any insolvency proceedings will relate to a specific company rather than a group. Directors who hold multiple directorships within a group must be astute both to recognise and address conflicts which may exist between different companies in the group and to make sure that their actions in respect of each company are justified by reference to the circumstances of each company. The conflicts of interest between a parent company and one or more of its insolvent subsidiaries may be particularly acute.

(a) Duties of directors to the company

2-003 In general, a company owes no duty of care in the conduct of its business to present or future creditors, and its directors likewise owe no duties to the present or future creditors of their company.[5] But if the company is insolvent, the directors owe a duty to the company to take care to protect the interests of its creditors.[6] The duty is that of each director; a director cannot avoid responsibility by leaving management to others.[7] This duty will be enforceable in the name of the company by a liquidator or administrator. The time at which the directors' duties require them to have primary regard to the interests of creditors rather than the interests of shareholders is difficult to define with any precision.[8] It may be that as a company's financial situation worsens, the directors will be under a duty to pay greater attention to the interests of its creditors, and that duty will be reinforced if a potential transaction or proposed course of action carries a high level of risk and therefore of potential prejudice to creditors if it goes wrong[9] (particularly since, in performing their duty to promote the success of the company, they are required by statute

5 per Dillon LJ in *Multinational Gas and Petrochemical Co v Multinational Gas and Petrochemical Services Ltd* [1983] Ch. 258 (CA).

6 See per Dillon LJ in *Liquidator of West Mercia Safetywear v Dodd* (1988) 4 B.C.C. 30 (CA), referring with approval to *Kinsela v Russell Kinsela Pty Ltd (In Liquidation)*(1986) 4 N.S.W.L.R. 722 (New South Wales Court of Appeal); *New South Wales and Yukong Line Ltd of Korea v Rendsburg Investments Corp of Liberia* [1998] 1 W.L.R. 294, 312. See also *Colin Gwyer & Associates Ltd v London Wharf (Limehouse) Ltd* [2003] B.C.C. 885; *Nicholson v Permakraft (NZ) Ltd* [1985] 1 N.Z.L.R. 242 (New Zealand Court of Appeal); and the obiter dicta in *Spies v The Queen* (2000) 201 C.L.R. 603 (High Court of Australia). It is suggested that the obiter dictum of Lord Templeman in *Winkworth v Edward Baron Development Co Ltd* [1986] 1 W.L.R. 1512 (HL), 1516, which suggests that the duty is owed to creditors as well as to the company, does not accurately represent English law. A director who acts in the interests of the general body of creditors, but inconsistently with the interests of a particular creditor, is not in breach of his fiduciary duty: see *Re Pantone 485 Ltd* [2002] 1 B.C.L.C. 266, 272. Conversely, it is a breach of duty to advance the interests of a particular creditor without believing that to be in the interests of the creditors as a whole: see *GHLM Trading Ltd v Maroo* [2012] 2 B.C.L.C. 369 at [168]. The rule against recovery of reflective loss applies to claims for breach of fiduciary duty and may apply to claims brought by creditors: see the obiter dictum of Neuberger LJ in *Gardner v Parker* [2005] B.C.C. 46 (CA), 77. Neuberger LJ's dictum should now be considered in the light of *International Leisure Ltd v First National Trustee Co UK Ltd* [2013] Ch. 346, where it was held that the rule against reflective loss did not prevent the appointor of an administrative receiver from bringing an action against the receiver for negligence. It is suggested that such claims were correctly distinguished on the ground that a receiver's primary duty is to his appointor and there is no correlative duty of directors to the general creditors as opposed to the company.

7 *F Options Ltd v Saunders* [2012] B.P.I.R. 113 at [10].

8 In *Facia Footwear Ltd v Hinchcliffe* [1998] 1 B.C.L.C. 218, 228, Sir Richard Scott VC held that the directors of a company which had been "in a very dangerous financial position" had been required to take account of the interests of creditors. See also, e.g. *Roberts v Frohlich* [2012] B.C.C. 407; *Re HLC Environmental Projects Ltd* [2014] B.C.C. 337; and *BTI 2014 LLC v Sequana SA* [2017] Bus. L.R. 82 at [464]–[478].

9 See per Street CJ in *Kinsela v Russell Kinsela Pty Ltd (In Liquidation)* (1986) 4 N.S.W.L.R. 722

to have regard to the likely long term consequences of their decisions[10]). Once it is the interests of creditors which are at stake, a ratifying resolution by shareholders will not protect the directors from the consequences of a breach of their fiduciary duty.[11]

(b) Fraudulent trading

2-004 If in the course of the administration or winding-up of a company it appears that any business of the company has been carried on with intent to defraud creditors[12] of the company or creditors of any other person, or for any fraudulent purpose,[13] the court may on the application of the administrator or liquidator of the company (as the case may be, and, in either case in the alternative on the application of their assignee) declare that any persons who were knowingly parties to the carrying on of the business in such manner are to be liable to make such contribution (if any) to the company's assets as the court thinks proper.[14]

2-005 For the purpose of this section, the authorities establish the following propositions:

(a) for a person to be held liable for fraudulent trading, it must be established that he was personally dishonest, and the more improbable such personal dishonesty, the more compelling must be the evidence needed to satisfy the court on the balance of probability.[15] Dishonesty is an essential element. It is accordingly necessary to show that there was either an intent to defraud or a reckless indifference whether or not the creditors were defrauded[16];

(b) the carrying out of one transaction alone may be sufficient, for example, the acceptance of a deposit or the purchase price for goods in advance knowing that the goods cannot be supplied and the deposit or price will not be repaid[17];

(c) the defrauding of an individual creditor may be sufficient, but the section

(New South Wales Court of Appeal). The opposite approach was taken in *BTI 2014 LLC v Sequana SA* [2017] Bus. L.R. 82 where it was agreed that the content of the duty did not vary according to the severity of the risk (see at [462]).

10 Companies Act 2006 s.172(1)(a).

11 *Liquidator of West Mercia Safetywear v Dodd* (1988) 4 B.C.C. 30 (CA).

12 The term "creditor" denotes one to whom money is owed, whether or not the debt is presently recoverable; in the context of the section the term includes both existing contingents and future creditors: see *R. v Smith* [1996] 2 B.C.L.C. 109 (CA), 122; and see *Cannane v J. Cannane Pty Ltd (In Liquidation)* (1998) 192 C.L.R. 557 (High Court of Australia), 566. There is no territorial limitation: see *Bilta (UK) Ltd v Nazir* [2015] A.C. 1 (SC).

13 For the distinction between these two limbs, at least for the purposes of criminal liability pursuant to Companies Act 2006 s.993, see *R. v Hollier* [2013] EWCA Crim 2041 (CA).

14 Insolvency Act 1986 ss.213, 246ZA and 246ZD. An assignment may include the right to the proceeds of an action. The contribution is of a compensatory nature and ought not to include a punitive element: see the obiter dictum of Chadwick LJ in *Morphitis v Bernasconi* [2003] Ch. 552 (CA), 579; *Re Overnight Ltd (No.2)* [2010] B.C.C. 796; and *Re Overnight Ltd (No.3) Ltd* [2010] B.C.C. 808. This section and s.214 (below) may be applicable to foreign companies operating in the UK: consider *Re A Company* [1988] Ch. 210. See also *Stocznia Gdanska v Latreefers Inc* [2001] B.C.C. 174 (CA). For potential criminal liability, see Companies Act 2006 s.993.

15 *Aktieselskabet Dansk Skibsfinansiering v Brothers* [2001] 2 B.C.L.C. 324 (Court of Final Appeal of Hong Kong), per Lord Hoffmann; *Re H (Minors)* [1996] A.C. 563 (HL), 586–587, per Lord Nicholls.

16 *Hardie v Hanson* (1960) 105 C.L.R. 451 (High Court of Australia); and see also *Cannane v J. Cannane Pty Ltd (In Liquidation)* (1998) 192 C.L.R. 557 (High Court of Australia), 565–567. See also *Bernasconi v Nicholas Bennett & Co* [2000] B.C.C. 921.

17 *Re Gerald Cooper Chemicals Ltd* [1978] Ch. 262, 268 F–G, per Templeman J: "[A] man who warms

is not engaged in every case where an individual creditor has been defrauded. It must be shown that the business of the company has been carried on with intent to defraud[18];

(d) the mere giving or receipt of a preference over other creditors will not necessarily constitute fraudulent trading[19];

(e) to be a "party" to the impugned trading, there must be shown: (i) to have been fraud on the part of the company in the conduct of its business[20]; and (ii) that the individual concerned took some active step to promote such business on the part of the company. It is not sufficient that he failed to warn or advise against it or indeed failed to prevent it[21];

(f) it is not necessary that the individual should have had any power of management or control over or have assisted in the carrying on of the company's business. It is sufficient that he has knowingly[22] taken advantage of such trading, for example by accepting repayment of his debts from monies he knew to have been obtained by the company carrying on business in this way for the purpose of making the repayment[23];

(g) a company may be held liable for fraudulent trading, and an employee's knowledge of fraud may be attributed to his employer notwithstanding that the employee acts dishonestly, in breach of duty and in circumstances where he would not have passed on his knowledge to his employer[24]; and

(h) there is a sufficient intent to defraud if credit is obtained at a time when the person knows that there is no good reason for thinking that funds will become available to pay the debt when it becomes due or shortly thereafter. It is unnecessary to establish knowledge that funds will never become available.[25]

2-006 The leading case on dishonesty in a commercial setting is *Royal Brunei Airlines Sdn Bhd v Tan*[26] in which Lord Nicholls stated:

"Honesty has a connotation of subjectivity, as distinct from the objectivity of negligence. Honesty, indeed, does have a strong subjective element in that it is a description of a type of conduct assessed in the light of what a person actually knew at the time, as distinct from

himself with the fire of fraud cannot complain if he is singed". See further *R. v Lockwood* (1986) 2 B.C.C. 99333 (CA). Query whether the provision requires the party to have been an accessory before, and not merely after, the fact, and therefore to have given some encouragement to the trading in question before it takes place.

18 *Morphitis v Bernasconi* [2003] Ch. 552 (CA).

19 *Re Sarflax Ltd* [1979] Ch. 592; *R. v Grantham* [1984] Q.B. 675 (CA). The giving of a preference might, however, lead to disqualification proceedings.

20 *Re Augustus Barnett & Son Ltd* (1986) 2 B.C.C. 98904.

21 *Re Maidstone Building Provisions Ltd* [1971] 1 W.L.R. 1085.

22 As to the meaning of "knowledge" in this context see *Morris v Bank of India* [2004] B.C.C. 404, [113]–[121]; affirmed in [2005] B.C.C. 739 (CA), 752.

23 *Re Gerald Cooper Chemicals Ltd* [1978] Ch. 262.

24 *Bank of India v Morris* [2005] B.C.C. 739 (CA).

25 *R. v Grantham* [1984] Q.B. 675 (CA). "A company incurs a debt when by its choice it does or omits to do something which, as a matter of substance and commercial reality, renders it liable for a debt for which it otherwise would not have been liable": *Standard Chartered Bank of Australia Ltd v Antico (No. 1)* (1995) 18 A.C.S.R. 1 (Supreme Court of New South Wales), 57. In this respect, the fraud of the company is the same as that of any customer for goods or services who obtains credit on the basis of an express or implied representation that he can and will pay in due course: see *DPP v Ray* [1974] A.C. 370 (HL).

26 *Royal Brunei Airlines Sdn Bhd v Tan* [1995] 2 A.C. 378 (PC), 389–391.

what a reasonable person would have known or appreciated. Further, honesty and its counterpart dishonesty are mostly concerned with advertent conduct, not inadvertent conduct. Carelessness is not dishonesty. Thus for the most part dishonesty is to be equated with conscious impropriety. However, these subjective characteristics of honesty do not mean that individuals are free to set their own standards of honesty in particular circumstances. The standard of what constitutes honest conduct is not subjective. Honesty is not an optional scale with higher or lower values according to the moral standards of each individual. If a person knowingly appropriates another's property, he will not escape a finding of dishonesty simply because he sees nothing wrong in such behaviour ...

... [it must be kept in mind] that honesty is an objective standard. The individual is expected to attain the standard which would be observed by an honest person placed in those circumstances. It is impossible to be more specific. Knox J. captured the flavour of this, in a case with a commercial setting, when he referred to a person who is 'guilty of commercially unacceptable conduct in the particular context involved': see *Cowan de Groot Properties v Eagle Trust Plc*.[27] Acting in reckless disregard of others' rights or possible rights can be a tell-tale sign of dishonesty. An honest person would have regard to the circumstances known to him, including the nature and importance of the proposed transaction, the nature and importance of his role, the ordinary course of business, the degree of doubt, the practicality of the trustee or the third party proceeding otherwise and the seriousness of the adverse consequences to the beneficiaries. The circumstances will dictate which one or more of the possible courses should be taken by an honest person ...

... Likewise, when called upon to decide whether a person was acting honestly, a court will look at all the circumstances known to the third party at the time. The court will also have regard to personal attributes of the third party, such as his experience and intelligence, and the reason why he acted as he did."

2-007 The extent to which dishonesty is a subjective or an objective concept has been the subject of some debate.[28] For a time, it was thought that a greater degree of subjectivity had been introduced into the concept of dishonesty by *Twinsectra Ltd v Yardley*.[29] One, widely-held, interpretation of the case was that in order to characterise a defendant as dishonest, he must have engaged in behaviour which was dishonest by objective standards, and he must have subjectively realised that his conduct was dishonest by those standards (or at least have been reckless as to the fact).[30] Lord Hoffmann, however, put a different interpretation on *Twinsectra* when giving the advice of the Privy Council in *Barlow Clowes International Ltd (in liquidation) v Eurotrust International Ltd*[31]:

"The judge stated that the law in terms largely derived from the advice of the Board given by Lord Nicholls of Birkenhead in *Royal Brunei Airlines Sdn. Bhd. v Tan* [1995] 2 A.C.

27 *Cowan de Groot Properties v Eagle Trust Plc* [1992] 4 All E.R. 700, 761.

28 In *Grupo Torras SA v Al-Sabah* [1999] C.L.C. 1469, a case, inter alia, about dishonest assistance, Mance LJ regarded dishonesty as essentially objective, yet he acknowledged that the test of dishonesty in *Tan* allowed some subjective considerations to be taken into account: "Ingredient (iii) [dishonesty] was considered in *Royal Brunei Airlines Sdn. Bhd. v Tan*, where Lord Nicholls gave the advice of the Privy Council. The case establishes that dishonesty in the context of a knowing assistance claim is an objective standard: see at 389B–G. The individual is expected to attain the standard which would be observed by an honest person placed in the circumstances he was: at 390F. But those circumstances include subjective considerations like the defendant's experience and intelligence and what he actually knew at the time: at 389D and 391B".

29 *Twinsectra Ltd v Yardley* [2002] 2 A.C. 164 (HL).

30 See the speeches of Lord Hoffmann and Lord Hutton in *Twinsectra* [2002] 2 A.C. 164 (HL), [20] and [35]–[36] respectively.

31 *Barlow Clowes International Ltd (in liquidation) v Eurotrust International Ltd* [2006] 1 W.L.R. 1476 (PC), [10], [15]–[16].

378. In summary, she said that the liability for dishonest assistance requires a dishonest state of mind on the part of the person who assists in the breach of trust. Such a state of mind may consist in knowledge that the transaction is one in which he cannot honestly participate (for example, a misappropriation of other people's money), or it may consist in suspicion combined with a conscious decision not to make inquiries which might result in knowledge: see *Manifest Shipping Co Ltd v Uni-Polaris Insurance Co Ltd* [2003] 1 A.C. 469. Although a dishonest state of mind is a subjective mental state, the standard by which the law determines whether it is dishonest is objective. If by ordinary standards a defendant's mental state would be characterised as dishonest, it is irrelevant that the defendant judges by different standards. The Court of Appeal held this to be a correct state of the law and their Lordships agree.

...

Their Lordships accept that there is an element of ambiguity in these remarks which may have encouraged a belief, expressed in some academic writing, that the *Twinsectra* case had departed from the law as previously understood and invited inquiry not merely into the defendant's mental state about the nature of the transaction in which he was participating but also into his views about generally acceptable standards of honesty. But they do not consider that this is what Lord Hutton meant. The reference to 'what he knows would offend normally accepted standards of honest conduct' meant only that his knowledge of the transaction had to be such as to render his participation contrary to normally acceptable standards of honest conduct. It did not require that he should have had reflections about what those normally acceptable standards were.

Similarly in the speech of Lord Hoffmann, the statement (in para.20) that a dishonest state of mind meant 'consciousness that one is transgressing ordinary standards of honest behaviour' was in their Lordships' view intended to require consciousness of those elements of the transaction which did not make participation transgress ordinary standards of honest behaviour. It did not also require him to have thought about what those standards were."

2-008 It is not easy to reconcile the Privy Council's "clarification" of the majority speeches in *Twinsectra* with the fact that Lord Millett dissented in that case on the question of the correct interpretation of Lord Nicholls' speech in *Royal Brunei*. In Lord Millett's opinion, dishonesty was a subjective concept insofar as account must be taken of considerations such as the defendant's experience and intelligence and his state of knowledge at the relevant time, but the question for the court was whether an honest person in those circumstances would appreciate that what he was doing was wrong or improper, not whether the defendant himself actually appreciated this.[32] It is suggested that although the Privy Council presented its judgment in *Barlow Clowes* as "clarification" of the majority judgments in *Twinsectra*, the effect of the decision in *Barlow Clowes* was in reality an affirmation of Lord Millett's dissenting judgment.

2-009 This apparent divergence of view between the Privy Council and the House of Lords[33] was considered by the Court of Appeal in *Abou-Rahmah v Abacha*.[34] The Court of Appeal decided, having considered the proper approach to precedent involving cases from the House of Lords and Privy Council, that the "interpreta-

32 "... it is not necessary that he should actually have appreciated that he was acting dishonestly; it is sufficient that he was": see *Twinsectra*, [121] and [122]. See also *Barnes v Tomlinson* [2007] W.T.L.R. 377; and *Al-Khudairi v Abbey Brokers Ltd* [2010] P.N.L.R. 32.

33 See Conaglen and Nolan, "Precedent from the Privy Council" (2006) 122 L.Q.R. 349.

34 *Abou-Rahmah v Abacha* [2007] 1 All E.R. (Comm) 827 (CA). See also *Cunningham v Cunningham* [2009] J.L.R. 227 (Royal Court of Jersey); *Aerostar Maintenance International Ltd v Wilson* [2010] EWHC 2032 (Ch), [183]–[184]; and *Aviva Insurance Ltd v Brown* [2012] Lloyd's Rep. I.R. 211.

tion" of *Twinsectra* given by the Privy Council in *Barlow Clowes* should be taken to represent the law of England and Wales.[35] Thus, a person is to be judged by an objective standard of honesty—he cannot set his own standard.[36] But in judging whether someone has attained this standard, the Court will take into account what he actually knew and intended, i.e. his subjective state of mind.[37]

2-010 Against this background, the real problem posed for management by the fraudulent trading rules is how far and how long the company can continue to incur credit when the directors realise that the outcome of future trading is uncertain and that there is a real risk that things may not improve so that creditors may not be paid. As set out above, although the test of dishonesty will involve a court inquiring into the subjective state of mind of the directors in order to ascertain what they actually knew and intended, the standard by which their conduct is judged to be honest or dishonest is an objective one. If by ordinary standards the directors' conduct in continuing trading is dishonest, they will not be able to escape liability by saying that they saw nothing wrong in what they did.

(c) Wrongful trading[38]

2-011 In contrast to the rules on fraudulent trading discussed above, where the principal focus is on the propriety of incurring new liabilities,[39] wrongful trading is concerned with the inevitability of an insolvent administration or liquidation. In any case where directors[40] have been responsible for wrongful trading by the company which, by depleting its assets, has occasioned loss, ss.214 and 246ZB of the Insolvency Act 1986 empowers the court to impose on those directors liability to

35 See *Abou-Rahmah v Abacha* [2007] 1 All E.R. (Comm) 827 (CA), [66]–[70], per Arden LJ. (On the question of precedent, see now *Willers v Joyce* [2016] 3 W.L.R. 534 (SC).)

36 The relevant standard is the ordinary standard of dishonest behaviour. It may not be a universal standard and the existence of a body of opinion to the effect that the ordinary standard is too high will not preclude dishonesty: *Starglade Properties Ltd v Nash* [2011] Lloyd's Rep. F.C. 102 (CA).

37 *Royal Brunei*, *Twinsectra* and *Barlow Clowes* were all cases on liability for dishonest assistance, but the *Royal Brunei* principles as clarified in *Barlow Clowes* are consistent with Lord Hoffmann's observations in the Court of Final Appeal of Hong Kong on the concept of dishonesty in fraudulent trading in *Aktieselskabet Dansk Skibsfinansiering v Brothers* [2001] 2 B.C.L.C. 324 (Court of Final Appeal of Hong Kong), 334.

38 See *Re A Company* [1988] Ch. 210; *Re A Company* (1988) 4 B.C.C. 424; *Re Produce Marketing Ltd* (1989) 5 B.C.C. 569; *Re DKG Contractors Ltd* [1990] B.C.C. 903.

39 It is possible (though relatively rare) that a company's business is carried on with intent to defraud existing creditors.

40 The term "director" for this purpose includes: (1) a de jure director; (2) a de facto director (i.e. a person who assumes the status and functions of a director although never or never validly appointed); (3) a "shadow director", i.e. a person (not claiming or purporting to be a director) in accordance with whose directions or instructions (but not on whose advice in a professional capacity) the directors are accustomed to act: Insolvency Act 1986 ss.214(7), 246ZB(7) and 251). It is sufficient that the shadow director has a real influence and it is unnecessary that the directors adopt a subservient role: see *Secretary of State v Deverell* [2001] Ch. 340 (CA). It is also sufficient that a governing majority of the board is accustomed to act accordingly: see *Ultraframe (UK) Ltd v Fielding* [2006] F.S.R. 17, [1272]. For a valuable analysis, see *Re Kaytech International Plc* [1999] B.C.C. 390 (CA). In that case, the Court of Appeal did not agree with the notion that the two concepts of a de facto director and a shadow director did not overlap, a view which had been espoused by Millett J in *Re Hydrodan (Corby) Ltd* [1994] B.C.C. 161. See also Noonan and Watson, "The Nature of Shadow Directorship: Ad Hoc Statutory Intervention or Core Company Law Principle?" [2006] J.B.L. 763; and *Smithton Ltd v Naggar* [2015] 1 W.L.R. 189 (CA). A director of a corporate director is not, without more, a de facto director of the subject company: *Commissioners of Revenue and Customs v Holland* [2010] 1 W.L.R. 2793 (SC) (subject to possible exceptions, corporate directors will be outlawed by ss.156A–C of the Companies Act 2006 when they take effect).

contribute to the assets of the company for the benefit of its creditors. Two conditions have to be satisfied before that power can be exercised:

(a) the company must have gone into insolvent administration or liquidation (meaning administration or liquidation at a time when its assets are insufficient for the payment of its debts and other liabilities and the expenses of the proceeding); and

(b) at some time before the commencement of that insolvency proceeding in respect of the company the person to be held liable was a director and either knew or ought to have concluded that there was no reasonable prospect that the company would avoid going into insolvent administration or liquidation.[41]

It is not enough to say that, if the company had not still been trading, a particular loss would not have been suffered. There has to be a sufficient connection between the directors' misconduct and the company's losses.[42] However, in any case when these conditions are satisfied, the court may, on the application of the administrator or liquidator, as the case may be (or their assignee), declare that such person is liable to make such contribution to the company's assets as the court thinks proper[43] unless it is satisfied that after the date of such actual or constructive knowledge the person took every step with a view to minimising the potential loss to the company's creditors as he ought to have taken (assuming him to have known that there was no reasonable prospect that the company would avoid going into insolvent administration or liquidation).[44] Accordingly, the burden of proof of "due diligence" is squarely placed on the director.[45] In order to make out the defence, a director must show not only that continued trading was intended to reduce the net deficiency in the company but also that it was designed to minimise loss to individual creditors (including new creditors for debts incurred during the continued trading).[46]

2-012 For the purpose of determining the extent of his constructive knowledge and for the purpose of determining the propriety and sufficiency of the action taken, the standard is taken to be that of a reasonably diligent person having both:

"(a) the general knowledge, skill and experience that may reasonably be expected of a person carrying out the same functions as are carried out by or entrusted to that director in relation to the company; and

(b) the general knowledge, skill and experience that director has.[47]"

Whether a company has a reasonable prospect of avoiding an insolvent liquida-

41 Insolvency Act 1986 ss.214(2) and 246ZB(2). So long as they had the required knowledge whilst a director, it is not essential that they remained a director when the acts or omissions constituting wrongful trading took place.

42 *Re Continental Assurance Co of London Plc* [2001] B.P.I.R. 733. *Grant v Ralls* [2016] Bus. L.R. 555 at [242].

43 An assignment may include the right to the proceeds of the claim.

44 Insolvency Act 1986 s.214(3). In *Re Produce Marketing Consortium Ltd (No. 2)* (1989) 5 B.C.C. 569 it was held that the jurisdiction was compensatory rather than penal and that the order should reflect the amount by which the company's assets had been depleted by the director's misconduct. In *Re DKG Contractors Ltd* [1990] B.C.C. 903, the court identified the date on which the directors should have recognised the inevitability of liquidation and assessed liability by requiring a contribution equal to the trade debts incurred after that date.

45 *Re Idessa(UK) Ltd* [2012] B.C.C. 315; *Brooks v Armstrong* [2015] B.C.C. 661.

46 *Grant v Ralls* [2016] Bus. L.R. 555 at [245].

47 Insolvency Act 1986 ss.214(4) and (5) and 246ZB(4) and (5), cf. *Department of Health and Social Security v Evans* [1985] 2 All E.R. 471.

tion cannot be determined on the basis of a snap-shot but must reflect rational expectations of what the future might hold. However, directors are not clairvoyant and their failure to foresee what subsequently happens does not necessarily mean that they are liable for wrongful trading.[48]

2-013 The following distinctions between fraudulent and wrongful trading stand out:

(a) liability for fraudulent trading can attach to anyone, whatever his role in or relationship to the company; in the case of wrongful trading, liability can extend only to directors (but including de facto and shadow directors)[49];
(b) liability in the case of fraudulent trading depends on some positive act, whilst liability for wrongful trading can attach in respect of an omission to act;
(c) in the case of fraudulent trading, the burden of proving fraud lies squarely on the complainant; but in the case of wrongful trading, once the two conditions for establishing liability are satisfied, the burden is upon the director to prove that he was diligent in attempting to avoid loss to the creditors;
(d) fraudulent trading involves primarily a failure to have proper regard to the interests of future creditors (i.e. those giving credit to the company); wrongful trading involves a failure to have regard to the interests of all the creditors as a class; and
(e) for the purpose of fraudulent trading actual knowledge must usually be established of the company's actual or prospective inability to pay debts as they fall due; for the purpose of wrongful trading there need only be shown that the director ought to have known of the inevitability of insolvent liquidation.

It is at least theoretically possible, albeit unlikely in practice, for a director to incur liability for fraudulent trading in circumstances where he would not be liable for wrongful trading. This could happen where a director had a legitimate expectation that his company would escape liquidation through some form of restructuring but meanwhile caused the company to incur new debts that he knew would not be paid in full. For that reason, directors dealing with a possible insolvency have to consider their actions in the light of both potential statutory liabilities and not merely treat fraudulent trading as an aggravated form of wrongful trading.

(d) Disqualification of directors for trading whilst insolvent

2-014 In cases under s.6 of the Company Directors Disqualification Act 1986, a ground of unfitness often relied upon is that the director concerned was responsible for the company trading whilst insolvent and that in so doing he took unwarranted risks with creditors' money. In *Re CU Fittings Ltd*[50] Hoffmann J. summarised the position as follows:

[48] *Re Hawkes Hill Publishing Co Ltd* [2007] B.C.C. 937. The court emphasised the need to guard against hindsight in *Re Langreen Ltd (In Liquidation)* unreported 21 October 2011, where a wrongful trading claim failed despite the company having been undercapitalised and having experienced cash flow problems. However, in *Re Kudos Business Solutions Ltd* [2012] 2 B.C.L.C. 65, the court held a director liable for wrongful trading as a result of (amongst other transgressions) having permitted another person to market services which the company was never in a position to provide. The court found that this was not a case of a director properly taking the view that it was in the interests of creditors that the company should be allowed to trade out of its difficulties.

[49] *Re A Company (No.005009 of 1987)* (1988) 4 B.C.C. 424.

[50] *Re CU Fittings Ltd* (1989) 5 B.C.C. 210, 213.

> "directors immersed in the day-to-day task of trying to keep their business afloat cannot be expected to have wholly dispassionate minds. They tend to cling to hope. Obviously there comes a point at which an honest businessman recognises that he is only gambling at the expense of creditors on the possibility that something may turn up".

Trading whilst insolvent is not, of itself, ordinarily sufficient to demonstrate unfitness; it has also to be shown that the director knew or ought to have known that there was no reasonable prospect of meeting creditors' claims.[51] Matters to be taken into account in determining unfitness include misfeasance and any breach of fiduciary duty.[52] Fraudulent trading and wrongful trading are free-standing grounds for disqualification under s.10 of the Company Directors Disqualification Act 1986.[53]

2-015 In *Secretary of State v Laing*,[54] Evans-Lombe J referred to the importance in all such cases of the directors maintaining accurate financial records and management accounts in order to know the position of their company with a reasonable degree of accuracy at any particular time and stated:

> "where it can be demonstrated that a company has continued trading for a substantial period of time while it was insolvent and as a result has put the claims of existing creditors at unwarrantable risk and has incurred fresh creditors at the unjustifiable risk of not being able to pay them, it is not open to a director of the company to avoid responsibility by contending that he did not know at the material time that such was taking place. It is the duty of all directors to ensure that they have from time to time a reasonably clear picture of the financial state and trading profitability of their companies."[55]

Indeed, a failure to keep accounting records sufficient to enable the directors to understand the financial position of the company may itself warrant disqualification.[56]

2-016 Following changes to the Company Directors Disqualification Act 1986 made by the Small Business, Enterprise and Employment Act 2015, directors who are the subject of disqualification orders (or have given disqualification undertakings in lieu) now face the additional hazard of the court's jurisdiction to make a compensation order (and the Secretary of State's power to accept a compensation undertaking). These new powers are triggered where the conduct giving rise to disqualification has caused loss to one or more creditors of an insolvent company. A compensation order or undertaking may require a contribution to the assets of the company but could require a payment for the benefit of particular creditors or a class of creditors.[57]

2-017 In light of the above, once the directors appreciate that to continue trading will

[51] *Secretary of State v Creegan* [2004] B.C.C. 835 (CA); *Re CS Holidays Ltd* [1997] 1 W.L.R. 407; and *Re Uno Plc* [2006] B.C.C. 725. A breach of fiduciary duty does not necessarily demonstrate unfitness: see *Secretary of State for Business, Innovation and Skills v Doffman (No.2)* [2011] 2 B.C.L.C. 541 at [251] (a case where disqualification orders were nonetheless made).

[52] Company Directors Disqualification Act 1986 s.12C and Sch.1. As originally enacted, Sch.1 contained a more detailed list of matters to be taken into account but it is suggested that, as regards trading whilst insolvent, the substantive test of unfitness remains unchanged.

[53] See, e.g. *Re Attorney General's Reference (Nos 88, 89, 90 and 91 of 2006)* [2007] 2 Cr. App. R. (S.) 28 (CA); also *Re Idessa (UK) Ltd* [2012] B.C.C. 315. Section 10 only applies where an order has been made under either s.213 or s.214 of the Act (the liquidation provisions).

[54] *Secretary of State v Laing* [1996] 2 B.C.L.C. 324, 342.

[55] See also *Re Galeforce Pleating Co Ltd* [1999] 2 B.C.L.C. 704. The corollary of the director's duty to maintain a clear picture of the company's finances is that the company should cease to trade if the directors do not have any such picture.

[56] *Re Artistic Investment Advisers Ltd* [2015] 1 B.C.L.C. 619.

[57] Company Directors Disqualification Act 1986 s.15A.

involve incurring further credit with no reasonable prospect of payment, they should not cause the company to trade at the risk of future creditors. It is important that all directors recognise that they have individual responsibilities in this respect and that even those with only a nominal or wholly non-executive role can face disqualification proceedings. Neither the directors nor the court can sanction further trading at the expense of future creditors. This would seem to be so even if the cessation of trading will damage the company and its current creditors, in particular by precluding a beneficial sale of the undertaking as a going concern. Continued trading is only legitimate if it is in the interests of creditors generally and either (a) the future creditors are warned and agree to accept the risk of non-payment; or (b) any further credit obtained is underwritten by somebody of sufficient substance.

2-018 If neither of these conditions is satisfied, closure of the business is probably inevitable unless:

(a) there is a voluntary arrangement under ss.1–7 of the Insolvency Act 1986 or a scheme of arrangement under Pt 26 of the Companies Act 2006; or
(b) if permitted by the insolvency legislation, a debenture-holder appoints an administrative receiver (as he may be invited to do by the company); or
(c) an administrator or interim manager is appointed by the court or by another person entitled to do so; or
(d) on presentation of a petition for winding up a provisional liquidator is appointed and is authorised to continue the company's business; or
(e) a liquidator is appointed who decides to continue trading with a view to a beneficial realisation.[58]

These are all possible solutions which the directors should consider (doubtless with the benefit of professional advice). This work is primarily concerned with administration and receivership, but a brief description of the other options available to directors who have concluded that some formal process is required follows in order to put administration and receivership in context and to explain the effect on the business and the differing ongoing roles of the directors. Following the Enterprise Act reforms which introduced the possibility of directors appointing administrators without recourse to the court and the substantial curtailment of the power of debenture holders to appoint administrative receivers, the directors of an insolvent company now have a more important decision-making role in relation to the choice of procedure than was formerly the case.

2. COMPANY VOLUNTARY ARRANGEMENTS AND SCHEMES OF ARRANGEMENT

2-019 In 1982 the Cork Committee proposed that the existing procedures for arrangements between companies and their creditors were unsuitable for many cases and suggested a new form of voluntary arrangement for companies which could be concluded without an order of the court but which would still be binding as between the company and its creditors.[59] Part I of the Insolvency Act 1986 gave effect to that proposal. The procedure was reformed by the Insolvency Act 2000, which also introduced for certain eligible companies an optional (but hardly used) variant of this procedure with the benefit of a moratorium while the proposal is being

[58] *Re General Service Co-operative Stores* (1891) 64 L.T. 228.
[59] Cmnd. 8558, paras 419–430.

formulated and considered.[60] The principal feature of the legislation is that any voluntary arrangement to be voted upon by creditors will have been reviewed and endorsed and will be administered by an insolvency practitioner. The voluntary arrangement cannot affect the rights of secured creditors without their consent[61] (although the rights of secured creditors are restricted during the period of any moratorium in relation to an eligible company).

(a) The moratorium for eligible companies

2-020 A moratorium comes into effect when the directors of an eligible company file certain documents with the court, which must include a document setting out the terms of the proposed voluntary arrangement. The qualifying conditions for a company to be eligible for a moratorium are prescribed by the legislation and primarily relate to small companies.[62] The company must not fall within one of the prescribed exceptions (relating mostly to the financial sector and structured finance transactions) and must not be subject to an existing voluntary arrangement (or have been subject to a moratorium within the previous year) or be in administrative receivership, administration or liquidation. The moratorium ends upon the arrangement becoming effective and, in any event, expires after 28 days (or earlier, upon the relevant approval procedures being concluded) unless it is extended. During the period of the moratorium, the directors' power to obtain credit for the company, pay its debts and dispose of its assets is restricted; creditors are prevented from enforcing certain rights; and special provisions apply to the disposal of assets subject to a security interest or hire-purchase arrangement.

(b) The approval and implementation of a voluntary arrangement

2-021 For an eligible company for which a moratorium is being sought, a proposal for a voluntary arrangement is formulated by the directors. Otherwise, it is formulated by the directors if the company is not in administration or liquidation, or by the administrator or liquidator if it is. If it is formulated by the directors (whether in connection with a moratorium or not), a statement by the nominee that there is a reasonable prospect of the voluntary arrangement being approved and implemented must be submitted to the court. The nominee must be a qualified insolvency practitioner.

2-022 The proposal is voted upon by a meeting of the company and by its creditors using a qualifying decision procedure and, to become effective, it must be accepted either by both or by the creditors only (in the latter case, subject to no member of the company challenging the creditors' decision successfully by application to the court within 28 days after the meeting of the company and the creditors' decision). If accepted, the arrangement will become binding upon all persons who in accordance with the rules were entitled to vote in the qualifying decision procedure by

[60] In May 2016, the Insolvency Service published *A Review of the Corporate Insolvency Framework* to consult on (amongst other things) proposals for a new pre-insolvency moratorium lasting up to three months which would be available to companies of all sizes in order to enable a restructuring to take place. In September 2016, the Service published its *Summary of Responses* in which it reported broad support for its proposal but a need for further consultation on the details. It is anticipated that legislation will follow in due course.
[61] See further *Webb v MacDonald* [2010] B.P.I.R 503 (a case on the equivalent provisions in relation to individual voluntary arrangements).
[62] Insolvency Act 1986 s.1A and Sch.A1.

which the creditors' decision to approve the arrangement was made, or who would have been so entitled if they had had notice of it, as if they were parties to the voluntary arrangement.[63] This has been described as giving rise to a statutory hypothesis that the creditor was a party to the arrangement as if he had consented to it.[64] A person entitled to vote in the qualifying decision procedure (or a person who would have been so entitled if he had had notice of it) is entitled to challenge an arrangement by application made to the court within 28 days of the outcome of the meeting of the company and the creditors' decision being reported to the court (or within 28 days of becoming aware that the creditors' decision procedure has taken place, if he had not had notice of it) on the grounds of either unfair prejudice or materiality irregularity in relation to the meetings, and the court has the power to revoke or suspend any decision which has taken effect and/or give a directions for further decisions to be taken.[65]

2-023 If approved, the voluntary arrangement is thereafter administered by a supervisor who must be a qualified insolvency practitioner. The supervisor is not an officer of the company and has no power to act in the name of the company unless given authority to do so pursuant to the terms of the voluntary arrangement. The supervisor is subject to the supervisory control of the court, and both he and creditors who are dissatisfied with any act, decision or omission of his can apply to the court for directions.[66] It has been held in relation to the analogous case of an individual voluntary arrangement that a supervisor is not susceptible to an action for damages for breach of statutory duty or tort in relation to his supervision of the voluntary arrangement[67] although, in a subsequent case,[68] it was held that a nominee in respect of a debtor's proposal for an individual voluntary arrangement owed the debtor a duty of care in both contract and tort in respect of advice given during a short adjournment of the creditors' meeting, on the basis that he had reverted to acting in an advisory capacity (and not in his respective capacities as nominee and chairman of the meeting) during that period.[69]

2-024 The Insolvency Act 1986 contains no provision enabling a voluntary arrangement to be amended or varied, whether by vote of creditors,[70] or on an application to the court for directions.[71] It is therefore usually desirable to include in the scheme

63 Insolvency Act 1986 s.5(2) and Sch.A1, para.37(2).

64 *Johnson v Davies* [1999] Ch. 117 (CA); *Raja v Rubin* [2000] Ch. 274 (CA) (both cases dealing with individual voluntary arrangements).

65 Insolvency Act 1986 s.6 and Sch.A1, para.38. See, e.g. *Revenue and Customs Commissioners v Portsmouth City Football Club Ltd* [2011] B.C.C. 149; *Mourant & Co Trustees Ltd v Sixty UK Ltd* [2010] B.C.C. 882. Unless a challenge is timeously made, the approval will stand despite an error or inaccuracy in reporting the outcome to the court: *Smith-Evans v Smailes* [2014] 1 W.L.R. 1548 (a case on the comparable provisions in relation to individual voluntary arrangements which was subsequently considered in *Narandhas-Girdhar v Bradstock* [2014] B.P.I.R. 1014).

66 Insolvency Act 1986 s.7 and Sch.A1, para.39.

67 *King v Anthony* [1998] 2 B.C.L.C. 517 (CA).

68 *Prosser v Castle Sanderson Solicitors* [2003] B.C.C. 440 (CA). See also *Firth v Everitt* (2007) 104(39) L.S.G. 30 (Ch).

69 More generally, as to the limitation on the ability of a creditor to maintain an action against an office-holder, see *A&J Fabrications (Batley) Ltd v Grant Thornton* [1998] B.C.C. 807; *Oldham v Kyrris* [2004] B.C.C. 111 (CA); *Re HIH Casualty & General Insurance Ltd* [2006] 2 All E.R. 671, [116]–[126] (the subsequent appeal to the House of Lords reported at [2008] 1 W.L.R. 852 does not affect this issue); *Lomax Leisure Ltd v Miller* [2008] 1 B.C.L.C. 262; *Hague v Nam Tai Electronics Inc* [2008] B.C.C. 295 (PC); and *Charalambous v B & C Associates* [2009] 43 E.G. 105 (C.S.).

70 *Raja v Rubin* [2000] Ch. 274 (CA).

71 *Re Alpa Lighting Ltd* [1997] B.P.I.R. 341 (CA).

itself a procedure enabling amendments to be made.[72] The question of whether the voluntary arrangement will end upon the making of a winding-up order is determined partly by the terms of the arrangement and, it seems, partly by the circumstances under which the winding-up petition is presented.[73] However, the termination of an arrangement does not necessarily have the effect of terminating any trust constituted thereunder in respect of the assets held by the supervisor.[74]

2-025 As an alternative to a company voluntary arrangement, it may be possible for a scheme of arrangement to be promoted and sanctioned under Pt 26 of the Companies Act 2006 (formerly ss.425–427 of the Companies Act 1985). Section 899 of the 2006 Act provides that a compromise or arrangement which is proposed between a company and its members or creditors,[75] or any class of them, is approved by a majority in number representing 75 per cent in value of those present in person or by proxy at meetings of each class of member[76] or creditor, and which is subsequently sanctioned by the court, shall be binding upon all members or creditors, or upon the class of members or creditors, and upon the company. Where a scheme involves a reduction of capital, the statutory provisions in that regard must also be complied with.[77]

2-026 The concept of a compromise or arrangement is a wide one.[78] Whilst the court will be slow to differ from the views of the statutory majorities of members or creditors, the role of the court in deciding whether to exercise its discretion to sanction a scheme is not simply to "rubber stamp" the decisions of the relevant meetings.[79] Not only will the court decide whether the relevant class meetings have been held[80]

72 *Horrocks v Broome* [2000] B.C.C. 257.

73 See, e.g. *Re Arthur Rathbone Kitchens Ltd* [1998] B.C.C. 450; *Re Excalibur Airways Ltd* [1998] 1 B.C.L.C. 436; and *Re NT Gallagher & Son Ltd* [2002] 1 W.L.R. 2380 (CA).

74 Where a voluntary arrangement provides for money or other assets to be paid or transferred to or held for the benefit of creditors, the result is to create a trust for the creditors. The effect of liquidation of the debtor or failure of the arrangement on such a trust depends on the terms of the arrangement. If provision is made for that contingency, effect must be given to the provision. If no provision is made, the trust continues and must take effect according to its terms notwithstanding the liquidation or failure of the arrangement. The creditors of the arrangement can then prove in the liquidation for so much of their debt as remains after taking into account their rights under the trust: see *Re NT Gallagher & Son Ltd* [2002] 1 W.L.R. 2380 (CA).

75 Every person who has a pecuniary claim against the company, whether actual or contingent, is a creditor within the Act. This will, e.g. include a lessor of property to the company.

76 In *Re Uniq Plc* [2012] 1 B.C.L.C. 783, 85% of the members had not voted but, since the company had an unusually high number of members with small shareholdings, this was not a matter of concern and the scheme was nonetheless sanctioned.

77 *Re White Pass Ry Co* [1918] W.N. 323.

78 See, e.g. *Re NFU Development Trust Ltd* [1972] 1 W.L.R. 1548.

79 See, e.g. *Re English, Scottish and Australian Chartered Bank* [1893] 3 Ch. 385 (CA), 398, 409; *Re National Bank Ltd* [1966] 1 W.L.R. 819, 829; *Re BTR Plc* [2000] 1 B.C.L.C. 740 (CA), 744; and *Re Hawk Insurance Co Ltd* [2002] B.C.C. 300 (CA), 310.

80 The approach of the court to the composition of classes was set out by Bowen LJ in *Sovereign Life Assurance Co v Dodd* [1892] 2 Q.B. 573 (CA), 583: "It seems plain that we must give such a meaning to the term 'class' as will prevent the section being worked so as to result in confiscation and injustice, and that it must be confined to those persons whose rights are not so dissimilar as to make it impossible for them to consult together with a view to acting in their common interest." The question of whether classes have been correctly constituted will depend upon the facts of each case: see *Re Osiris Insurance Ltd* [1999] 1 B.C.L.C. 182; *Re BTR Plc* [1999] 2 B.C.L.C. 675; [2000] 1 B.C.L.C. 740 (CA); *Re Anglo-American Insurance Co Ltd* [2001] 1 B.C.L.C. 755; *Re Hawk Insurance Co Ltd* [2002] B.C.C. 300 (CA), 309–310, in which, in his leading judgment, Chadwick LJ referred to the test set out by Bowen LJ in *Sovereign Life* (above) as "settled law"; *Re Telewest Communications Plc* [2005] B.C.C. 29 (CA); and *Re British Aviation Insurance Co Ltd* [2006] B.C.C.

and the procedures properly followed[81] and check that full and accurate information has been given to members and creditors,[82] but it will also decide "whether the proposal is such that an intelligent and honest man, a member of the class concerned and acting in respect of his interest, might reasonably approve".[83] This is an obvious difference to the court's role in relation to a company voluntary arrangement, which, in the absence of challenge from dissident creditors, is far more administrative in nature.

3. THE APPOINTMENT OF A RECEIVER

2-027 There is in most cases a world of difference between the value of a company's undertaking as a going concern and its scrap value. It is for this reason that, historically, creditors have sought floating charges on the undertaking as well as specific charges on certain assets of the debtor company. However, as a result of reforms introduced by the Enterprise Act 2002, regardless of the terms of the debenture, the holder of a floating charge created on or after 15 September 2003 may not appoint an administrative receiver of the debtor company unless the transaction falls within one of the statutory exceptions.[84] Accordingly, administrative receivership is now a rarely encountered and consequently much less significant procedure for rescuing the business of an insolvent company.

2-028 A debenture in the ordinary case provides for the appointment by the secured creditor, on the occasion of any default by the debtor or the occurrence of other specified events, of a receiver with power to carry on the company's business.[85] The appointment takes the management of the company's property out of the hands of the directors and places it in the hands of the receiver.[86] This power may be exercised either with a view to reviving the company or with a view to the beneficial sale of the undertaking as a going concern. The power to carry on the business of the company through an administrative receiver is deemed to be granted by the debenture except in so far as the existence of such power is inconsistent with any

14. The focus is on the effect of any differences in the creditors' rights against the company rather than differences in their individual interests: see *Re BTR Plc* (above); *Re Hawk Insurance* (above); *Re Telewest Communications Plc* (above); and *Re Metinvest BV* [2016] I.L.Pr. 19. Where a proposed scheme is in practical terms an alternative to a liquidation or administration, it is not wrong to consider, when determining the classes of creditors, how the creditors would have been treated in the liquidation or administration: see *Marconi Corp Plc v Marconi Plc* [2003] EWHC 663 (Ch), [20].

81 See *Practice Statement (Companies: Schemes of Arrangement)* [2002] 1 W.L.R. 1345.

82 See *Re Minster Assets Plc* (1985) 1 B.C.C. 99299.

83 See per Maugham J. in *Re Dorman, Long & Co Ltd* [1934] Ch. 635, 657. See also *Re National Bank Ltd* [1966] 1 W.L.R. 819, 829A–E; *Re Hellenic & General Trust Ltd* [1976] 1 W.L.R. 123; *Re Osiris Insurance Ltd* [1999] 1 B.C.L.C. 182, 188g–189g; *Re BTR Plc* [1999] 2 B.C.L.C. 675 (Ch), 680b–g, [2000] 1 B.C.L.C. 740 (CA).

84 Insolvency Act 1986 s.72A. For the statutory exceptions, see Insolvency Act 1986 ss.72B–72H (inclusive). The appointment of an administrative receiver under s.72E (the fourth exception: project finance) was held invalid in *Feetum v Levy* [2006] Ch. 585 (CA).

85 Although the power of appointment is a power of the secured creditor, there is no reason why directors who conclude that receivership is the best solution should not invite the creditor to exercise its power. In practice, creditors prefer to make receivership appointments by invitation in order to reduce the risks of an appointment being challenged.

86 *Re Joshua Shaw & Sons Ltd* (1989) 5 B.C.C. 188, 190. The appointment does not terminate the office of director: *Re Barton Manufacturing Co Ltd* [1998] B.C.C. 827, 828; but the loss of control means that directors are unlikely to be able to act to safeguard the interests of creditors and therefore will not be held to be in breach of such duties to the company.

provision of the debenture.[87] The power to present or defend (and presumably by implication to support or not oppose) a petition to wind up the company is likewise deemed to be granted,[88] and if properly exercised must preclude any representation of the company at the instance of the directors.[89] A non-administrative receiver will only have such powers if conferred by the debenture.[90] The appointment of a receiver in no way precludes other creditors petitioning for winding up, and indeed unsecured creditors may be well advised to petition to protect their position in case a surplus exists after completion of the receivership and in order to preserve the "relation back" period for any challenge to the grant of the debenture to the secured creditor under ss.238 (preferences) and 245 (avoidance of floating charges) of the Insolvency Act 1986. The appointment of a receiver does not prevent time running for purposes of limitation[91] and the liquidator may exercise some supervision and restraining influence on the receiver.[92]

2-029 A creditor with the power to appoint a receiver has the choice whether to make the appointment (if permitted to do so by the insolvency legislation, in the case of an administrative receiver).[93] Once the appointment is made, it is then for the receiver to decide whether to carry on the business with the objective of a rescue in the long term or of a beneficial sale as a going concern in the short term or to close the business and sell up.[94] There is no general duty on the creditor or the receiver to carry on business on the mortgaged premises in order to safeguard the company's goodwill or attempt to procure the most beneficial realisation.[95]

2-030 If the receiver does continue the company's business, five limitations on his freedom of action come into operation. First, the receiver will ordinarily be granted power and authority to carry on the company's business as agent of the company.[96] But though the power to carry on the business survives liquidation, the agency does

87 Insolvency Act 1986 s.42(1) and Sch.I, para.14.

88 Insolvency Act 1986 s.42(1) and Sch.I, para.21.

89 *Bank of New Zealand v Essington Developments Pty Ltd* (1991) 5 A.C.S.R. 86 (Supreme Court of New South Wales), 89. The only course available to the directors if they oppose such action by the receiver will be an application to the court for a contrary direction to be given to the receiver, but such direction can only be expected if it can be shown that the receiver's proposed course of action would be unconscionable. cf. *Edwards v Singh* (1990) 5 N.Z.C.L.C. 66,770 (High Court of Auckland).

90 In the case of such a receivership, if the power is not so conferred, the directors can authorise the company's defence to the petition: see *Re Reprographic Exports (Euromat) Ltd* (1978) 122 S.J. 400.

91 *Re Cases of Taff's Well Ltd* [1992] Ch. 179; *Re Joshua Shaw & Sons Ltd* (1989) 5 B.C.C. 188.

92 *Re Northern Developments (Holdings) Ltd* unreported 16 June 1976; affirmed by the Court of Appeal unreported 1 March 1977. Although not its usual practice, the Companies Court has the power to adjourn a winding-up petition for long periods if the interests of unsecured creditors so require (*Re Northern Developments*). For an example of the exercise of this power, see *Re Demaglass Holdings Ltd* [2001] 2 B.C.L.C. 633.

93 *Raja v Austin Gray* [2003] B.P.I.R. 725 (CA), [55]; *Silven Properties Ltd v Royal Bank of Scotland Plc* [2004] 1 W.L.R. 997 (CA); *Meretz Investments NV v ACP Ltd* [2007] Ch. 197 (this point was not challenged on the appeal reported at [2008] Ch. 244 (CA)); and *Coomber v Bloom* [2010] EWHC 121 (Ch). See further below, Ch.7.

94 *Silven Properties Ltd v Royal Bank of Scotland Plc* [2004] 1 W.L.R. 997 (CA); and *Coomber v Bloom* [2010] EWHC 121 (Ch).

95 See *Medforth v Blake* [2000] Ch. 86 (CA); and below, Chs 10 and 13.

96 In the case of the administrative receiver the power and authority are deemed to be granted by the debenture in the absence of some inconsistent provision in the debenture: Insolvency Act 1986 s.42(1) and Sch.I, para.14. In the case of non-administrative receivers, they must be conferred by the debenture (as to the implication of additional powers, see *McDonald v McDonald* [2015] Ch. 357).

not. Thereafter the receiver can only trade as principal or (with his debenture-holder's consent) as agent for his debenture-holder.

2-031 Secondly, the provisions of ss.213 and 246ZA of the Insolvency Act 1986 will apply to the receiver in respect of the period of his carrying on business as agent for the company prior to administration or liquidation, and accordingly if he is a party to fraudulent trading, he may be subject to a claim in a subsequent administration or liquidation.[97] The wrongful trading provisions of ss.214 and 246ZB of the Insolvency Act 1986 could also apply to him if he exercises such influence over the affairs of trading subsidiaries that the directors of those companies become accustomed to act on his directions or instructions but this risk will be avoided if the receiver merely causes the parent company to exercise its shareholder powers.[98]

2-032 Thirdly, in respect of certain aspects of his conduct he owes duties to the company and may be held liable in negligence or for acts which damage the company.[99] All his powers (statutory and otherwise) are exercisable only for the purposes for which he is appointed, i.e. the preservation, recovery and realisation of the assets subject to the charge in order to bring about a situation in which interest on the secured debt can be paid and the debt itself paid.[100]

2-033 Fourthly, the directors' powers of management of the undertaking are placed in suspense during the period of his appointment in so far as their exercise would be inconsistent with the exercise by the receiver of powers conferred on the debenture-holder under his debenture.[101] There is no kind of diarchy over the company's assets: the board has no power over assets in the possession or control of the receiver. The directors remain in office[102] and their powers remain exercisable so far as they are not incompatible with the right of the receiver to exercise the powers conferred on him.[103]

2-034 The law is unsettled as to the extent to which, independently of the receiver, the

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97 See *Re Leyland DAF Ltd* [1994] 4 All E.R. 300, 311–312.

98 See fn.40 above in relation to the meaning of "shadow director".

99 The company's remedy will ordinarily be against the receiver, even if the receiver's agents and advisers have been at fault. The obligation of a receiver to sell at a proper price is not delegable and the receiver remains liable for any under-performance by his selling agents: see *Glatt v Sinclair* [2012] B.P.I.R. 306 at [52]. In *Edenwest Ltd v CMS Cameron McKenna* [2013] B.C.C. 152, it was held that solicitors retained to advise a bank and its receivers on a pre-pack sale owed no duty of care to the debtor company because the receiver's own primary duty is to the debenture-holder. Thus, a negligent receiver can also be liable to his appointor, such liability not being precluded by the rule against reflective loss: see *International Leisure Ltd v First National Trustee Co (UK) Ltd* [2013] Ch. 346. See below, Chs 13 and 14.

100 *Bank of New Zealand v Essington Developments Pty Ltd* (1991) 5 A.C.S.R. 86 (Supreme Court of New South Wales), 88; and *Medforth v Blake* [2000] Ch. 86 (CA), 102G.

101 See Brightman J. in *Re Emmadart Ltd* [1979] Ch. 540, 544. "The receiver replaces the board as the person having the authority to exercise the company's powers", per Lord Hoffmann in *Village Cay Marina Ltd v Acland* [1998] B.C.C. 417 (PC), 422. See also *Capital Globe Investments Pty Ltd v Parker Investments Australia Pty Ltd* [2011] Q.S.C. 31 (Supreme Court of Queensland).

102 *Independent Pension Trustee Ltd v L.A.W. Construction Co Ltd*, 1997 S.L.T. 1105 (Court of Session, Outer House).

103 Their statutory duties to keep accounts under the Companies Act 2006 ss.386–389 continue (notwithstanding that the effect of the appointment of the receiver is to deprive them of access to the funds required to pay for the discharge of them), and they have a continuing right to require the receiver to provide information for this purpose: see para.13–077. See also *Gomba Holdings v Homan* [1986] 1 W.L.R. 1301 (the directors have no right to information from the receiver in order to prosecute an action where the provision of such information would be contrary to the interests of the debenture-holder); *Re Geneva Finance Ltd; Quigley v Cook* (1992) 7 A.C.S.R. 415 (Supreme Court of Western Australia) (in a pre-receivership context, the directors have a right of access to the company's books and records without demonstrating a "need to know" but the appointment of a

directors have the right in the name of the company to bring proceedings on causes of action of the company. In *Newhart Developments Ltd v Cooperative Commercial Bank Ltd*,[104] Shaw LJ stated that the appointment of the receiver:

> "does not divest the directors of the company of their power, as the governing body of the company, of instituting proceedings in a situation where so doing does not in any way impinge prejudicially upon the position of the debenture-holders by threatening or imperilling the assets which are subject to the charge. ... If in the exercise of his discretion [the receiver] chooses to ignore some asset such as a right of action, or decides that it would be unprofitable from the point of view of the debenture-holders to pursue it, there is nothing in any authority which has been cited to us which suggests that it is not then open to the directors of the company to pursue that right of action if they think it would be in the interests of the company. Indeed, in my view, it would be incumbent upon them to do so".

In line with this approach, the directors have been allowed in the name of the company to institute proceedings challenging the validity of the debenture or the appointment of the receiver, and, acting as monitors of the stewardship of the company's affairs by the receiver, to challenge his actions in the court[105] and to seek to enforce independent causes of action against the appointing debenture-holder. Indeed Shaw LJ questioned whether the receiver can enforce claims against the debenture-holder, for such a step and any negotiations for compromise would involve such conflicts of interest on his part as to make it desirable that enforcement is left to the directors. Protection of the assets charged and the interests of the debenture-holders may require provision of an indemnity to the company against any liability for costs.[106]

2-035 In *Tudor Grange Holdings Ltd v Citibank NA*,[107] Sir Nicolas Browne-Wilkinson VC expressed substantial doubts whether the decision of the Court of Appeal in *Newhart Developments Ltd v Cooperative Commercial Bank Ltd* was correct,

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receiver alters the position to the extent necessary to recognise the receiver's pre-eminent position in realising assets for the benefit of the debenture-holder); and *Oswal v Burrup Holdings Ltd* [2011] F.C.A. 609 (Federal Court of Australia) (because of the pre-eminent role that receivers have to realise assets on behalf of the debenture-holder, the court should not facilitate inspection that may threaten the proper administration of the receivership and imperil the assets the subject of the charge by which the receivers have been appointed).

104 *Newhart Developments Ltd v Cooperative Commercial Bank Ltd* [1978] Q.B. 814 (CA); followed in *Shanks v Central Regional Council*, 1987 S.L.T. 410 (Court of Session, Outer House); which differed from the view expressed in *Imperial Hotels (Aberdeen) Ltd v Vaux*, 1978 S.L.T. 113 (Court of Session, Outer House). See also Brightman J in *Re Emmadart Ltd* [1979] Ch. 540, 544. But cf. the language of Danckwerts LJ in *Lawson v Hosemaster Co Ltd* [1966] 1 W.L.R. 1300 (CA), 1315. See also *Gartner v Ernst & Young* (2003) 21 A.C.L.C. 560 (Federal Court of Australia). As an alternative the court may appoint a receiver ad litem: see below, Ch.29.

105 *Hawkesbury Development Co Ltd v Landmark Finance Pty Ltd* (1969) 92 W.N. (NSW) 199, 210; and see *Watts v Midland Bank Plc* [1986] B.C.L.C. 15 where Gibson J held that the mortgagor company was entitled to sue the receiver in respect of an improper exercise of his powers.

106 See *Tudor Grange Holdings Ltd v Citibank NA* [1992] Ch. 53; *Newhart Developments Ltd v Cooperative Commercial Bank Ltd* [1978] Q.B. 814 (CA), 819. Consider also *Fairholme and Palliser v Kennedy* (1890) 24 L.R. Ir. 498 (High Court of Ireland) (receiver permitted to sue in name of personal representatives on giving indemnity); and *Deangrove Pty Ltd v Commonwealth Bank of Australia* (2001) 37 A.C.S.R. 465 (Federal Court of Australia) (directors permitted to sue debenture-holder in name of company on giving indemnity) (reasoning adopted in *Gartner v Ernst & Young* (2003) 21 A.C.L.C. 560 (Federal Court of Australia)). See also *Enigma Technique Ltd v Royal Bank of Scotland* [2005] EWHC 3340 (Ch), where a director was ordered to compensate the company for its wasted costs in bringing an action against the receivers and, further, to meet the receivers' costs in defending the action.

107 *Tudor Grange Holdings Ltd v Citibank NA* [1992] Ch. 53.

though he accepted that the decision bound him. He was of the view that the reasoning based on the embarrassment of the receiver deciding to sue his appointor could be met by an application by the receiver under s.35 of the Insolvency Act 1986 to the court for directions as to the course to be taken, a point apparently not drawn to the attention of the Court of Appeal; and that the decision ignored the difficulty which arose if two different sets of people, the directors and the receiver, who may have widely differing views and interests, both have power to bring proceedings on the same cause of action. He raised the question, in the situation where the directors bring proceedings and there is a counterclaim directly attacking the property of the company, as to who is to have the conduct of the counterclaim. Browne-Wilkinson VC insisted that in any event any action at the instance of the directors must be struck out until the company provides a complete indemnity in respect of any liability for costs.[108]

2-036 It is suggested that two different situations require to be considered:

(a) where both the receiver and the directors have power to represent the company, e.g. on a petition to wind up the company, if the receiver properly exercises his power, the power of the directors is suspended and is not exercisable. The exercise of such power by the receiver must be bona fide. On this ground a receiver's purported discontinuance of proceedings commenced by the directors in the name of the company for a declaration that the debenture was invalid as already cancelled and that the appointment of the receiver accordingly was invalid, was held capable of challenge[109]; and

(b) where the company's cause of action is included in the debenture, it is thereby assigned to the mortgagee.

It is suggested that the solution to this quandary lies in the recognition that the relevant relationship is not between the directors and the company and the receiver and the company, but between the rights of the company and the debenture-holder respectively or mortgagor and mortgagee of the relevant chose in action. After the assignment has been effected by the charge, the assignee alone can seek to enforce the assigned right. Accordingly in respect of any cause of action charged to the debenture-holder, only the debenture-holder can sue. The only qualification is that in practice the receiver, without objection, sues in the name of the company, though technically the claimant should be the mortgagee.[110] The company itself by its directors can only sue (a) in respect of causes of action not assigned to the mortgagee or released by the mortgagee from the charge[111]; or (b) in respect of causes of action so assigned after redemption or perhaps with the consent of the debenture-holder.

2-037 Fifthly, as soon as the debenture-holder, preferential creditors, unsecured creditors (if applicable)[112] and all receivership costs, liabilities and expenses are or can

[108] For a "reconciliation" placing critical importance on the availability of the indemnity as to costs, see *L. Lascomme Ltd v UDT* [1994] I.L.R.M. 227 (High Court of Ireland).

[109] *Edwards v Singh* (1990) 5 N.Z.C.L.C. 66,770 (High Court of Auckland).

[110] cf. below, Ch.22.

[111] All that is required for a release is a unilateral consent to the release: *Scottish & Newcastle Plc, Petitioners* [1993] B.C.C. 634 (Court of Session, Outer House).

[112] See Insolvency Act 1986 s.176A.

be paid off, the receiver must in the absence of any provision to the contrary in the debenture cease to act and hand back to the directors the powers of management.[113]

2-038 Occasionally, but comparatively rarely, the court will appoint a receiver and manager of a company. Usually this is done on the application of a debenture-holder when the debenture for some reason does not enable him to make an appointment out of court or does not give the powers required to ensure a beneficial realisation of the company's undertaking in the interests of all to the company's creditors. An appointment may also be made if the validity of the debenture or of the appointment of a receiver out of court is challenged.[114] A court-appointed receiver is an officer of the court and does not act as agent for the company or anyone else, but in so far as he carries on business he contracts and incurs liabilities personally. Such appointments are invariably short-lived, being designed to achieve an early sale as a going concern.[115]

2-039 Whichever the form of the appointment, if the company's fortunes improve, the receivership will give way to a resumption of management by the directors. If the receivership merely produces sufficient money to pay off the appointing debenture-holder, its conclusion may give rise to a further appointment of a different receiver by a subsequent encumbrancer, the appointment of an administrator or a liquidation.

4. ADMINISTRATOR[116]

2-040 The office of administrator is the creation of statute, namely Pt II of the Insolvency Act 1986 although the legislation currently in force is substantially changed and expanded from the original enactment.[117] An administrator may be appointed by the court, by the holder of a qualifying floating charge in respect of the company's property, by the company itself or by its directors.[118] However appointed, in performing his functions, the administrator must have regard to the interests of the creditors of the company as a whole.[119] An administrator must perform his functions with the objective of rescuing the company as a going

[113] See below, Ch.28.

[114] In general, court-appointed receivers have the same duties as receivers appointed out of court. However, in *Glatt v Sinclair* [2012] B.P.I.R. 306 at [55], the Court of Appeal left open the question of whether a court-appointed receiver should have the same liability for the negligence of agents as an out-of-court receiver. See also *Barclays Pharmaceuticals Ltd v Waypharm LP* [2014] 2 All E.R. (Comm) 82 at [46], citing this work.

[115] See below, Ch.29.

[116] For full consideration of this topic, see below, Chs 6 and 12. Only companies registered under the Companies Act 2006 in England and Wales or in Scotland and certain companies formed or incorporated outside the UK may enter administration: see Insolvency Act 1986 s.8 and Sch.B1 para.111(1A) and (1B). This is subject to EU law, see generally below, Ch.31. An entity incorporated under Luxembourg law which was a combination of a joint stock company and a limited partnership was held be be a "company" for these purposes in *Re Hellas Telecommunications (Luxembourg) II SCA* [2010] B.C.C. 295.

[117] This part of this chapter deals only with the regime under Pt II of the Insolvency Act 1986 as amended by the Enterprise Act 2002 s.249 and as applied to "ordinary" companies (different vintages of administration legislation are applied to an increasingly large number of special types of company, e.g. banks, utility and railway companies, all of which are outside the scope of this work).

[118] Insolvency Act 1986 s.8 and Sch.B1, para.2.

[119] The prudent administrator will have file notes to reflect his decision-making process, and this is particularly the case with so-called "pre-packaged" administrations where he will have to comply with the requirements of Statement of Insolvency Practice 16 which calls for an explanation of the administrator's decision to be given. (See also *Re Kayley Vending Ltd* [2009] B.C.C. 578 as to disclosure duties to the court.) A new version of SIP 16 took effect on 1 November 2015.

concern, unless he thinks either that it is not reasonably practicable to achieve that objective, or that an alternative course of action would achieve a better result for the company's creditors as a whole than would be likely if the company were wound up (without first being in administration)[120], in which case he must perform his functions with the objective of achieving that result instead. If he thinks that it is not reasonably practicable to achieve either of those objectives, then he may pursue the objective of realising property in order to make a distribution to one or more secured or preferential creditors, but only if in doing so he does not unnecessarily harm the interests of the creditors as a whole.[121]

2-041 If on an application to the court for an administration order the applicant satisfies the court that the order is reasonably likely to achieve the relevant objective, the court has a discretionary power to make the order.[122] However, the court must be satisfied that the company is or is likely to become unable to pay its debts[123]; and a company or its directors giving notice of intention to appoint an administrator "out of court" must file with the court a statutory declaration confirming that this is the case. Inability to pay debts for these purposes means inability to pay debts as they become due or a deficiency of assets in relation to liabilities, either is sufficient.[124] Insolvency is not a prerequisite to an appointment by a qualifying floating charge-holder, nor to an appointment by the court on an application by a qualifying floating charge-holder, although the floating charge must be enforceable on the date of the appointment.[125]

2-042 Once the appointment has taken effect, whether made by court order or out of court, there begins a period under the stewardship of the administrator in which to set the affairs of the company in order, to reorganise and repay its debts, or dispose of its business or assets for the benefit of creditors.[126] Administration is intended to

[120] Avoidance of statutory fees applicable in a compulsory liquidation was a relevant consideration in *Europcar Ltd v Top Marques Car Rental Ltd* [2005] All E.R. (D) 388 (Feb), but note that the relevant fee structures are now different.

[121] Insolvency Act 1986 Sch.B1, para.3. The objectives were not met in *Doltable Ltd v Lexi Holdings Plc* [2006] B.C.C. 918, where the primary purpose of the administration application was to use the moratorium on enforcing a secured creditor's rights in order to attempt to achieve a higher sale price for some land.

[122] See, e.g. *Bank of Scotland Plc v Targetfollow Properties Holdings Ltd* [2013] B.C.C. 817. For unusual cases in which the court exercised its discretion not to make an order despite the necessary grounds for such an order ostensibly being satisfied, see *Re Information Governance Ltd* [2015] B.C.C. 277; and *Rowntree Ventures Ltd v Oak Property Partners Ltd* [2016] EWHC 1523 (Ch).

[123] "Likely" in this context means "more probable than not": *Re COLT Telecom Group Plc* [2003] B.P.I.R. 324. In *Re Gigi Brooks Ltd* [2015] EWHC 961 (Ch), the court dismissed a creditor's application for an administration order because it was not satisfied that the company was, or was likely to be, unable to pay its debts even though the circumstances were such that some form of court intervention might be appropriate.

[124] Insolvency Act 1986 s.123 as applied by Sch.B1, para.111(1).

[125] (1) In *Barclays Bank Plc v Choicezone Ltd* [2012] B.C.C. 767, there was an issue as to enforceability because of cross-claims asserted by the debtor company. It was held that the floating charge would have been enforceable even if the cross-claims were substantiated (which they were not). (2) In *Closegate Hotel Development (Durham Ltd) v McLean* [2014] Bus L.R. 405, it was held that directors of companies which had been placed into administration by the holder of qualifying floating charges nonetheless retained the necessary powers to cause the companies to challenge the validity of the appointments. (3) In *Hooley Ltd v Ganges Jute Private Ltd* [2016] B.C.C. 826, the Court of Session held that the test of enforceability does not require any assessment of whether the charge could, in practice, be enforced against foreign assets.

[126] Examples are to be found in cases decided before the Insolvency Act 1986 of companies which went into liquidation but whose insolvency was only "temporary", e.g. *Re Rolls Royce Ltd* [1974] 1 W.L.R. 1584; and for the conversion of an insolvent into a solvent liquidation see *Re Islington Metal and Plating Works Ltd* [1984] 1 W.L.R. 14. The concept of a period of orderly stewardship following appointment, upon which the legislation was modelled, is somewhat at variance with the common practice of pre-packaged administrations.

be "only an interim and temporary regime"[127] which is not to remain in force for a long time[128] and which is "designed to revive, and to seek the continued life of the company if at all possible".[129] Though it is convenient to describe the breathing space afforded to the company as a moratorium, there is no authorisation to the company to postpone payment of its debts or discharge of its liabilities, but merely a limited immunity granted to the company against the enforcement of a number of legal rights and remedies (including various rights incidental to securities) without the leave of the court or the consent of the administrator.

2-043 Whilst the appointment of a receiver (administrative or non-administrative) can co-exist with that of a liquidator, the appointment of an administrator cannot co-exist with the appointment of an administrative receiver or liquidator.[130]

2-044 The court has no jurisdiction to appoint an administrator if there is an administrative receiver in office without the consent of his appointor, unless it thinks that the security under which the receiver was appointed can be challenged on specified grounds.[131] Once an administrator is appointed, no administrative receiver can be appointed throughout the administrator's period in office.

2-045 The administrator has extensive statutory powers which include a power to continue the company's business as agent for the company.[132] He is given power to appoint and dismiss the directors,[133] and any powers of the directors which might interfere with the exercise by the administrator of his powers are exercisable only with his permission.[134] His appointment will cease to have effect after one year (although it may be extended for a limited period by court order or by consent of the creditors). Otherwise, once the administrator has fulfilled his role, or his role ceases to be capable of fulfilment, his appointment will cease to have effect, and either the board of directors (as reconstituted) will regain full power or the company will be dissolved or wound up.[135]

2-046 Prior to the reform of Pt II of the Insolvency Act 1986 by the Enterprise Act 2002, there were substantial limitations on the effectiveness of this jurisdiction. Previously an administrator could not be appointed against the wishes of a debenture-holder if there was a floating charge under which the debenture-holder had ap-

[127] *Re Atlantic Computer Systems Plc* [1992] Ch. 505 (CA), 528, per Nicholls LJ.

[128] *Re Arrows Ltd (No.3)* [1992] B.C.C. 131, 135. See now also Insolvency Act 1986 Sch.B1, para.76.

[129] *Re MTI Trading Systems Ltd* [1998] B.C.C. 400 (CA), 403, per Saville LJ.

[130] As to co-existence of administration and non-administrative receivership, see below, Ch.6.

[131] Insolvency Act 1986 Sch.B1, para.39; *Chesterton International Group Plc v Deka Immobilien Inv GmbH* [2005] B.P.I.R. 1103. See further below, Ch.6.

[132] In *Re John Slack Ltd* [1995] B.C.C. 1116 it was held that an administrator had the power to pay off pre-administration debts in full out of the company's assets to ensure the survival of the company as a going concern but this decision should now be read subject to paras 65 and 66 of Sch.B1 to the Insolvency Act 1986. He should seek the guidance of the court where there is a substantial change in the circumstances which led to the making of the administration order, but should not seek the court's guidance as to the making of commercial decisions: *Re CE King Ltd* [2000] 2 B.C.L.C. 297; *Re T & D Industries Ltd* [2000] 1 W.L.R. 646.

[133] Insolvency Act 1986 Sch.B1, para.61.

[134] Insolvency Act 1986 Sch.B1, para.64. In Scotland, it has been held that para.64 does not prevent the directors of a company from causing the company to apply for the removal of an administrator: *Re Grant Estates Ltd* [2012] B.C.C. 537 (Court of Session, Outer House).

[135] As to ending administration generally, see the Insolvency Act 1986 Sch.B1, paras 76–86 (inclusive); and see also below, Ch.27.

CHAPTER 8

OFFICE-HOLDERS

1. INTRODUCTION

8-001 The Insolvency Act 1986 created the concept of the "office-holder", a novel status carrying special statutory privileges and responsibilities, which was conferred upon administrative receivers, liquidators (including provisional liquidators) and administrators.[1] A person holding any of these offices (unless an official receiver) is required to be qualified to act as an insolvency practitioner in relation to the company.[2] The requirement for a professional qualification in part reflects the far-reaching nature of an office-holder's special statutory privileges and responsibilities. These are designed to secure the beneficial management of the company's undertaking and the proper investigation of the company's affairs, to which the office-holder will usually be a stranger.

8-002 It is important to distinguish between the statutory concept of an "office-holder", and the different concept of an "officer of the court". Historically, officers of the court[3] have been persons appointed by the court who are subject to its general supervisory jurisdiction.[4] In accordance with the rule in *Ex p. James*,[5] officers of the court are obliged to act not only lawfully, but fairly and honourably.[6] Interference with their functions may be a contempt.[7] Court-appointed receivers and administrators have always been officers of the court. Somewhat curiously, but no doubt to ensure uniformity, administrators appointed out of court following the changes introduced by the Enterprise Act 2002 have also been accorded the status of officers of the court.[8] However, even though administrative receivers may seek the directions of the court in relation to matters arising in the administrative

1 Insolvency Act 1986 s.233(1).
2 Insolvency Act 1986 s.230 in relation to administrative receivers, liquidators and provisional liquidators, and para.6 of Sch.B1 in relation to administrators.
3 Such as court-appointed receivers, administrators, provisional liquidators and liquidators in a compulsory liquidation.
4 See, e.g. *Re Atlantic Computer Systems Plc* [1992] Ch. 505 (CA).
5 *Re Condon, Ex p. James (1873–74) L.R. 9 Ch. App. 609* (CA in Chancery).
6 See the consideration of the doctrine in *Re T&N Ltd* [2004] O.P.L.R. 343; *Re Agrimarche Ltd* [2010] B.C.C. 775; and *Re Alitalia Linee Aeree Italiane SpA* [2011] 1 W.L.R. 2049. See also the comments of Lord Neuberger in *Re Nortel Companies; Bloom v Pensions Regulator* [2014] A.C. 209 at [122] onwards. Liquidators in creditors voluntary liquidations are not officers of the court and are therefore not subject to the same principle: see *Re TH Knitwear (Wholesale) Ltd* [1988] Ch. 275 (CA). However, Lewison J commented (obiter) in *Re Agrimarche Ltd* that if the same person was an administrator (who is an officer of the court) and then became liquidator as the company, it would be odd to expect a different standard of conduct from that same person as an office-holder.
7 *Re Mead* (1875) L.R. 20 Eq. 282.
8 Insolvency Act 1986 Sch.B1, para.5.

receivership,[9] they are not officers of the court subject to the general control of the court, they are not susceptible to the rule in *Ex p. James*, and they are not protected by the principles of contempt of court.[10]

2. INSOLVENCY PRACTITIONERS

8-003 Only an individual, i.e. a natural person, can be qualified to act as an Insolvency Practitioner.[11] In order to be qualified,[12] an individual must be appropriately authorised under s.390A of the Insolvency Act 1986, which was introduced as part of the new "partial authorisation" regime.[13] An individual may now be either "fully authorised" or "partially authorised". An individual who is fully authorised may act as an insolvency practitioner in relation to companies, individuals and insolvent partnerships.[14] An individual who is partially authorised may act only in relation to companies or only in relation to individuals.[15] In both cases, the individual must also have security in force for the proper performance of his functions.[16] An individual can no longer be authorised in respect of voluntary arrangements only.[17]

8-004 In order to be fully authorised, a person must be[18]:

(a) a member of a professional body recognised under s.391(1) and permitted to act as an insolvency practitioner for all purposes under its rules; or
(b) authorised by the Department of Enterprise, Trade and Investment in Northern Ireland under art.352 of the Insolvency (Northern Ireland) Order 1989.

Insolvency practitioners may obtain authorisation from one of five recognised professional bodies.[19]

8-005 In order to be partially authorised, a person must be:

9 Pursuant to an application under s.35 of the Insolvency Act 1986. The list of persons who can apply to the court under s.35 is limited, and it is an unresolved question whether there is a general right in other interested parties to apply to the court for directions to be given to a receiver appointed out of court.
10 *Re Hill's Waterfall Estate and Gold Mining Co* [1896] 1 Ch. 947; *Re Magic Aust Pty Ltd* (1992) 10 A.C.L.C. 929.
11 Insolvency Act 1986 s.390(1).
12 Insolvency Act 1986 s.390(2). For the background to the introduction of the partial authorisation regime, see The Insolvency Service, *Consultation on Reforms to the Regulation of Insolvency Practitioners*, February 2011; *Consultation on Reforms to the Regulation of Insolvency Practitioners: Summary of Consultation Responses*, December 2011.
13 Introduced by the Deregulation Act 2015, with further amendments made by the Small Business, Enterprise and Employment Act 2015.
14 Insolvency Act 1986 s.390A(1)
15 Insolvency Act 1986 ss.390A and 390B.
16 Insolvency Act 1986 s.390(3), in Scotland a caution.
17 Section 389A of the Insolvency Act 1986, which provided for this, was repealed with effect from 1 October 2015 by Sch. 6(6) para.19 to the Deregulation Act 2015. BIS believed that the new partial authorisation regime made this section redundant.
18 Insolvency Act 1986 s.390A(2). Section 393, which provided for authorisation by a competent authority (the Secretary of State), was repealed with effect from 1 October 2015 by Sch.6(6) para 21 to the Deregulation Act 2015.
19 The Secretary of State has recognised for this purpose the following professional bodies: The Insolvency Practitioners Association, The Chartered Association of Certified Accountants, The Institute of Chartered Accountants in England & Wales, The Institute of Chartered Accountants in Ireland, The Institute of Chartered Accountants of Scotland. See the Insolvency Act 1986 ss.391, 419 and the Insolvency Practitioners (Recognised Professional Bodies) Order 1986 (SI 1986/1764). The Law Society and The Law Society of Scotland are, at their request, no longer recognised profes-

(a) a member of a professional body recognised under s.391(1) and permitted to act as an insolvency practitioner in relation only to companies or only to individuals under its rules; or
(b) a member of a professional body recognised under s.391(2) and permitted to act as an insolvency practitioner under its rules.

Additional restrictions are placed on individuals who are partially authorised and who are aware at the time of appointment, or who later become aware, that the company or individual (as the case may be) is or was a member of a partnership (other than, in the case of individuals, a Scottish partnership) and has outstanding liabilities in relation to the partnership. A person who is aware of these matters at the time of appointment may not accept that appointment.[20] A person who later becomes aware of these matters may not continue to act unless he is granted permission to do so by the court, save that he does not contravene this prohibition if he applies to the court for permission or for a replacement order within seven business days beginning with the day after that on which he becomes aware.[21]

8-006 In addition, there are six disqualifications under the 1986 Act.[22] A person is not qualified to act as an insolvency practitioner if:

(a) he is an undischarged bankrupt or an undischarged sequestration of his estate has been awarded;
(b) a moratorium period under a debt relief order applies to him;
(c) he is subject to a disqualification order made, or a disqualification undertaking accepted, under the Company Directors Disqualification Act 1986,[23] or the Company Directors Disqualification (Northern Ireland) Order 2002;
(d) he is a patient within the meaning of s.329(1) of the Mental Health (Care and Treatment) (Scotland) Act 2003 or has had a guardian appointed under the Adults with Incapacity (Scotland) Act 2000 (asp 4);
(e) he lacks capacity (within the meaning of the Mental Capacity Act 2005) to act as an insolvency practitioner; or
(f) a bankruptcy restrictions order or a debt relief restrictions order is in force in respect of him.

The Secretary of State is given power to make regulations (inter alia) prohibiting

sional bodies.

20 Insolvency Act 1986 s.390B(1) and (2).

21 Insolvency Act 1986 ss.390B(3) to (10). An individual may alternatively apply to the court for a "replacement order" appointing in his or her place a person who is fully authorised to act in relation to the company or the individual: s.390B(6).

22 Insolvency Act 1986 s.390(4) and (5).

23 Insolvency Act 1986 s.390(4)(b). The provisions of the Company Directors Disqualification Act 1986 (as amended): (i) give the court a discretion to make a disqualification order (an order disqualifying a person for a specified period from being a director of a company or receiver of its property or being concerned in any way in the promotion, formation or management of a company or from acting as an insolvency practitioner) if a person is found guilty of an indictable offence in connection with the promotion, formation, management or liquidation or striking off of a company, or with the receivership of a company's property or with being an administrative receiver of a company, or for persistent default in relation to specified provisions of the Companies Act; (ii) impose on the court a duty to make a disqualification order against a director or former director of a company which has gone into insolvent liquidation or administration or into administrative receivership and whose conduct as a director of that company (or of that and other companies) makes him unfit to be concerned in the management of a company (see, e.g. *Re Sevenoaks Stationers (Retail) Ltd* [1991] Ch. 164 (CA)); and (iii) permit the Secretary of State to accept a disqualification undertaking in lieu of applying to the court for a disqualification order for unfitness.

persons from acting as insolvency practitioners where a conflict of interest will or may arise.[24] The power has never been exercised but there is a very detailed Insolvency Code of Ethics which has been adopted by all the recognised professional bodies.[25] The Code includes five fundamental principles: integrity, objectivity, professional competence and due care, confidentiality and professional behaviour. It sets out a framework that practitioners can use to identify actual or potential threats and to determine what safeguards may be available to meet them. In particular, it deals with when an insolvency practitioner cannot properly accept appointment.[26]

If an unqualified person acts as an insolvency practitioner when he knows or has **8-007** reasonable cause to suspect that he is not qualified, he commits a criminal offence punishable on conviction by imprisonment or a fine or both.[27] But his acts as such insolvency practitioner are valid notwithstanding the defect in his qualification or appointment.[28]

3. SUPPLIES BY UTILITIES

Prior to the current insolvency legislation, public utilities (like any other creditor- **8-008** supplier) could require the payment of all arrears as a condition of continued or resumed supply to the company in receivership or liquidation, and thus, by the exercise of their monopoly position in the market, obtain a preference in respect of their unsecured debts over the debts due to preferential creditors and, indeed, a debenture-holder.[29] But unlike any other creditor-supplier, public utilities could not refuse supplies to a new occupier of property. A mortgagee of a company in dif-

24 Insolvency Act 1986 s.419(2)(b).

25 The Code can be found on the Insolvency Service website along with a short Background and Overview paper. See *http://www.bis.gov.uk/insolvency/insolvency—profession/Professional%20conduct/code—of—ethics* [Accessed 4 November 2014]. Adoption by the various recognised professional bodies may be subject to minor modifications to achieve compatibility with other ethical guidance.

26 *Sheppard & Cooper Ltd v TSB Bank Plc* [1996] B.C.C. 653 (CA) was an unusual case in which the court granted an injunction to prevent two insolvency practitioners from the same firm from being appointed as administrative receivers of a company. Their firm had previously been engaged to investigate the financial affairs of the company on terms that, to avoid any conflicts of interest, the firm "would not undertake any responsibility for the management of the company's affairs either now or in the future". The Court of Appeal stated that the receivers "were not appointed individually" but "were appointed jointly". This statement should be read in the context of the issue which was whether they, as partners of the firm for the time being, were bound to abide by the terms of the earlier contract. Compare *Re York Gas Ltd (In Creditors' Voluntary Liquidation)* [2011] B.C.C. 447 where an additional liquidator in the same firm was appointed to address a potential conflict of interest. Whatever the position as a matter of commercial reality, as a matter of law it is only individuals who can be appointed as office-holders under the Insolvency Act 1986, not firms or partnerships: see, e.g. *Re Sankey Furniture Ltd Ex p. Harding* [1995] 2 B.C.L.C. 594, 600–601.

27 Insolvency Act 1986 ss.389 and 390B.

28 Insolvency Act 1986 s.232. In the absence of such a validating provision, the appointment would be a nullity: see *Portman Building Society v Gallwey* [1955] 1 W.L.R. 96. Section 232 does not apply to administrators, but para.104 of Sch.B1 to the Insolvency Act 1986 validates acts of a defectively appointed or qualified administrator. However, this provision only applies to a defective appointment rather than where the appointment is a complete nullity: *Re Frontsouth (Witham) Ltd (In Administration)* [2011] B.C.C. 635.

29 The courts recognised no restriction on the right of a creditor to insist upon a collateral advantage, or a condition of continuing supplies, if the creditor possessed the legal right to cut off supplies: *Husey v London Electricity Supply Corp* [1902] 1 Ch. 411 (CA), 421 (court-appointed receiver). See also *Wellworth Cash & Carry (North Shields) Ltd v North Eastern Electricity Board* (1986) 2 B.C.C. 99265, where the threatened use of the Electricity Board's power to cut off electricity needed by a voluntary liquidator to keep food frozen, unless the pre-liquidation debt to the Board was paid in

ficulties therefore had a choice. He could appoint a receiver as agent of the company, in which case the company continued in occupation and payment or security could be demanded by the utility. Or the mortgagee could take possession as a new occupier, in which case payment or security could not be demanded.[30] If, as was usually the case, the mortgagee decided to appoint a receiver, there was an advantage in a receiver hiving down the company's business to a subsidiary which, as a new occupier, could require supplies without any responsibility for past arrears.[31]

8-009 This continues to be the position where a company property is the subject of a receivership other than an administrative receivership though, in practice, such receivers are not so often concerned with the continuation of the company's business, and are therefore less vulnerable to the withdrawal of supplies. The position is different in the case of an administrative receiver, administrator, liquidator, provisional liquidator, nominee or supervisor of a company voluntary arrangement.[32] Section 233 of the Insolvency Act 1986 provides that, where a request is made by or with the concurrence of an office-holder for supplies of gas, electricity, water, communication or certain information technology[33] services, the utility[34] may not, as a condition of supply, require the payment of charges for supplies provided prior to the "effective date".

8-010 Where an administrative receiver is the only office-holder in relation to a particular company, the "effective date" is the date on which he was appointed or the date on which the first of his predecessors in office was appointed.[35] In the case of an administration, it is the date when the company entered administration.[36] Questions arise as to the effective date where there are two dates potentially available, e.g. in the case of a concurrent administrative receivership and liquidation. Is the effective date that of the appointment of the administrative receiver or the date of the liquidation? And, where there are concurrent office-holders, is it relevant which of the office-holders requests or concurs in the request for supplies? It is suggested that the effective date is that relating to the appointment of the office-holder in question, save that, where a composition or scheme is approved after the date of his appointment, the effective date is the date of such approval.[37]

8-011 The legitimate interests of the supplier in getting paid are protected, in that the utility may make it a condition of giving a supply that the office-holder personally

full, was "deplored". Nevertheless, the Board was held to be entitled to exercise such power. Creditors other than utilities can still withhold supplies unless pre-receivership debts are paid in full, and this does not amount to an abuse of a dominant position within art.86 of the EEC Treaty: *Leyland DAF Ltd v Automotive Products Plc* [1993] B.C.C. 389 (CA).

30 *North American Trust Co v Consumer Gas Co* (1997) 147 D.L.R. (4th) 645.

31 For hive-downs, see Ch.6; cf. the technique available to a liquidator appointed by the court to seek an order vesting the property in the liquidator himself, who thereby becomes a new occupier: *Re Fir View Furniture Co Ltd, The Times*, 8 February 1971, per Brightman J; and see the Insolvency Act 1986 s.145(1).

32 All of whom are designated "office-holders" in this context: s.233(1) of the Insolvency Act 1986.

33 See para.8-012 below.

34 See Insolvency Act 1986 s.233(3) and (5) for a description of the relevant utilities whose services are covered by the section.

35 Insolvency Act 1986 s.233(4)(b).

36 Insolvency Act 1986 s.233(4)(a).

37 For the effective date in the case of administrations and company voluntary arrangements see s.233(4)(a), (ba) and (c).

guarantees the payment of any new charges.[38] To this extent, a hive-down still carries the advantage that no guarantee by the office-holder can be required. But a hive-down is unlikely to be worthwhile if undertaken simply for this reason and in practice an office-holder will always see to it that the post-hive-down debts of the subsidiary are paid, if only to avoid the risk of facing an allegation of fraudulent trading by himself or wrongful trading by the subsidiary's directors.

8-012 The services to which s.233 (and its bankruptcy equivalent, s.372) applies were extended with effect from 1 October 2015 to the supply of certain electronic goods or services by a person who carries on a business which includes giving such supplies, where the supply is for the purpose of enabling or facilitating anything to be done by electronic means.[39] These goods and services include point of sale terminals, computer hardware and software, information, advice and technical assistance in connection with the use of information technology, data storage and processing, and website hosting.

8-013 Section 233A provides that an insolvency-related term in a contract for the supply of essential goods or services to the company ceases to have effect when a company enters administration or a company voluntary arrangement takes effect.[40] This will apply to clauses (often known as "break" clauses) such as those providing for the automatic termination of the contract or supply of the service in the event that the company goes into administration or a voluntary arrangement. However, an insolvency-related term does not cease to have effect to the extent that it provides for an insolvency procedure other than administration or a voluntary arrangement, or to the extent that it entitles a supplier to terminate the contract or supply because of an event that occurs, or may occur, after the company enter administration or the voluntary arrangement takes effect.[41] Where s.233A applies, the contract of supply may only be terminated by the supplier if the insolvency office-holder consents to the termination, the court grants permission for the termination, or any charges in respect of the supply incurred after the company enters administration (or the company voluntary arrangement takes effect) are not paid within 28 days of the due payment date.[42] The court may only grant permission for termination if satisfied that the continuation of the contract would cause the supplier hardship.[43]

4. DELIVERY AND SEIZURE OF PROPERTY

8-014 Under s.234 of the Insolvency Act 1986 an administrative receiver or administrator can apply to the court[44] for an order that any person[45] who has in his possession any property, books, papers or records to which the company appears to be

38 Insolvency Act 1986 s.233(2)(a).

39 Insolvency Act 1986 ss.233(f) and (3A). These were inserted by art.2 of the Insolvency (Protection of Essential Supplies) Order 2015/989, which was made pursuant to s.92 of the Enterprise and Regulatory Reform Act 2013. For the background to these developments see *Continuity of Supply of Essential Services to Insolvent Businesses*, a consultation paper on the implementation of these changes published by the Insolvency Service on 8 July 2014.

40 Inserted by art.4 of the Insolvency (Protection of Essential Supplies) Order 2015/989, made pursuant to s.93 of the Enterprise and Regulatory Reform Act 2013.

41 Insolvency Act 1986 s.233A(2).

42 Insolvency Act 1986 s.233A(3) to (5).

43 Insolvency Act 1986 s.233A(4).

44 See the Insolvency (England and Wales) Rules 2016 (SI 2016/1024) Pt 12, on the detailed procedure for an application by an office-holder.

45 This may include a liquidator appointed prior to an administrative receiver: *Re First Express Ltd* [1991] B.C.C. 782.

entitled should give those items up to the office-holder. No specific sanctions are prescribed in the Act to deal with non-compliance. The office-holder has a lien on the property or proceeds of sale for expenses incurred in connection with the seizure or disposal.[46]

8-015 The section applies both to items actually belonging to the company and also to those that are the subject matter of a dispute as to ownership.[47] The court can, in proceedings under this section, decide questions of title.[48] The court will only make an order under this section if the items involved are being sought in order to enable the office holder to carry out his functions as such. In the case of an administrative receiver, this will be in order to protect and realise the mortgaged property for the benefit of the company and its creditors and will not be in order to assist the debenture holder in litigation against third parties.[49] This will generally mean that the items involved will have to fall within the property charged,[50] are needed to support the debenture-holder's title or are otherwise required by the administrative receiver to carry out his duties and functions. In granting an order for delivery up of property so that the office-holder may fulfil his statutory duties, the court may refuse an order that would be expensive to comply with and hence would have a draconian effect on a respondent who has few resources, or where the property sought was not sufficiently clearly defined. The court may also use its case management powers in making the order and encourage co-operation between the parties.[51]

8-016 Where an office-holder has reasonable grounds for believing that he is entitled to seize or dispose of any property and does so, he has special statutory protection under s.234(4) of the Insolvency Act 1986.[52] If it turns out that the property seized or disposed of did not belong to the company, the office-holder will not be liable to any person in respect of any loss or damage resulting from the seizure or disposal except in so far as it is caused by his negligence. This applies whether or not the office-holder has acted following a court order under s.234(2). The protection afforded by these provisions is limited to tangible property, although the office-holder may have recourse to other defences in any action for wrongful interference with contractual relations.[53] The court may not require a person to deliver up company property to the office-holder under s.234 if it is not satisfied that the office-

46 Insolvency Act 1986 s.234(4)(b).

47 See *Re London Iron & Steel Co Ltd* [1990] B.C.C. 159, where the court held that it had power to deal with an application under s.234 for an order that property be handed over to an administrative receiver even though there was a dispute as to its ownership which could have been the subject of separate legal proceedings. It now appears that the courts are readily prepared to address questions of disputed ownership on an application under s.234: see *Euro Commercial Leasing Ltd v Cartwright & Lewis* [1995] B.C.C. 830 (a solicitors' lien); *Re Cosslett (Contractors) Ltd* [1998] Ch. 495 (CA) (plant on a construction site). The court has no power to determine ownership where the question of ownership is to be resolved by a foreign court: *Re Leyland DAF Ltd* [1994] B.C.C. 166.

48 *Re London Iron & Steel Co Ltd* [1990] B.C.C. 159.

49 *Sutton v GE Capital Commercial Finance Ltd* [2004] 2 B.C.L.C. 662 (CA).

50 See *Re First Express Ltd* [1991] B.C.C. 782.

51 *Jackson v Cannons Law Practice LLP* [2013] B.P.I.R. 1020.

52 See, for example, *Euromex Ventures Ltd v BNP Paribas Real Estate Advisory and Property Management UK Ltd* [2013] EWHC 3007 (Ch). For a consideration of the risk to an office-holder of a personal claim, see E. Goodwin, "Retention of title, conversion and administrators" (2009) Insolv. Int. 4-10.

53 See *Welsh Development Agency v Export Finance Co Ltd* [1992] B.C.C. 270 (CA), 287–288 where the court rejected the receivers' defence to an action for wrongful interference on the basis that s.234(3) and (4) were inapplicable to choses in action but held that the receivers' conduct as agents of the company was immune on the basis of the rule in *Said v Butt* [1920] 3 K.B. 497. The Court of Appeal concluded that the references to seizure meant that s.234(3) and (4) only applied to tangibles.

holder's conditions for the protection of the person are adequate to protect that person's rights, particularly if the net benefit to the company is small in relation to the likely detriment to that person.[54]

8-017 Applications under s.234 should be made in the name of the office-holder, rather than the company.[55] Applications should normally be made on notice, and an application without notice can only be justified if two conditions are met:

(i) notice to the respondent would be likely to cause injustice to the applicant as a result of delay or because of action that would be taken before the hearing; and

(ii) any damage that the respondent might suffer can be compensated by a cross-undertaking or the risk of loss to the respondent which cannot be compensated is clearly outweighed by the risk of injustice to the applicant.[56]

Section 234 only allows an office-holder to gain possession of an item in specie. It does not form the statutory basis for an action in conversion by the office-holder.[57]

5. CO-OPERATION FROM DIRECTORS, ETC.

8-018 Under s.235(2) of the Insolvency Act 1986, an office-holder may require, without a court order, that directors and certain others attend upon him and/or give him such information about the company as he may reasonably require. The persons subject to the requirements of this provision include not only all present and past officers of the company, but also certain promoters, and certain persons "in the employment of" the company.[58] The term "employment" is given an expanded definition by s.235(3)(c), so as to include "employment under a contract for services". This will accordingly include professional advisers to the company.

8-019 Section 235 does not provide any guidance as to how a court should determine the reasonableness of any requirement by the office-holder. By analogy with cases decided under s.236 (see paras 8-024 to 8-029 below),[59] it is suggested that what may reasonably be required must involve a consideration of what is required for the efficient conduct of the insolvency process in question. The test is what is "reasonably required" not what is "necessary", and the onus of showing that a requirement is a reasonable one will be on the office-holder. In most cases the views of the office-holder will be entitled to a good deal of weight.[60] The interviewee can only be compelled to answer questions relating to the affairs of the company of which they were an office-holder or employee; however this includes questions

54 *Uniserve Ltd v Croxen* [2013] B.C.C. 825.

55 *Smith (Administrator of Cosslett (Contractors) Ltd) v Bridgend CBC* [2002] 1 A.C. 336 (HL). In the case of documents, since they will be the property of the company, it will be for the office-holder to determine whether to disclose them to the relevant authorities: see *Walker Morris v Khalastchi* [2001] 1 B.C.L.C. 1.

56 See *Re First Express Ltd* [1991] B.C.C. 782, 785E.

57 *Re Cosslett (Contractors) Ltd* [1998] Ch. 495 (CA), [24].

58 Insolvency Act 1986 s.235(3), (4).

59 See *Re Alocasia Ltd* [2014] EWHC 1134 (Ch), in which the two provisions were applied simultaneously.

60 See *Re Corporate Jet Realisations Ltd* [2015] B.C.C. 625 at [23]-[24]. In the context of s.236 of the Insolvency Act 1986, see, e.g. *Sasea Finance Ltd v KPMG* [1998] B.C.C. 216, 220F; and *Re Atlantic Computers Plc* [1998] B.C.C. 200, 209D, per Robert Walker J. The further proceedings in the *Sasea Finance* case at [1999] B.C.C. 103 indicate limits on the possible use of s.236 for tactical purposes in litigation (see para.8-040 below).

which may shed light on the affairs of another company of which they were not an officer or employee.[61]

8-020 Failure to heed the office-holder's request without reasonable excuse is a criminal offence punishable by the imposition of a fine.[62] A failure to respond can also be the subject of an application to the court to compel compliance,[63] or can be a ground for an application under s.236.[64] Failure by a director of an insolvent company to co-operate with an office-holder who is attempting to exercise their powers under s.235 may be relevant on an application for a disqualification order under s.6 of the Company Directors Disqualification Act 1986.[65] An unreasonable request by an administrator may be the subject of an application to the court to exercise its supervisory jurisdiction to order the request to be withdrawn. But as an administrative receiver is not an officer of the court, there would not appear to be any obvious mechanism for the recipient of an unreasonable request under s.235 from an administrative receiver to seek an order that the request be withdrawn. A claim for a declaration that the request was unreasonable may be the only remedy. However, the office-holder's unreasonable conduct in making a request will be a defence to any application to enforce the request or to a criminal charge.[66]

8-021 A person who is subject to a request under s.235 of the Insolvency Act 1986 would have no defence to an application to enforce compliance or to criminal liability under the section if he refused to respond to questions simply because he feared that he might incriminate himself by his answers. This is because s.235 implicitly abrogates the privilege against self-incrimination.[67] Such criminal liability for non-disclosure would not itself infringe the European Convention on Human Rights,[68] but the later use of information obtained might do so.[69]

8-022 The proper functions of an office-holder in an insolvency proceeding include an investigation into the causes of the company's failure and as to whether any criminal offences have been committed.[70] An office-holder has a duty to report to the Secretary of State on the conduct of the company's directors if the company has

61 *Re Bernard L Madoff Investment Securities LLC* [2010] B.C.C. 328. In that case, which involved allegations of complex international fraud, Lewison J said "the trustee would not, in my judgment, be entitled to attend a meeting to ask questions about the American company. The office-holder would, of course, be entitled to ask questions about the English company which may shed light on the dealings and affairs of the American company, but s.235 is not, as I see it, a shortcut to an application by the American trustee in bankruptcy under art.21 [in Sch.1 to] the Cross-Border Insolvency Regulations 2006 (SI 2006/1030)."

62 Insolvency Act 1986 ss.235(5) and 430 and Sch.10.

63 See 2016 Rules r.12.52; *Re Corporate Jet Realisations Ltd* [2015] B.C.C. 625; and *Re Wallace Smith Trust Co Ltd* [1992] B.C.C. 707.

64 See, e.g. *Miller v Bain* [2002] B.C.C. 899; and *Hunt v Renzland* [2008] B.P.I.R. 1380.

65 *Re Artistic Investment Advisers Ltd* [2015] 1 B.C.L.C. 619 (ChD); *Re Brampton Manor (Leisure) Ltd* [2009] EWHC 1796 (Ch).

66 See Insolvency Act 1986 s.235(5) where liability depends on failure to meet the office-holder's request "without reasonable excuse".

67 *Bishopsgate Investment Ltd v Maxwell* [1993] Ch. 1 (CA).

68 See *Al-Fayed v United Kingdom* (1994) 18 E.H.R.R. 393 (ECtHR); and *Saunders v United Kingdom* [1997] B.C.C. 872 (ECtHR) on investigations under Pt XIV of the Companies Act 1985. The *Saunders* case was followed in *Kansal v United Kingdom* (2004) 39 E.H.R.R. 31 (ECtHR).

69 *Saunders v United Kingdom* [1997] B.C.C. 872 (ECtHR). See also the Insolvency Act 1986 s.433, as amended by the Youth Justice and Criminal Evidence Act 1999 s.59 Sch.3, para.7, the scope of which was considered in *R v Sawtell* [2001] B.P.I.R. 381 (CA).

70 *Re Pantmaenog Timber Co Ltd* [2004] 1 A.C. 158 (HL); *R. v Brady* [2004] 1 W.L.R. 3240 (CA).

become insolvent.[71] Accordingly, the office-holder can make a request under s.235 aimed solely at determining the responsibility of the directors for the collapse of the company and with a view to assisting the Secretary of State to determine whether disqualification proceedings should be brought against the directors concerned.[72] The office-holder can also disclose information or documents obtained under s.235 to the relevant prosecuting authorities, in order that they might decide whether to bring criminal charges.[73]

8-023 The Secretary of State also has powers to compel disclosure of information acquired by any person (including an office-holder).[74] This is so even if the office-holder has given an assurance that information or documents will only be used for the office-holder's own, limited, purposes.[75] So while an office-holder may, in his discretion, give undertakings of confidentiality in respect of information obtained or to be obtained by him under s.235, he cannot be required to give such undertakings,[76] and he cannot give an assurance that information will be withheld from anyone to whom he must report the information, or anyone who can by law require the information of him.[77]

6. EXAMINATION ON OATH OF DIRECTORS, ETC

8-024 Section 236 of the Insolvency Act 1986 confers on an office-holder "an extraordinary power to assist him in obtaining information about the company's affairs",[78] a power also described as "drastic and far-reaching".[79] This work is principally concerned with applications made by administrators or receivers, but it should not be forgotten that they might be the object of such an application.[80] Under the section, an office-holder[81] may seek an order from the court for the attendance of any officer of the company, any person known or suspected of having any

71 Company Directors Disqualification Act 1986 s.7A.

72 *Re Pantmaenog Timber Co Ltd* [2004] 1 A.C. 158 (HL).

73 *R. v Brady* [2004] 1 W.L.R. 3240 (CA).

74 Company Directors Disqualification Act 1986 s.7(4).

75 See *Re Polly Peck International Plc* [1994] B.C.C. 15. The case concerned an administrator, rather than an administrative receiver, but the reasoning is equally applicable to an administrative receiver, being based on the duties and responsibilities of office-holders in general under the Company Directors Disqualification Act 1986.

76 *Re Barlow Clowes Gilt Managers Ltd* [1992] Ch. 208; *McIsaac, Petitioners; Joint Liquidators of First Tokyo Index Trust Ltd* [1994] B.C.C. 410 (Court of Session, Outer House).

77 In *Re Arrows Ltd (No.4)* [1995] 2 A.C. 75 (HL), 102–103, per Lord Browne-Wilkinson.

78 In *Re Castle New Homes Ltd* [1979] 1 W.L.R. 1075, 1080G, per Slade J, referring to s.268 of the Companies Act 1948, one of the statutory predecessors to s.236 of the Insolvency Act 1986. See also *Joint Administrators of British & Commonwealth Holdings Plc v Spicer & Oppenheim* [1993] A.C. 426 (HL), 439D, per Lord Slynn.

79 *Re Rolls Razor Ltd (No.2)* [1970] Ch. 576, 583D, per Megarry J, addressing s.268 of the Companies Act 1948. For a summary of the development of the powers of the courts to order private examinations, see the judgment of Lord Millett NPJ in *The Joint & Several Liquidators of Akai Holdings Lte v The Grande Holdings Ltd* [2006] HKCFA 113; and the judgment of Bokhary PJ in *Akai Holdings Ltd v Ernst & Young* [2009] HKCFA 14.

80 See, e.g. *Re Trading Partners Ltd* [2002] 1 B.C.L.C. 655; and *Re Delberry Ltd* [2008] B.C.C. 653.

81 The court may, in recognising a foreign insolvency office-holder under the Cross-Border Insolvency Regulations 2006, confer upon him the powers accorded to his UK counterparts under s.236 where there exists a sufficient connection with the UK and the order would facilitate the purpose of the overseas insolvency procedure: see *Re Phoenix Kapitaldienst GmbH* [2008] B.P.I.R. 1082. See also *Re Chesterfield United Inc* [2012] B.C.C. 786 where s.236 was used to enable foreign liquidators of two offshore companies, in proceedings recognised under the Cross-Border Insolvency Regulations 2006 (SI 2006/1030), to obtain an order for disclosure of documents from a German bank in

property of the company or supposed to be indebted to it, or any person the court thinks capable of giving information concerning the promotion, formation, business, dealings, affairs or property of the company.[82] Also under the section, such a person may be ordered to submit an affidavit to the court containing an account of his dealings with the company or to produce any books, papers or records in his possession or under his control relating to the company or to its promotion. An order for production of documents may be made even if the person in possession of the documents holds a valid lien,[83] although any order for production will be without prejudice to the lien. An order to produce books, papers or other records can include documents in electronic form.[84] A person summoned under this procedure can also be examined in private on oath, either orally or by interrogatories.[85]

8-025 Section 237(3) of the Insolvency Act 1986 provides that the court may order a person to be examined in any part of the UK where he may be for the time being, or in any place outside England and Wales. In a few cases, an examination overseas may be more convenient than requiring the proposed examinee to attend in England and Wales, with travelling and hotel expenses and the possible need for an interpreter.[86] It is not clear whether the court may, under ss.236 and 237, order someone who is resident abroad to submit to an examination in the UK.[87] The court has, however, ordered a person who is abroad to submit an account of his dealings

relation to the two companies.

82 The jurisdiction under s.236 extended, in the unusual case of *Cowlishaw v O&D Building Contractors Ltd* [2009] N.P.C. 112, to an order for production of documents held by building contractors to enable the liquidator to ascertain the state of completeness of a property development. In that case the respondent was not an officer or employee of the company, nor was it in a contractual relationship with the company. Nor did the company own the documents or have any entitlement to inspect them. However the application failed in part because of the indiscriminate nature of the request for documents.

83 *Re Aveling Barford Ltd* [1989] 1 W.L.R. 360, 364–365: according to Hoffmann J a lien was irrelevant in an action by the administrative receiver for production as between himself and the solicitor since the lien could not affect third parties and s.236 had conferred third party status on an administrative receiver ("a solicitor's lien is simply a right to retain his clients' documents as against the client and persons representing him" per Lord Lindley MR in *Re Hawkes* [1898] 2 Ch. 1, 7). Although administrative receivers, unlike other office-holders, cannot rely on s.246 of the Insolvency Act 1986 to render the lien unenforceable, the availability of an order for possession effectively renders the solicitor's lien substantially worthless.

84 *Re Comet Group Ltd (In Liquidation)* [2015] B.P.I.R. 1.

85 Insolvency Act s.237(4). 2016 Rules r.12.20 sets down the procedure for hearings. In particular, a full transcript must be provided and approved by the person giving evidence. cf. Insolvency Act 1986 s.133, which involves a public examination of officers or others before the court.

86 2016 Rules Sch.4 para.1 now provides that service out of the jurisdiction is governed by Pt 6 of the Civil Procedure Rules. The position under the Insolvency Rules 1986 was that rr.6.30–6.51 of the Civil Procedure Rules did not apply in insolvency proceedings and the provisions in the Practice Direction on Insolvency Proceedings 2014 applied instead: *Hosking v Apax Partners LLP* [2016] B.P.I.R. 903. See also *Official Receiver v Sahaviriya Steel Industries Plc* [2016] B.C.C. 456. The court's jurisdiction in relation to persons residing abroad is discussed below in Chs 30 and 31.

87 See *Re MF Global UK Ltd* [2016] Ch. 325; and *Re Omni Trustees Ltd* [2015] B.C.C. 906. In *McIsaac, Petitioners; Joint Liquidators of First Tokyo Index Trust Ltd* [1994] B.C.C. 410 (Court of Session, Outer House) the court rejected a submission than an order under s.236 for oral examination and the production of documents could not be made against a person resident in New York (although in *Re MF Global UK Ltd* it was accepted by both parties that that decision was based on the mistaken belief that the US fell within the definition of a relevant country or territory for the purposes of s.426(5) of the Insolvency Act 1986). See also *Re Casterbridge Properties Ltd (No.2)* [2002] B.C.C. 453 (esp. [37] onwards, noting the criticism, at [43], of the *First Tokyo Index Trust* case); on appeal [2004] 1 W.L.R. 602 (CA); *Miller v Bain* [2002] B.C.C. 899; and the comments, obiter, of Lord Mance in the House of Lords in *Masri v Consolidated Contractors International (UK) Ltd (No.4)* [2010] 1 A.C. 90, [20]-[23]. In *Re MF Global UK Ltd* [2016] Ch. 325, David Richards J

with the company to the court or to produce documents under s.236(3).[88] Where a potential respondent is abroad, a possible alternative to an application under s.236 is to request the court to issue letters rogatory, addressed to a foreign court, seeking the assistance of that court for the purposes of examining the respondent or acquiring documents.[89] A foreign representative (such as a liquidator of a foreign company) may obtain an order recognising foreign proceedings under the Cross-Border Insolvency Regulations 2006[90] and go on to obtain relief from the English court to protect the assets of the debtor and interests of the creditors: this can include a s.236 order for the production of documents.[91] In such a case, however, it may be appropriate for the court to require the foreign representative to provide security for the respondent's costs if the application for recognition and/or for an order under s.236 is contested.[92]

8-026 It is unclear whether a court may on a s.236 application order the disclosure by a public body of information obtained from a foreign authority pursuant to a letter of request under the Crime (International Co-operation) Act 2003, where guarantees have been given to the foreign authority that the information provided would be used for a limited purpose only. In *XYZ v Revenue and Customs Commissioners*[93] such orders were given by consent of the foreign authorities in circumstances where the HMRC was both the requesting authority and the sole creditor of the insolvent company.

8-027 Failure to comply with an order under s. 236 is a contempt of court and may merit a custodial sentence.[94] Where a person summoned to appear under s.236 fails to do so without reasonable excuse or where there are reasonable grounds for believing that he is about to abscond, or has absconded, with a view to avoiding an appearance before the court, the court may issue a warrant for that person's arrest and for the seizure of any books, papers, records, money or goods in that person's

held at [33] that s.237(3) does have extraterritorial effect, but that before making any such order the court will need to be satisfied that the case is covered by available procedural machinery by which the respondent can be compelled to comply with the order.

88 In *Re MF Global UK Ltd* [2016] Ch. 325, David Richards J felt obliged to hold that, following the bankruptcy case of *Re Tucker* [1990] Ch. 148, s.236 does not have extraterritorial effect and that no order could be made under it against a French company. However, in *Re Omni Trustees Ltd* [2015] B.C.C. 906, HH Judge Hodge QC distinguished *Re Tucker* on the basis that s.236(3) confers a free-standing power, independent of the power to summon a person to appear before the court for examination, to require a person to produce documents. The court therefore concluded that s.236(3) does have extraterritorial effect. In the exercise of its discretion under the section, the court will however be mindful of: (i) the possibility that disclosure might expose the respondent, or its officers or employees, to liability under foreign law; (ii) the need to respect the sovereignty of other jurisdictions; and (iii) whether the order is likely to be effective. See *Re Mid East Trading Ltd* [1998] 1 All E.R. 577 (CA).

89 *Re Anglo American Insurance Co Ltd* [2002] B.C.C. 715.

90 SI 2006/1030 Sch.1 arts 15, 17

91 In *Re Chesterfield United Inc* [2012] B.C.C. 786 the court under art.21(1)(g) ordered "additional relief" under s.236 against a German bank to produce documents in relation to two offshore companies on the application of their liquidators as recognised representatives in recognised foreign proceedings. The liquidators "reasonably required" the documents under s.236 to enable them to establish whether the companies had a valuable course of action so that relief was likely to be "necessary to protect the assets of the debtor or the interests of the creditors" under art.21(1)(g), which gave wider relief than art.21(1)(d) which allowed the examination of witnesses, the taking of evidence or the delivery of information concerning the debtor's assets, affairs, rights, obligations or liabilities.

92 *Re Dalnyaya Step LLC* [2017] EWHC 756 (Ch).

93 *XYZ v Revenue and Customs Commissioners* [2010] B.P.I.R. 1297.

94 See *Re Hartmayes Ltd* [2013] EWHC 4624 (Ch); and *Power v Hodges* [2016] B.P.I.R. 140.

possession.[95] Express provision is made in the 2016 Rules for the tender of conduct money to a proposed examinee,[96] and it may presumably be a reasonable excuse for non-appearance that no conduct money has been tendered.

8-028 Where it appears to the court from any evidence obtained under this provision that "any person" has in his possession any property of the company or is indebted to the company, the court may order delivery up of the property or payment of the sum involved to the administrative receiver as office-holder.[97] This part of this provision appears to have been derived from s.25 of the Bankruptcy Act 1914. In practice, such summary orders are rare and should only be made against the examinee himself on the basis of a clear admission.[98] The court should not use this provision to determine title to an asset without giving a hearing to anyone making an adverse claim to that asset. To do otherwise might constitute a breach of the provisions of the European Convention on Human Rights (the right to peaceful enjoyment of possessions, subject to due process of law and the right to a fair trial), which the courts must now uphold under ss.3 and 6 of the Human Rights Act 1998.

8-029 The court's powers under s.236 of the Insolvency Act 1986 are very wide, and even bind the Crown, so that information may be obtained under the section from government officials.[99] Nevertheless, the powers are limited by other statutory obligations of confidentiality and non-disclosure. So, in *Re Galileo Group Ltd*,[100] Lightman J held that the court's jurisdiction to order disclosure under s.236 of the Insolvency Act 1986 was implicitly limited by s.82 of the Banking Act 1987, which requires that information received for the (regulatory) purposes of the Banking Act be kept confidential, unless the relevant consents to disclosure are obtained. He therefore held that the court could not order disclosure of documents containing information within the scope of s.82, and that while the court had jurisdiction to order disclosure of redacted copies of the documents from which the confidential information had been excised,[101] it was inappropriate to exercise that jurisdiction in the circumstances, given that: (i) making such an order might undermine the protection afforded by s.82 and thereby prejudice the free flow of information to the Bank of England, which was vital for the performance of the function which it then had as regulator of the banking system; (ii) framing and performing such an order might well be very difficult; (iii) there was a risk that failure to remove all

95 Insolvency Act 1986 s.236(4) and (5). The court may even, in a serious case, seek to restrain a person from leaving the jurisdiction under the powers in the Senior Court Act 1981, until he has complied with his obligations: *Re Oriental Credit Ltd* [1988] Ch. 204; and *Morris v Murjani* [1996] 1 W.L.R. 848 (CA). In an appropriate case, for example, where a prospective examinee had previously failed to co-operate with the liquidators of the company concerned, the court may require security from the examinee as a condition that he be allowed to leave the country, even though he is not a British national: see *Re BCCI (No.7)* [1994] 1 B.C.L.C. 455.

96 2016 Rules r.12.22(4).

97 Insolvency Act 1986 s.237(1) and (2). "Property of the company" can include not only property beneficially owned by the company, but also property or money held by the company on trust and not beneficially owned by it: *Re Omni Trustees Ltd* [2015] B.C.C. 906 (HH Judge Pelling QC).

98 See *Re A Debtor (No.26 of 1982)* (1983) 126 S.J. 783.

99 *Soden v Burns* [1996] 1 W.L.R. 1512.

100 *Re Galileo Group Ltd* [1999] Ch. 100.

101 In this case, any redaction would have been undertaken by the recipient of information, because of its duties in relation to the information. Note also *Soden v Burns* [1996] 1 W.L.R. 1512, 1532C, per Robert Walker J, where, in the absence of such duties, any redaction was to be undertaken at the behest of the examinee in question, rather than by the recipient of the information.

embargoed material might constitute a criminal offence; and (iv) there was a risk that the redacted document might prove misleading.

7. THE APPROACH OF THE COURTS TO MAKING ORDERS UNDER SECTION 236

8-030 The position under s.236 was explained by Buckley J in *Re Rolls Razor Ltd (No.1)*,[102] in a passage subsequently approved by the Court of Appeal in *Re Esal (Commodities) Ltd (In Liquidation)*,[103] and by the House of Lords in the leading case of *British & Commonwealth Holdings Plc (Joint Administrators) v Spicer & Oppenheim*[104]:

> "The powers conferred by section [236] are powers directed to enabling the court to help a liquidator to discover the truth of the circumstances connected with the affairs of the company, information of trading, dealings, and so forth, in order that the liquidator may be able, as effectively as possible, and, I think, with as little expense as possible to complete his function as liquidator, to put the affairs of the company in order and to carry out the liquidation in all its various aspects, including, of course, the getting in of any assets of the company available in the liquidation."

8-031 In the same case the House of Lords rejected a suggestion that had arisen in earlier cases that the powers of the court under s.236 might be limited to assisting the office-holder to reconstitute the state of knowledge of the company.[105]

> "The wording of the section contains no express limitation to documents which can be said to be part of a process of reconstituting the company's state of knowledge. The words are quite general … nor do I see any support in earlier judgments which may have been cited to us relating to the predecessors of section 236 or to comparable sections for such a limitation to 'reconstituting the company's knowledge'."[106]

The Official Receiver may make an application under s.236(1) even where the Official Receiver is not the liquidator of the company, and in those circumstances the scope of s.236 is extended to include the investigatory functions of the Official Receiver, and not merely to the efficient conduct of the winding up of the company.[107]

8-032 Before making any order under s.236, the office-holder will need to prove to the satisfaction of the court that the information he seeks under the proposed order is in fact reasonably required.[108] In the usual case his views will be given great weight, and he is under no duty to make out the requirement in such detail as would be

102 *Re Rolls Razor Ltd (No.1)* [1968] 3 All E.R. 698, 700.

103 *Esal (Commodities) Ltd (In Liquidation)* (1988) 4 B.C.C. 475 (CA), 480.

104 *British & Commonwealth Holdings Plc (Joint Administrators) v Spicer & Oppenheim* [1993] A.C. 426 (HL). See also the summary of principles by Lord Millett NPJ in *The Joint & Several Liquidators of Akai Holdings Ltd v The Grande Holdings Ltd* [2006] HKCFA 113, [22]–[30].

105 See, e.g. *Re Rolls Razor Ltd (No.2)* [1970] Ch. 576, 591–592, per Megarry J; and *Cloverbay Ltd v Bank of Credit and Commerce International* [1991] Ch. 90 (CA), 102, per Browne-Wilkinson VC.

106 *British & Commonwealth Holdings Plc (Joint Administrators) v Spicer & Oppenheim* [1993] A.C. 426 (HL), 437B–D, per Lord Slynn.

107 *Re Pantmaenog Timber Co Ltd* [2004] 1 A.C. 158 (HL).

108 The test is one of "reasonable requirement", not "absolute need": see *Re Atlantic Computers Plc* [1998] B.C.C. 200; and *Joint Liquidators of Sasea Finance Ltd v KPMG* [1998] B.C.C. 216; *Re XL Communications Group Plc* [2005] EWHC 2413 (Ch). See also *The Joint & Several Liquidators of Akai Holdings Ltd v The Grande Holdings Ltd* [2006] HKCFA 113, [30] per Lord Millett NPJ; *Re Corporate Jet Realisations Ltd (In Liquidation)* [2015] B.C.C. 625; and *Re Ex Ced Foods, ANZ National Bank v Sheahan* [2012] NZHC 3037 at [51]–[67].

expected in, for example, an application for specific disclosure in the context of ongoing litigation.[109]

8-033 When considering the exercise of its discretion under s.236, the court may also be interested in the steps taken by the office-holder before applying to the court. Unless there are factors negativing this (for instance, cases of great urgency), an office-holder ought in most cases to seek co-operation under s.235 of the Insolvency Act 1986 where a proposed examinee comes within that section, and in other cases may be well advised to submit a questionnaire seeking written answers. Although under the old bankruptcy and winding-up provisions information was often sought first by means of a questionnaire, it is entirely a matter for the court's discretion whether the office-holder is required to submit a questionnaire before being granted an order for an affidavit or an examination on oath.[110] In practice, persons of whom misconduct is suspected, usually directors or other insiders, will often not be allowed the advance notice of inquiries that a questionnaire would give, whereas parties who have no likely motive for concealing information will often only be requested to answer a questionnaire, and may only be examined if the answers to the questionnaire prove unsatisfactory.[111]

8-034 As s.236(2) confers a general discretion on the court,[112] any question concerning the exercise of that discretion will involve the court in a balancing exercise.[113] On the one hand, the court will wish to help the office-holder discharge his functions efficiently, expeditiously and in the interest of creditors, recognising that the office-holder is usually a stranger to the relevant events. On the other, the courts have long been aware of the potential for oppression in the use of such powers,[114] and have sought to limit that potential through their approach to the exercise of discretion under the section.

8-035 In each case, the court will take into account several factors when exercising its

[109] In relation to the matters stated in this paragraph, see *Re John T. Rhodes Ltd* (1986) 2 B.C.C. 99284, per Hoffmann J; 2016 Rules r.12.18(1); and *Joint Liquidators of Sasea Finance Ltd v KPMG* [1998] B.C.C. 216. See also *Re Alocasia Ltd* [2014] EWHC 1134 (Ch) at [53], where regard was had to the fact that "[t]hese are liquidators, and experienced liquidators ..". HH Judge Mark Raeside QC also rejected outright the proposition that "if liquidators were short on material that was not a proper reason to seek an application".

[110] *Re Norton Warburg Holdings Ltd* (1983) 1 B.C.C. 98907; and *Re Embassy Art Products* (1987) 3 B.C.C. 292.

[111] See *Re Norton Warburg Holdings Ltd* (1983) 1 B.C.C. 98907 (detailed written questions were required since the examinees had indicated that they would provide all reasonable assistance); and *Re Embassy Art Products* (1987) 3 B.C.C. 292 (where no prior notice of questioning was required). cf. *Re Rolls Razor (No.2)* [1970] Ch. 576 (no need for prior questioning where suspicious circumstances existed); and *House of Spring Gardens Ltd v Waite (No.1)* [1985] F.S.R. 173 (CA) (cross-examination in proceedings for a freezing injunction as to assets without prior notification of area of questioning). If less than full disclosure is made, the respondent may be required to attend for cross-examination: *JSC BTA Bank v Solodchenko* [2011] EWHC 843 (Ch).

[112] *British & Commonwealth Holdings Plc v Spicer and Oppenheim* [1993] A.C. 426 (HL), 437A–440A, per Lord Slynn. See also Lord Woolf's judgment in the Court of Appeal in the same case [1992] Ch. 342 (CA), 392–393.

[113] The need for a balancing exercise is repeated in numerous cases: see, e.g. *Cloverbay Ltd v Bank of Credit and Commerce International* [1991] Ch. 90 (CA); *British & Commonwealth Holdings Plc v Spicer and Oppenheim* [1993] A.C. 426 (HL); *Re BCCI (No.7)* [1994] 1 B.C.L.C. 455; *Re Bishopsgate Investment Management Ltd (No.2)* [1994] B.C.C. 732; *Re Maxwell Communications Corp Plc* [1994] B.C.C. 741; *Re BCCI (No.12)* [1997] B.C.C. 561; *Re Atlantic Computers Plc* [1998] B.C.C. 200; *Joint Liquidators of Sasea Finance Ltd v KPMG* [1998] B.C.C. 216.

[114] Such powers date back to s.115 of the Companies Act 1862: see, e.g. *Re North Australia Territory Co* (1890) 45 Ch. D. 87 (CA), 93, per Bowen LJ; and *Re Castle New Homes Ltd* [1979] 1 W.L.R. 1075, 1089G, per Slade J.

discretion in relation to what is an extraordinary power. For example, the case for making an order against an officer of the company will usually be stronger than against a third party because of the fiduciary duties and the statutory duty under s.235(2)(a) owed by the former.[115] Similarly, the court will take into account the width of the order sought and the amount of work involved in complying with the order.[116] The court will not generally require the applicant to specify the documents which are required to be produced with great precision, because the applicant is ordinarily a stranger to the company and to do so would reduce the utility of the section. But, the width of description of the documents to be produced will be treated as a matter going to the discretion of the court to make the order.[117]

Although in many cases the reasonable requirements of the office-holder will not **8-036** extend beyond that contained in the company's records and the knowledge of its officers, in some cases the interest of creditors will be substantial (particularly in the case of a large-scale corporate failure) and the reasonable requirements of the office-holder will be treated as extending to information which the company itself may never have possessed.[118] The production of such documents will be ordered where this will enable the office-holder to perform his functions properly.[119] It is, however, not appropriate for an office-holder to use s.236 for the purposes of obtaining documentation from a creditor for the purposes of adjudicating upon his proof of debt.[120]

8. SECTION 236 AND PENDING LITIGATION

8-037 One particularly important aspect of the balancing exercise the court undertakes when faced with an application under s.236 is ensuring that the section "is not to be used for giving a litigant (just because he is an office-holder) special advantages in ordinary litigation".[121] Such an unfair advantage is regarded as one of the main

[115] See *Re Cloverbay Ltd (No.2)* [1991] Ch. 90 (CA), 102G and 108D; *Re RBG Resources Plc* [2003] 1 W.L.R. 586 (CA), [35]; and *Re Westmead Consultants Ltd* [2002] 1 B.C.L.C. 384.

[116] See *British & Commonwealth Holdings Plc v Spicer and Oppenheim* [1993] A.C. 426 (HL), 440H–441A, per Lord Slynn: whilst recognising that the order placed an extensive and inconvenient burden on the auditors and may lay them open to further claims, he stated that these were only factors in the balancing exercise. The auditors' argument that such an order would result in a flood of similar applications was dismissed. In any event, it was not disputed that the examinee was entitled to an order for the costs of compliance. The court may take into account the limited resources of the examinee: *Jackson v Cannons Law Practice LLP* [2013] B.P.I.R. 1020. See also *Re Alocasia Ltd* [2014] EWHC 1134 (Ch) at [60]: the "starting point" was that the volume of work did not present a problem: the respondents were a professional firm.

[117] *The Joint & Several Liquidators of Akai Holdings Ltd v The Grande Holdings Ltd* [2006] HKCFA 113, [35]–[45]; referring to *Re Cloverbay* (1989) 5 B.C.C. 732; and *Re Mid East Trading* [1998] 1 All E.R. 577 (CA). See also *Re Comet Group Ltd (In Liquidation)* [2015] B.P.I.R. 1. In *Jackson v Cannons Law Practice LLP* [2013] B.P.I.R. 1020, Registrar Jones said that he would use case-management powers in making the order to avoid a slow and expensive process.

[118] See *Re Brook Martin & Co (Nominees) Ltd* [1993] B.C.L.C. 328. In *Re Chesterfield United Inc* [2012] B.C.C. 786 at [16], Newey J ordered the production of documents going beyond those needed to reconstitute the company's knowledge and responded to a submission that the order sought was illegitimate "fishing" by remarking that, "within limits, s.236 can properly be used for what might be termed 'fishing': an office-holder can invoke the section because he wishes to investigate."

[119] See per Woolf LJ in the Court of Appeal in *British & Commonwealth Holdings Plc v Spicer and Oppenheim* [1992] Ch. 342 (CA), 390: "the reason for the existence of the powers was to assist office holders to achieve the relevant administrative purposes identified in s.8(3) of the Act".

[120] *Bellmex International Ltd v British American Tobacco* [2001] B.C.C. 253.

[121] *Re Atlantic Computers Plc* [1998] B.C.C. 200, 208F–209A, per Robert Walker J; citing *Re North*

forms of oppression to which an order under s.236 may give rise.[122] The court will have regard both to the reasonable requirements of the office-holder to carry out his task, and to the need to avoid making an order which is unnecessary, unreasonable or oppressive to the person who is the subject of the order, because it would give the office-holder an unfair advantage over him in litigation.

8-038 Under the pre-1986 winding-up provisions, these restrictions usually meant that, where a liquidator had either begun or made a firm decision to begin proceedings against the proposed examinee, it would be rare for him to obtain an order for examination.[123] This approach was known as the "Rubicon Test": "a rule of thumb under which relief under section 236 would be withheld if office-holders had already commenced proceedings against, or definitely decided (mentally crossed the Rubicon) to proceed against the proposed witness [i.e. examinee]".[124] An order might have been granted, however, if the examination avoided questions connected with the proceedings.[125]

8-039 Subsequently, in proceedings brought under the current legislation, the Court of Appeal has recognised that a firm decision by an office-holder to bring an action against the person to be examined is not a bar to the grant of an order, although it may be an important factor to take into account on the question of discretion.[126] The court will primarily be concerned to understand the purpose for which the application is made. Accordingly, an application which is shown to be for the primary purpose of enabling the office-holder to understand the affairs of the company and to recover its assets may be granted, even though the information obtained may incidentally bear on, or expand the scope of, existing civil proceedings by the company against its ex-directors.[127] In *Re RBG Resources Plc*, Peter Gibson LJ summarised the position as follows[128]:

> "It is oppressive to require a defendant accused of serious wrongdoing to provide what amount to pre-trial depositions and to prove the case against himself on oath. But that oppression may be outweighed by the legitimate requirements of the liquidator."[129]

Nevertheless the old "Rubicon Test" had at least a "germ of truth" in it,[130] and the courts remain wary of making orders under s.236 if the office-holder of the

Australian Territory Co (1890) 45 Ch. D. 87 (CA); *Re Bletchley Boat Co Ltd* [1974] 1 W.L.R. 630; *Re Castle New Homes Ltd* [1979] 1 W.L.R. 1075; and *Re Esal (Commodities) Ltd (No.2)* [1990] B.C.C. 708. See also *Cloverbay Ltd v BCCI* [1991] Ch. 90 (CA), 102E, per Browne-Wilkinson VC.

122 *Re BCCI (No.12)* [1997] 1 B.C.L.C. 526.

123 *Re Castle New Homes Ltd* [1979] 1 W.L.R. 1075, per Slade J.

124 *Re Atlantic Computers Plc* [1998] B.C.C. 200, 208E, per Robert Walker J.

125 *Re Franks, Ex p. Gittins* [1892] 1 Q.B. 646, per Vaughan Williams J.

126 *Cloverbay v BCCI* [1991] Ch. 90 (CA); *Re John T Rhodes Ltd* [1987] B.C.L.C. 77. Browne-Wilkinson VC in *Cloverbay* specifically noted that the subjective nature of the office-holder's precise intentions was an inappropriate basis for determining whether an order should be available. The court consequently recommended a more "case-by-case", empirical approach to making orders under s.236.

127 *Re RBG Resources Plc* [2003] 1 W.L.R. 586 (CA).

128 *Re RBG Resources Plc* [2003] 1 W.L.R. 586 (CA), [39]. See also *Daltel Europe Ltd (in liquidation) v Makki (No.1)* [2005] 1 B.C.L.C. 594.

129 See also *Daltel Europe Ltd (in liquidation) v Makki (No.1)* [2005] 1 B.C.L.C. 594, where an order was made notwithstanding pending proceedings for fraud and dishonesty.

130 *Re Bishopsgate Investment Management (No.2)* [1994] B.C.C. 732, 739E, per Hoffmann J; *Re BCCI (No.12)* [1997] B.C.C. 561, 571–572, per Robert Walker J; *Re Atlantic Computers Plc* [1998] B.C.C. 200, 208F, per Robert Walker J.

company in question might thereby gain an unfair advantage in current or imminent litigation.[131]

8-040 The principles can be illustrated by reference to the *Sasea Finance* case. In *Joint Liquidators of Sasea Finance Ltd v KPMG*,[132] the liquidators made an application under s.236 against the former auditors of the company, seeking disclosure of documents. By the time of their application, the liquidators had issued a "protective writ" against the auditors, to stop limitation periods running, alleging professional negligence. Robert Walker J (as he then was) held that, although there was some prejudice to KPMG in granting the liquidators' application, because it might give information to the liquidators earlier than otherwise, the balance weighed in favour of making the order sought, as there was considerable public interest in ascertaining the truth about a very substantial corporate collapse. Of significance to the court in making its decision were the facts that the litigation was still at a very early stage, and that only negligence, and not fraud or dishonesty, had been alleged against KPMG. The fact that the examination could render the evidence of the examinee open to scrutiny at an earlier point in time than would be the case in normal litigation was a factor, but not an overriding factor, to be taken into account in determining whether or not the order would be oppressive.

8-041 When, however, a further application was made later in the same proceedings,[133] by which the office-holders sought an order that the respondents answer interrogatories, Scott VC refused the application. He deplored the office-holders' tactic of issuing a protective writ and then seeking to use s.236. He also indicated that trying to use s.236 to extract explanations or justifications for known facts in the context of pending litigation, rather than to discover facts, was an unacceptable tactic, and any such application would be refused. Hence if the office-holder has the benefit of extensive disclosure of documents in connection with an action already commenced, the court may decline to grant an order under s.236.

8-042 The mere fact that proceedings had already been successfully taken against a person involved with the company will not of itself make an examination oppressive, vexatious or unfair. Nor does the principle against being sued twice about the same matter apply in these circumstances since the grant of an order does not necessarily mean that the office-holder will be commencing further proceedings.[134]

8-043 Documents (including the transcripts of the examinations) obtained by the use of s.236 in order to assist an office-holder to decide whether or not to commence proceedings (or to continue proceedings in respect of which a protective writ had been issued) may be covered by legal professional privilege in the hands of the office-holders if the sole or dominant purpose of conducting such examinations was to obtain legal advice as to the merits of the proposed proceedings. If so, such documents will not be required to be disclosed to the other parties to such proceedings.[135] In deciding which country's law of privilege applies, if the EU Regulation on

131 *Re Atlantic Computers Plc* [1998] B.C.C. 200, 208F–209A, per Robert Walker J, citing *Re North Australian Territory Co* (1890) 45 Ch. D. 87 (CA); *Re Bletchley Boat Co Ltd* [1974] 1 W.L.R. 630; *Re Castle New Homes Ltd* [1979] 1 W.L.R. 1075; and *Re Esal (Commodities) Ltd (No.2)* [1990] B.C.C. 708. See also *Cloverbay Ltd v BCCI* [1991] Ch. 90 (CA), 102E, per Browne-Wilkinson VC. In *RBG Resources Plc* [2003] 1 W.L.R. 586 (CA), [56], Mance LJ observed that for liquidators to seek an examination under s.236 to gain advantage or to ascertain whether or not they have a claim in current civil litigation "seems bound to offend against elementary fairness.

132 *Joint Liquidators of Sasea Finance Ltd v KPMG* [1998] B.C.C. 216.

133 *Re Sasea Finance Ltd (in liquidation)* [1999] B.C.C. 103.

134 *Re John T Rhodes Ltd* [1987] B.C.L.C. 77.

135 *Akai Holdings Limited v Ernst & Young* [2009] HKCFA 14.

Insolvency Proceedings[136] applies because main proceedings were opened in England, English law of legal professional privilege will also apply.[137]

9. OTHER FORMS OF PROTECTION FROM OPPRESSION UNDER S.236

8-044 As well as giving a proposed examinee protection from oppression by carefully considering whether an order under the section should be made at all, a court may also choose the particular type of order it makes with a view to minimising any prejudice. The courts regard an order for oral examination as the most potentially oppressive order they can make under s.236. An order to swear an affidavit deposing to the affairs of the company in question is less likely to be oppressive,[138] and least likely to be oppressive is an order for the production of documents relating to the dealings or affairs of the company.[139] Consequently, a court may be more willing to make an order for the production of documents than for oral examination.[140] Furthermore, the court has jurisdiction to order disclosure of redacted documents, where ordering disclosure of the unedited document would be unlawful or undesirable.[141] The court may also direct the staged disclosure of documents, where the bulk of the documents to be disclosed is very great, in order to minimise the risk of oppression and prejudice by disruption, stress or expense. When considering such factors, the court will have regard to the respondent's resources, as well as the requirements of the office-holder.[142]

8-045 Further, where the court is considering an application under s.236 for an order directing disclosure of evidence previously given by some third party to the person who is the subject of the proposed order, either the court can refuse to make the order without first hearing objections from the third party, or it can impose a condition that the third party be notified of the order and given the opportunity to object to disclosure within a specified time.

8-046 So, in *Morris v Director of the Serious Fraud Office*,[143] Nicholls VC indicated that, save in exceptional cases, an office-holder was not entitled to use s.236 to obtain documents from the Serious Fraud Office, which the SFO had obtained from a third party, without giving the third party (in that case, a firm of accountants) an opportunity to object to the production of those documents on the basis that such production would be oppressive.

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136 Regulation (EU) 2015/848 on insolvency proceedings (recast) [2015] OJ L141/19 will apply to all new cases from 26 June 2017. Both the original Insolvency Regulation (Council Regulation (EC) 1346/2000 on insolvency proceedings [2000] OJ L160/1) and the recast regulation are discussed in Ch.31.

137 *Re Hellas Communications (Luxembourg) II SCA; Hosking v Nautadutilh Avocats Luxembourg* [2013] B.P.I.R. 756.

138 *Soden v Burns* [1996] 1 W.L.R. 1512, 1531D–E, per Robert Walker J.

139 *Cloverbay Ltd v BCCI* [1991] Ch. 90 (CA), 103C, per Browne-Wilkinson VC; *Re British & Commonwealth Holdings Plc* [1992] B.C.C. 165 (CA), 185, per Ralph Gibson LJ. See also *The Joint & Several Liquidators of Akai Holdings Ltd v The Grande Holdings Ltd* [2006] HKCFA 113, [30]. But see *Re China Medical Technologies Inc* [2015] 2 HKC 502, in which the court took the view (in the context of the differently worded statutory provision in Hong Kong) that an order for production of private papers may be more intrusive than an examination at which the respondent could be asked questions about his financial circumstances.

140 See *Re JN Taylor Finance Pty Ltd* [1999] B.C.C. 197.

141 *Re Galileo Group Ltd* [1999] Ch. 100.

142 *Re BCCI (No.12)* [1997] B.C.C. 561. And see *Jackson v Cannons Law Practice LLP* [2013] B.P.I.R. 1020, where Registrar Jones would not make a draconian order in light of the examinee's limited resources and would use the court's case-management powers as necessary.

143 *Morris v Director of the Serious Fraud Office* [1993] Ch. 372.

8-047 In *Soden v Burns*,[144] inspectors had been appointed by the Department of Trade and Industry under s.432 of the Companies Act 1985 to investigate the collapse of Atlantic Computers Plc, and they had received evidence from third parties. The administrators of Atlantic applied under s.236 for disclosure of the transcripts of that evidence, which they admitted they might use in pending civil litigation. The court ordered disclosure of the transcripts, but not of documents mentioned in them, on condition that each witness who had given evidence was notified of such disclosure, and was given the opportunity to apply to set aside the order in so far as it affected him. The court also considered what might be done about citations in a transcript, which were attributed or attributable to some other person than the person giving evidence. If the citations were important, the person cited should be asked for his views about disclosure. If the citations were less important, they might be obliterated, or certified unimportant by counsel for the DTI Inspectors.

10. THE PARTICULAR POSITION OF ADMINISTRATIVE RECEIVERS AND ADMINISTRATORS

8-048 The present s.236 of the Insolvency Act 1986 is largely based upon similar powers formerly only applying in the case of bankruptcy[145] and winding up.[146] In argument on the exercise of the court's discretion, reference is frequently made to authorities dealing with those earlier provisions. It is questionable whether applications by administrative receivers and administrators under s.236 should always be treated in exactly the same way as similar applications in relation to a company by its liquidators. This is because although an administrative receiver is an office-holder under the insolvency legislation, with all that implies, the fact remains that an administrative receiver acts principally for the benefit of the debenture-holder who appointed him. His position is to be contrasted with the role of a liquidator who acts for the general body of unsecured creditors, and with the role of an administrator under the revised regime following the Enterprise Act 2002, who may be appointed by the holder of a qualifying floating charge but is under a statutory duty to act for the benefit of all the creditors of the company.[147]

8-049 In winding-up cases under the statutory forerunners of s.236, a party other than a liquidator who sought an examination of this kind had to show that it would be for the general benefit of the winding-up, rather than for the personal advantage of the applicant.[148] Equally, in the old bankruptcy cases, the applicant was said to be required to show some probable benefit to the creditors.[149] An administrative receiver (or even an administrator) may well wish to use s.236 for the particular benefit of his appointor, for example by using the section to obtain information which is then to be disclosed to his appointor. This issue arises frequently, and is often compounded by the fact that (at least in the early days of the receivership) the

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144 *Soden v Burns* [1996] 1 W.L.R. 1512.

145 Bankruptcy Act 1914 s.25.

146 Companies Act 1985 s.561.

147 See para.3 of Sch.B1 to the 1986 Act (as amended).

148 *Re Imperial Continental Water Corp* (1886) 33 Ch. D. 314 (CA); and *Re Embassy Art Products Ltd* (1987) 3 B.C.C. 292.

149 *Ex p. Nicholson, Re Willson* (1880) 14 Ch. D. 243 (CA).

same firm of solicitors will often act for both the administrative receiver or administrator and the debenture-holder who appointed him.[150]

8-050 Before the concept of the administrative receiver was created, and the powers under s.236 were conferred on him as an office-holder, it was said that a debenture-holder was entitled, as against the receiver appointed by him, to be put in possession of all information concerning the receivership which was available to the receiver.[151] It is highly unlikely that this statement would be regarded as applicable to information obtained by an administrative receiver (and still less by an administrator) as an office-holder using his powers under ss.235 or 236.

8-051 Instead, the overriding principle is that disclosure of information obtained under ss.235 or 236 by an administrative receiver or an administrator to a debenture-holder will only be permissible where such disclosure will assist the beneficial conduct of the receivership or administration (as the case may be).[152]

8-052 A particularly glaring example of the improper disclosure of documents obtained by receivers under ss.235 or 236 occurred in *Sutton v GE Capital Commercial Finance Ltd*.[153] The administrative receivers of a company had obtained documents from the company's ex-solicitors on the ostensible grounds that they required them for the purposes of their investigations into the affairs of the company. On receipt, the receivers immediately handed the documents over to a solicitor acting for their appointor, which was in litigation with the principal backer of the company to enforce a personal guarantee which the backer had given for the company's debts.[154] The receivers did not even retain copies of the documents and the evidence showed that they had given no consideration to whether it was appropriate that they should disclose information obtained under ss.235 and 236 to their appointor. The Court of Appeal held that such disclosure, which did not confer any benefit on the receivership, had been improper,[155] and that the company's confidence in, and any legal privilege attaching to, the documents had not been waived.

8-053 Although this was not the case in *Sutton*, in other situations, an administrative receiver or administrator might claim that the receivership or administration would be assisted by his disclosing such information to the debenture-holder, either for the purposes of securing additional funding for the conduct of litigation by the company

[150] Even if the debenture-holder is content that it should not receive confidential information, the examinee may not be happy that an assurance to this effect from the solicitor is workable in practice. Moreover, if information disclosed in the examination is obtained by the debenture-holder from another source, it may be difficult for the solicitor to disprove the suspicions that will inevitably arise. It is not a satisfactory solution to try to erect a "Chinese wall" by designating one partner in a firm to deal with the s.236 application by the administrative receiver, and designating another partner to advise the debenture-holder: see *Re A Firm of Solicitors* [1992] Q.B. 959 (CA); *Re Solicitors* [1997] Ch. 1; and *Bolkiah v KPMG* [1999] 2 A.C. 222 (HL). Similar concerns and issues may arise in practice where administrators are appointed by the debenture-holder under a qualifying floating charge notwithstanding that the administrator so appointed is under a statutory duty to use his powers in the interests of the creditors of the company as a whole.

[151] See per Fox LJ in *Gomba Holdings UK Ltd v Minories Finance Ltd (No.1)* [1988] 1 W.L.R. 1231, 1233H.

[152] See *Sutton v GE Capital Commercial Finance Ltd* [2004] 2 B.C.L.C. 662 (CA), per Chadwick LJ; referring to the dictum of Lord Millett in *Re Pantmaenog Timber Co Ltd (In Liquidation)* [2004] 1 A.C. 158 (HL), [64]. See also, by analogy to liquidations, per Millett J in *Re Barlow Clowes Gilt Managers* [1992] Ch. 208, 217G and per Dillon LJ in *Re Headington Investments Ltd* [1993] Ch. 452 (CA), 494G–495B.

[153] *Sutton v GE Capital Commercial Finance Ltd* [2004] 2 B.C.L.C. 662 (CA).

[154] The solicitor for the appointor was a partner in the same firm that acted for the receivers.

[155] For the duties of receivers in relation to the exercise of their powers for the purposes of the receivership, see Ch.13.

against the directors of the company or its professional advisers, or in order to facilitate the making of a direct claim by the debenture-holder against such persons,[156] in the hope that such a claim might reduce the claim of the debenture-holder against the company, with a possible knock-on effect for the benefit of unsecured creditors. Such issues have been raised in two decisions, one in England and one in Scotland, with differing results.

Chronologically, the first case is the decision of Harman J in *Re A Company (No.005374 of 1993)*.[157] In that case, administrative receivers sought leave to disclose to their appointor bank information obtained under s.236 which appeared to show that a director of the company had misappropriated a VAT refund in breach of his duties to the company. Harman J held that he had a discretion to grant leave on two grounds: first, if the disclosure was "for the purposes of the office which the office-holders hold"; or secondly, if disclosure is "otherwise justified by the balance of considerations of how justice is properly to be attained". He permitted disclosure, but it is not clear on which ground. Harman J held that the claims that the bank might bring were "closely analogous to the claims by the company and might lead to the company being relieved of liability" and that "there appear to be dealings here of such a nature that, in my view, justice can only properly be achieved if the information is made available to the bank which lent the money". **8-054**

Harman J clearly based his reasoning on the earlier decision of Millett J in *Re Esal (Commodities) Ltd (No.2)*,[158] that being the only case referred to in his judgment. In *Esal*, the company concerned was in liquidation, and a member of the committee of inspection had applied for access to information gathered by the company's liquidator under s.236. The applicant wished to obtain the documents for use in a fraudulent trading action which he had already brought against the company's bank. Millett J held that, save in exceptional circumstances, access to the information sought should be allowed by the court only if the use proposed to be made is within the purpose of the statutory procedure, that is to say, that the use proposed to be made of the material is to assist the beneficial winding-up of the company.[159] In the circumstances, therefore, disclosure could not be said to be for the purposes of the beneficial winding-up of the company. In spite of this, Millett J held that this was an exceptional case which justified the grant of leave. He gave as his reasons the fact that the third party's claim was "closely related to the liquidation"; that the third party's allegations, if true, disclosed a major banking scandal that ought not to be hushed up; that the material was already to some extent in the public domain and would increasingly come into the public domain in the course of the litigation; and that the third party's counsel said that he could plead his case without the documents but in such a way that he could get them on discovery. **8-055**

It is suggested that Harman J's reasons in *Re A Company* do not stand close scrutiny. It is far from clear what the bank's claim against the director would be, **8-056**

[156] The position often arises that the lender believes that it may have its own claims against the directors of the company in fraud or misrepresentation arising out of the statements made to obtain the loan to the company. Or the administrative receiver may obtain information which suggests that, if the lender knew of these facts, it could bring such a claim.

[157] *Re A Company (No.005374 of 1993)* [1993] B.C.C. 734.

[158] *Re Esal (Commodities) Ltd (No.2)* [1990] B.C.C. 708.

[159] Note that this statement of the reasons for disclosure of information would now be regarded as too narrow: see *Re Arrows Ltd (No.5)* [1995] 2 A.C. 75 (HL), 102E-G, per Lord Browne-Wilkinson; and *Re Pantmaenog Timber Co Ltd* [2004] 1 A.C. 158 (HL), per Lord Millett, because an office-holder can lawfully make disclosure to public authorities to whom he is obliged or permitted to give information concerning the collapse of the company and the conduct of its directors.

and even more difficult to see how advancement of any such claim could assist the beneficial realisation of the bank's security. Further, Millett J did not hold that there was an overriding discretion to order disclosure when the judge's view of the interests of justice requires it. Millett J had commented that "the proper administration of justice would be better served by the grant of leave than by its refusal", but only in the context of permitting advance disclosure of documents which would in any event come into the third party's hands on discovery. He did this as a practical matter to prevent repeated applications to amend and arguments as to whether what was pleaded had come from the documents (which had already been seen by the third party in his capacity as a member of the committee of inspection).

8-057 In *Sutton v GE Capital Commercial Finance Ltd*,[160] Chadwick LJ referred to Harman J's decision in support of the proposition that disclosure could be made or authorised by the court where that would further the purposes of the receivership or otherwise be in the interests of the company in receivership.[161] He did not indicate that there was any wider power to permit disclosure in the interests of justice.

8-058 A different approach to that of Harman J was taken by Lord Cameron of Lochbroom in a Scottish case arising out of the Maxwell saga, *Re First Tokyo Index Trust Ltd*.[162] In that case, the liquidators of a company applied for leave to disclose documents obtained under s.236 to a bank. Rather unusually, the company had no creditors of any significance. Instead the bank had become the sole shareholder of the company as a consequence of enforcing a charge over the shares from the company's parent to secure a loan from the bank on which the parent had defaulted. The bank had then appointed the liquidators. In this sense the case had close parallels with the situation which arises in receiverships in which the party principally interested in the outcome of the insolvency was the bank which appointed the office-holder. Over a period of a year or more, the bank had spent very substantial sums of money funding an inquiry by the liquidators of the company into the circumstances surrounding the disposal of the assets of the company. Apparently it had been intended that the company's assets should have been pledged to secure the loan from the bank, but the assets were in fact sold elsewhere and the proceeds used to support other Maxwell companies.

8-059 The liquidators made it clear to the court that the company intended to commence proceedings against certain of the persons who had given the information under s.236 and who had been the custodians of the company's assets. The bank also indicated that it was considering commencing its own proceedings against the same persons, but on different and distinct grounds from those of the company, such as misrepresentation. The liquidators, supported by the bank, sought orders permitting wholesale disclosure of all of the information obtained to the bank on two grounds:

(a) that in the particular circumstances where the bank was the only party having a substantial interest in the liquidation of the company, the "purposes of the liquidation" extended to attempting to obtain redress for the bank; and

[160] *Sutton v GE Capital Commercial Finance Ltd* [2004] 2 B.C.L.C. 662 (CA).

[161] Harman J's decision was also relied on for this narrower proposition in *Sunwing Vacation Inc v E-Clear (UK) Plc* [2011] B.C.C. 889, a case in which creditors sought disclosure of documents by liquidators of a company and inspection thereof under ss.112 and 155 of the Insolvency Act 1986. Morgan J granted the application on the basis that the information obtained would allow the creditors to pursue an arbitration against another company with the result that they could use those receipts as a credit to reduce their claims against the company in liquidation, and thereby further the purposes of the liquidation.

[162] *Re First Tokyo Index Trust Ltd* [1996] B.P.I.R. 406 (Court of Session, Outer House).

(b) that as the bank would be funding the litigation by the company, disclosure was necessary to demonstrate to the bank that the proceedings would be likely to be successful and to keep it informed of progress.

8-060 Lord Cameron rejected these arguments. He held that the crucial point in the case which distinguished it from the *Esal* case was that the claim of the bank would proceed on separate and distinct grounds to the claim of the company, and there was in any event no such claim yet pleaded by the bank. In contrast, in *Esal* the information had been obtained to found a fraudulent trading claim by the liquidators, which was precisely the same claim which the third party had also brought and had been able to formulate. Lord Cameron applied the dictum of Dillon LJ in the case of *Re Headington Investments Ltd*[163]:

> "Cases where persons other than prosecution or regulatory authorities seek disclosure or inspection of transcripts may raise a variety of different considerations. In some cases, disclosure will clearly be justified because, to adopt the words of Millett J. in *Re Barlow Clowes Gilt Managers Ltd*, 'the use proposed to be made of the material is to assist the beneficial winding up of the company;' ...
>
> But the mere fact that the transcript is wanted for use in proceedings, whether civil or criminal, is not enough. The process of private examination does not leave the Court with a pool of information to be made available to any third party who may want to go fishing to see what he can find that might be helpful in civil or criminal proceedings, e.g. as material for cross-examination if a witness gives evidence in such proceedings which might be thought inconsistent with what he had said on examination under section 236 of the Act of 1986, or as material to anticipate discovery."

8-061 On the facts, Lord Cameron was also not impressed by the argument that the bank needed to have access in order to determine whether to continue funding the litigation by the company. The bank had already spent considerable sums and had undertaken to support the commencement of proceedings. Given that the bank presumably had confidence in the solicitors and counsel employed by the liquidators, at that stage the bank did not need access to further information. In other cases, however, where an appointing bank is not already committed to providing support for litigation in the receivership or administration, it is suggested that the court might be prepared to permit limited disclosure, subject to suitable undertakings being given to ensure confidentiality was preserved, in order to enable the office-holder to persuade the appointor to provide such funding.

8-062 In the event that a receiver or administrator forms the view that it would be in the interests of the receivership or administration (as the case may be) to make disclosure of confidential or even privileged information obtained under s.235 or 236 to a debenture-holder, he ought to apply for permission from the Companies Court on notice to the person from whom the information was obtained. That person could then appear to assert its confidentiality or privilege and put forward argument as to why the disclosure should not be permitted.[164]

Conversely, where the office holder in the exercise of his discretion has decided not to seek documents or information pursuant to s.236, a disgruntled creditor cannot use CPR r.31.17, which permits orders for disclosure against third parties to

[163] *Re Headington Investments Ltd* [1993] Ch. 452 (CA), 494G-495B: see also per Megarry J in *Re Spiraflite Ltd* [1979] 1 W.L.R. 1096, 1100.

[164] See *Sutton v GE Capital Commercial Finance Ltd* [2004] 2 B.C.L.C. 662 (CA). cf. *Re PNC Telecom Ltd* [2004] B.P.I.R. 314, where Evans-Lombe J refused to give administrators directions about how they might use information which had come into their hands independently of statutory processes.

proceedings, as a back door to seek documents which the office-holder did not obtain under s.236.[165]

11. SELF-INCRIMINATING INFORMATION

8-063 The importance attached to ensuring that the office-holder can perform his functions in an effective and expeditious manner has meant that persons subject to duties under s.235, whether obliged to provide information under that section or under s.236, cannot, as a matter of English domestic law, invoke the privilege against self-incrimination.[166] The courts have recognised that the task of the office-holder would be incapable of proper performance if the examinee could invoke such a privilege.

8-064 The abrogation of the privilege against self-incrimination in inquisitorial proceedings, such as those under s.236, is compatible with the European Convention on Human Rights. Article 6 of the Convention provides in part that:

> "In the determination of his civil rights and obligations or of any criminal charge against him, everyone is entitled to a fair and public hearing within a reasonable time by an independent and impartial tribunal established by law."

Article 6 does not appear to apply to an investigation under s.236, since in essence it is not a determination of civil or criminal rights.[167] This is so notwithstanding that there is in s.237(1) a summary but separate power to order delivery up of the company's property on the basis of evidence obtained under s.236.

8-065 This distinction is demonstrated by *Al-Fayed v United Kingdom*[168] and *Saunders v United Kingdom*.[169] Both cases concerned a challenge to the activities of Department of Trade and Industry inspectors who had been appointed under Pt XIV of the Companies Act 1985 to examine the affairs of various companies, and in their reports had made adverse findings against respectively Mr Fayed and Mr Saunders. The activities of the inspectors were held not to fall within the scope of art.6, being investigations rather than adjudications: the reports themselves did not determine any legal right or obligation so as to fall within art.6.

8-066 In *Saunders v United Kingdom*, the European Court of Human Rights also held that self-incriminating information lawfully obtained from a person under compulsion or threat of compulsion could not, under art.6, be used against him in his trial on criminal charges. As a result of the incorporation of the Human Rights Convention into domestic law by the Human Rights Act 1998, such material would therefore have to be excluded from evidence in any criminal trial.[170] While the *Saunders* case concerned information obtained by Department of Trade and

[165] *Rubin v Coote* [2011] B.P.I.R. 536.

[166] See *Re Arrows Ltd (No.4)* [1995] 2 A.C. 75 (HL); *Bishopsgate Investment Management Ltd v Maxwell* [1993] Ch. 1 (CA). In the latter case, Stuart-Smith LJ at 46 noted that Insolvency Rules 1986 r.9.4(7) permits written records taken under s.236 to be used as evidence against a respondent of any statement made by him in the course of the examination: cf. *Re Keypak Homecare Ltd (No.2)* [1990] B.C.C. 117, which related to the position under the old winding-up provisions. Note also *Re Arrows Ltd (No.2)* [1992] B.C.C. 446; *Re A E Farr Ltd* [1992] B.C.C. 150; and *Re Jeffrey Levitt* [1992] Ch. 457.

[167] Other articles of the European Convention on Human Rights will affect the conduct of examinations under s.236 of the Insolvency Act 1986.

[168] *Al-Fayed v United Kingdom* (1994) 18 E.H.R.R. 393 (ECtHR).

[169] *Saunders v United Kingdom* [1997] B.C.C. 872 (ECtHR); followed in *Kansal v United Kingdom* (2004) 39 E.H.R.R. 31 (ECHR).

[170] See also Insolvency Act 1986 s.433, as amended by the Youth Justice and Criminal Evidence Act 1999 s.59 Sch.3, para.7, the scope of which was considered in *R. v Sawtell* [2001] B.P.I.R. 381 (CA).

Industry inspectors, appointed under Pt XIV of the Companies Act 1985, there is no reason why the case should not apply equally to information obtained by the use, or threatened use, of s.236, or under s.235, which is itself backed by criminal sanctions.[171]

8-067 The Human Rights Act 1998 will, however, probably have less impact on the use in subsequent civil proceedings, for example by the administrative receiver, of information obtained under these sections, or by threat of an application for an order under s.236.

8-068 In *Official Receiver v Stern*,[172] the Court of Appeal held that proceedings under the Company Directors Disqualification Act 1986 were not criminal proceedings, and it was not in breach of the respondents' rights to a fair trial under the European Convention for the Official Receiver to use against them information he had received pursuant to s.235 of the Insolvency Act 1986.

8-069 The relevant factors relied on by the court in coming to this conclusion were: (i) disqualification proceedings are not criminal proceedings, but are regulatory proceedings primarily for the protection of the public, even though the proceedings often involve serious allegations and almost always carry stigma for a person disqualified; (ii) there are various degrees of coercion involved in the different investigative procedures available in corporate insolvency, which may therefore give rise to different degrees of prejudice if the information obtained is sought to be used in disqualification proceedings; and (iii) it is generally best for questions of fairness to be decided by the trial judge rather than in advance.

8-070 It is likely that ordinary civil proceedings instituted by an office-holder, for example for breach of duty against a director, will be even less likely to incline a trial judge to exclude material obtained by compulsion under ss.235 or 236, because such proceedings do not carry the "stigma" of disqualification.

8-071 In the context of civil litigation, the right to a fair hearing under art.6 of the European Convention also requires compliance with the principle of "equality of arms"[173]: "as regards litigation involving opposing private interests,[174] 'equality of arms' implies that each party must be afforded a reasonable opportunity to present his case—including his evidence—under conditions which do not place him at a substantial disadvantage vis-à-vis his opponent".[175] The English courts already strive to ensure that no unacceptable "inequality of arms" results from an order under s.236 by means of the limitations on the section examined above, such as the

[171] In *Rottmann v Brittain* [2010] 1 W.L.R. 67 the Court of Appeal applied the decision of the Privy Council in *Brannigan v Davison* [1997] A.C. 238 and held that the privilege against self-incrimination did not apply in the case of an examination of a bankrupt who was accused of a criminal offence in another country. The judge hearing the examination could exercise his discretion to permit or exclude incriminating questions, and it would be for the court conducting the criminal trial in the other country to control the use to which the examinee's answers could be put.

[172] *Official Receiver v Stern* [2000] 1 W.L.R. 2230 (CA), affirming the decision of Scott VC 1999 WL 1805552, 20 December 1999. See also *R. v Secretary of State for Trade & Industry Ex p. McCormick* [1998] B.C.C. 379 (CA).

[173] *Neumeister v Austria* (1979-80) 1 E.H.R.R. 91 (ECtHR); *X v Federal Republic of Germany* (1963) 6 Y.B. 520 (ECtHR), 574.

[174] This is how the English courts clearly understand litigation by a liquidator for the benefit of the company and those "interested" in its assets: see *Cloverbay Ltd v BCCI* [1991] Ch. 90 (CA), 108D, per Nourse LJ.

[175] *Dombo Beheer v Netherlands* (1994) 18 E.H.R.R. 213 (ECtHR), 229-230. See also *Feldbrugge v Netherlands* (1986) 8 E.H.R.R. 425 (ECtHR), 436-437; and *Van de Hurk v Netherlands* (1994) 18 E.H.R.R. 481 (ECtHR).

CHAPTER 20

TRUSTS

1. TRUSTS

20-001 Property held on trust by a company will not normally fall under any of the debenture-holder's charges. Nor will it form part of the property of a company under the control of administrators.[1] Whilst the question of what property constitutes trust property may be relatively straightforward in the case of an express trust,[2] difficult situations can arise where the terms of the trust are unclear, or where persons who might otherwise be ordinary unsecured creditors claim priority by virtue of an entitlement under a resulting, constructive or implied trust. For a valid trust to be created, the three certainties, namely of intention (i.e. certainty of words), of subject matter (i.e. certainty of trust property) and of objects (i.e. certainty of beneficiaries), must all be present.[3]

20-002 Certainty of intention is established objectively: the subjective intention of the settlor is irrelevant.[4] Certainty of intention can be inferred from the conduct of the settlor, such as payment of monies into a separate bank account, and hence the expression "certainty of words" can be too restrictive.[5] Certainty of intention refers to the intention of the settlor alone: it is not necessary that the beneficiaries should

1 However, in *Polly Peck International Plc (In Administration) v Henry* [1990] 1 B.C.L.C. 407, it was held that the administrators' statutory duty to manage the affairs of the company included causing the company to fulfil its duties as trustee under a pre-existing trust (the relevant trusts in that case being pension schemes established by the company). See also *Re Allanfield Insurance Services Ltd (In Administration)* [2016] Lloyd's Rep. I.R. 217, [47]–[56], cf. *Bell v Birch* [2017] 1 W.L.R. 667.

2 But see, e.g. the difficulties encountered in *Re ILG Travel Ltd (In Administration)* [1996] B.C.C. 21; and cf. the approach of the Court of Appeal of New South Wales in *Stephens Travel Service v Qantas Airways* (1998) 13 N.S.W.L.R. 331. See also paras 20-026 to 20-034 below in relation to the difficulties arising in the context of statutory trusts of client money under the Financial Services and Markets Act 2000.

3 *Wright v Atkyns* (1823) Turn. & R. 143; *Knight v Knight* (1840) 3 Beav. 148.

4 *Twinsectra v Yardley* [2002] 2 A.C. 164 (HL), [71] per Lord Millett; and see *Mills v Sportsdirect.com Retail Ltd (formerly Sports World International Ltd)* [2010] 2 B.C.L.C. 143, [55], where Lewison J specifically ignored the evidence of the settlor's subjective intention; *Re Lehman Brothers International (Europe)* [2010] EWHC 2914 (Ch), [225(v)] and [225(vi)], and [249], pointing out that the words used by the parties may be persuasive, but they are not conclusive if the terms of the agreement or relationship between the parties, viewed objectively, compel a different conclusion. The decision was affirmed by the Court of Appeal: *Re Lehman Brothers International (Europe) (In Administration)* [2011] Bus. L.R. 277. In *Re Chelsea Cloisters Ltd* (1980) 41 P. & C.R. 98 (CA), the Court of Appeal appears, however, to have taken into account the subjective intentions of the settlor: see para.20–006, below.

5 *Mills v Sportsdirect.com Retail Ltd (formerly Sports World International Ltd)* [2010] 2 B.C.L.C. 143, per Lewison J [52]–[54].

even be aware of the trust.[6] A trust does not fail for want of certainty merely because its subject matter is at present uncertain, if the terms of the trust are sufficient to identify its subject-matter in the future.[7] The onus of proving the intention to create a trust is on the person asserting it.[8]

20-003 *Re Kayford*,[9] is an example of an express trust, inferred in part from the conduct of the settlor. The company, being on the verge of liquidation, sought and obtained advice on how to safeguard customers who sent deposits with orders. A separate account was used for new deposits and the company's bank was told of the arrangement. Megarry J held that the intention to create a trust was clear even though the word "trust" was not used and the subject matter and beneficiaries were sufficiently certain.[10] The subject matter being personalty, no writing was needed. Payment into a separate bank account was indicative of, but not essential to, the creation of a trust.[11]

6 *Re BA Peters Plc (In Administration)* [2010] 1 B.C.L.C. 110, [18] (Nicholas Strauss QC); and [2010] 1 B.C.L.C. 142 (CA), [9] per Lord Neuberger, approving the following passage from the first instance judgment: "Where parties have agreed that money will be paid into a separate account and will be held on trust, a trust is created. Even where the parties have not expressly agreed that money should be held on trust, a trust is created if the settlor pays money into a separate account for the benefit of specific third parties: see *Re Lewis's of Leicester Ltd* [1995] B.C.C. 514."

7 *Re Lehman Brothers International (Europe) (In Administration)* [2010] EWHC 2914 (Ch), [225 (iv)] and [235]. An appeal to the Court of Appeal was dismissed: *Re Lehman Brothers International (Europe) (In Administration)* [2011] Bus. L.R. 277. The judgments cast no doubt on this aspect of the judgment of Briggs J at [2010] EWHC 2914 (Ch).

8 *Thandi v Sands* [2015] B.P.I.R. 162 (a bankruptcy case in which a father failed to prove by convincing evidence that properties he had purchased and later transferred to his son who was afterwards made bankrupt were held on a "common intention trust" for the father).

9 *Re Kayford (In Liquidation)* [1975] 1 W.L.R. 279.

10 It seems that Megarry J envisaged that each beneficiary of the trust fund (i.e. each customer) had a distinct beneficial interest in the trust fund; see the discussion in *Hunter v Moss* [1993] 1 W.L.R. 934, 943B–945F (Colin Rimer QC); which decision was affirmed by the Court of Appeal ([1994] 1 W.L.R. 452) without comment on this point. A beneficial interest under a trust was not found by the Eastern Caribbean Supreme Court in *Financial Services Commission v Lemma Europe Insurance Co Ltd* unreported 11 June 2014, where funds were deposited in a bank account as a condition of a Gibraltarian insurance company's licence to carry on insurance business in the British Virgin Islands. The word "trust" was not employed in relation to the deposit. Bannister J held that there was no certainty of intention; a mere intention on the part of a person on his insolvency to apply a portion of his assets in paying a particular class of his creditors was not sufficient to confer beneficial interests upon them, even if he set money aside for the purpose: absent any other overt step being taken, the money remained his. An equitable charge was held to apply to the funds in favour of BVI insurance creditors, although this aspect of the decision has been subject to criticism, on the facts of the case. See also *Re TXU Europe Group Plc (In Administration)* [2004] B.C.L.C 519, in which Blackburne J held that there was no certainty of intention to create a trust and no intention to create an equitable charge in respect of a portfolio of units in various instruments held by the company to provide pension top-up benefits to senior executives of the company and certain associated companies.

11 cf. *Re English and American Insurance Co Ltd* [1994] 1 B.C.L.C. 649 (where an insurance company agreed to hold all monies relating to a particular class of its business in a segregated account, and was found to hold the account on trust for the assureds); *Re Lewis's of Leicester Ltd* [1995] B.C.C. 514 (where trusts were held to be established in favour of concessionaires of a department store); *Re Holiday Promotions (Europe) Ltd* [1996] B.C.C. 671 (where the alleged trust funds were deposits in respect of holidays, but where there was no segregated account and no sufficient indication of any intention to create a trust); *OT Computers Ltd (In Administration) v First National Tricity Finance Ltd* [2004] Ch. 317 (CA) (where two trust funds were set up in favour of customers of the company and suppliers); *Re Pinnacle Entertainment Ltd and Re Windsong Ltd* unreported 27 October 2010. In the *OT* case, the fund in favour of customers satisfied the three certainties, notwithstanding practical difficulties in determining the entitlement of the customers between themselves; there was,

20-004 One can contrast with this the case of *Re London Wine Co (Shippers) Ltd*.[12] The company sold wine for investment, and often merely "kept" wine for the client without any particular bottles being appropriated to any particular contract of sale. The buyer was sent a certificate purporting to signify his beneficial ownership of the wine purchased by him. Certain buyers suggested after the appointment of the receiver that, even if title to the wine had failed to pass under the usual rules relating to sale of goods, the company held the wine on trust for them. Oliver J held that the trust failed for uncertainty of subject matter, since the wine which would have been beneficially owned had not been segregated and could not be identified. The argument that the company held a specified proportion of the wine on trust, so that the buyer became an equitable tenant in common of the entire stock of wine, was also rejected.[13]

20-005 By way of further contrast with *Re Kayford*, in *Re Wedgwood Museum Trust*

however, no valid trust of the fund in favour of suppliers because it was inherently uncertain which suppliers ("for supply of urgent goods") were intended to benefit. The valid trust was, it appears, a trust for the benefit of the entire class of customers who made payments to the company, whether or not the company then paid an equivalent sum into the trust account, and hence their beneficial entitlement in the trust fund abated ratably in the event of a shortfall: cf. *Brazzill v Willoughby* [2010] 2 B.C.L.C. 259 (CA) (where a *Kayford*-type trust account set up by an insolvent bank on the terms of a supervisory notice issued by the Financial Services Authority (as it then was) was held to be a trust for the entire class of depositors, whether or not any sum equivalent to their deposits were paid into the account). Under regulations applicable to insurance brokers, premiums were to be held in an "insurance broking account", or "IBA"; however, such monies were not, without more, held by the broker on trust: *Re Multi-Guarantee Co Ltd* unreported 15 July 1987; followed in *Mann v Coutts & Co* [2004] 1 All E.R. (Comm.) 1; cf. *Re Telesure Ltd* [1997] B.C.C. 580 which concerned an application for a *Berkeley Applegate* order (see paras 20–035 to 20–045, below) in respect of whether monies in an IBA account were held on trust for insurers. It appears that the insurers contended that there had been specific agreements to hold the funds on trust (see at [581C]), hence the insurers' case rested on more than the mere fact that the funds were paid into an IBA account. In *Re Branston & Gothard Ltd* [1999] 1 All E.R. (Comm) 289, monies held by a stockbroker in a "client money requirement" account were held to be trust monies. See also *Qimonda Malaysia Sdn Bhd v Sediabena Sdn Bhd* [2012] B.L.R. 65, where the Malaysian Court of Appeal applied *Re Kayford* [1975] 1 W.L.R. 279 in deciding that retention monies deducted from monies payable by the employer under a construction contract were held by the employer on trust in its liquidation, notwithstanding that the contract contained no express provision to this effect. Whilst it is certainly the case that a trust may be found to exist even though the settlor does not use the word "trust" or any similar words (as is clear from *Re Kayford*), it is nonetheless difficult to see on what basis the Malaysian Court of Appeal concluded that the necessary intent was manifested. The conclusion that the "retention monies" were held on trust and the Court's refusal to follow *Rayack Construction Ltd v Lampeter Meat Co Ltd* 12 B.L.R. 30 is, in any event, open to doubt: query what the trust property was, given that there had been no segregation of the sums to be deducted from the amounts payable to the contractor. In this respect, *Re Kayford* is plainly distinguishable in that the proceeds of the customers' deposits were identifiable property, whether paid into a segregated account or not. For further discussion of the *Qimonda* case, see the notes to para.25-063. On payment into a separate bank account see also *Financial Services Commission v Lemma Europe Insurance Co Ltd* unreported 11 June 2014 (Eastern Caribbean Supreme Court) where there was no intention to create a trust (and see fn.8 above).

12 *Re London Wine Co (Shippers) Ltd* [1986] P.C.C. 121.

13 Similar issues arose against a similar factual background in *Re Stapylton Fletcher Ltd (In Administrative Receivership)* [1994] 1 W.L.R. 1181, which also concerned the purchase and storage of wine. However, on the facts of *Stapylton*, when a customer contracted to purchase wine, that wine was taken from the company's general trading stock, moved to an adjacent storage unit, and stored with wine of the same character and vintage which had already been bought by other customers. Judge Paul Baker QC held that this segregation from the general stocks of the company was the crucial distinction from the *London Wine Co* case, as it meant that the wine was ascertained for the purposes of s.16 of the Sale of Goods Act 1979. The fact that the bottles were then mixed with other wine of the same character and vintage, and thus could not be identified as belonging to any particular customer, meant that the customer became a tenant in common of the whole bulk of the wine of that

Ltd,[14] the creation of a trust of a unique collection of pottery and other artefacts of historical importance in favour of another person had the effect of constituting that person a beneficiary in its own right and did not suffice to constitute a separate subtrust for charitable purposes. Notwithstanding the use of the word "trust", therefore, the assets were beneficially held by the transferee and available for creditors in its group's administration.

Re Kayford was considered by the Court of Appeal in *Re Chelsea Cloisters Ltd*.[15] **20-006** In that case, an insolvency accountant supervising the affairs of a company in serious financial trouble placed deposits from tenants into a separate account. The intention to create a separate fund apart from the company's property available to its creditors generally was held to be sufficient to create a trust. In *Re Farepak Foods and Gifts Ltd*[16] the company had similarly attempted to create a trust of certain proceeds received into its accounts after the date on which the company had decided to cease trading. The company traded as a form of savings company. Customers would typically pay relatively small sums periodically, which could then be exchanged for hamper vouchers or similar items come Christmas. Crucially, the monies were collected, in the first instance, by a number of agents: the agents were not obliged to keep the monies collected separate from other, or their own, monies: and those agents then periodically paid the monies which they had collected on to the company. Since the agents were agents of the company (and not of the customers), as and when the customers paid the monies to the agents, the customers became creditors of the company. Therefore, the attempt by the company to create a trust of monies received into the company's accounts after it had decided to cease trading failed, since the effect was to prefer the claims of those creditors over others. Although the conclusions reached were merely provisional, they were confirmed when the issues came before the court once more for final determination.[17]

It is a key indicator of the existence of a trust that the trustee is bound to keep **20-007** the trust property separate from his own and apply it exclusively for the benefit of the beneficiary: hence, any right on the part of the alleged trustee to mix the alleged trust monies with his own and use them for his own cash-flow would be inconsistent with the existence of a trust.[18] Hence, in cases where the alleged trust property is money, an obligation, or absence of any obligation, to pay the alleged trust monies into a segregated account is significant. It has been said that the requirement to keep monies separate is normally an indicator that they are impressed with a trust, and that the absence of such a requirement, if there are no other indicators of a trust, normally negatives it: the fact that a transaction

character and vintage, along with the other customers who had bought such wine.

14 *Re Wedgwood Museum Trust Ltd* [2013] B.C.C. 281.

15 *Re Chelsea Cloisters (In Liquidation)* (1980) 41 P. & C.R. 98 (CA).

16 *Re Farepak Foods and Gifts Ltd* [2008] B.C.C. 22.

17 *Re Farepak Foods and Gifts Ltd (In Liquidation)* [2010] B.C.C. 735. The existence of certain limited trust claims was conceded by those representing the unsecured creditors, but only in circumstances in which the company had received payments from customers after the date on which the company had ceased trading.

18 *Paragon Finance Plc v Thakrar & Co (a firm)* [1999] 1 All E.R. 400 (CA), 416, per Millett LJ; cf. *Ayerst v C&K (Construction) Ltd* [1976] A.C. 167 (HL), 180 per Lord Diplock, stating that the "essential characteristic" which distinguishes trust property from other property is that trust property "... could not be used or disposed of by the legal owner for his own benefit, but must be used or disposed of for the benefit of other persons".

contemplates the mingling of funds is, therefore, not necessarily fatal to a trust.[19] In *Re Lehman Brothers International (Europe); Pearson v Lehman Brothers Finance SA*,[20] Briggs J commented that broad and general statements about the "core characteristics" of a trust needed to be addressed with some caution, since a consensual disapplication of some fiduciary obligation generally regarded as a basic feature of a trust may not necessarily prevent a trust arising. The true principle, it was said, is that while there are no "hard-and-fast" rules whereby the consensual disapplication of some basic trustee duty precludes the recognition of a trustee beneficiary relationship between the parties, nonetheless the greater the extent to which those duties are disapplied, the harder it will be for the court to conclude that the parties objectively intended to create such a relationship.

20-008 Both the *Re Kayford* and *London Wine Co* decisions were considered in relation to certainty of subject matter in *Hunter v Moss*.[21] The London Wine Co approach to certainty was held to apply only to tangibles and not to intangibles, on the grounds that tangible assets, even where they appear to be part of a homogeneous mass, are physically separate and therefore distinguishable from others in the same mass.[22] Furthermore, certain items in such a mass may have distinguishing characteristics, for example, wine that has gone bad through faulty storage. By contrast, intangibles, such as shares, are not distinguishable from each other and need not be separately identified in any way. There is therefore sufficient certainty of subject matter where a trust is declared as to a particular percentage of the shares in a company where the trustee has more than enough shares to form the subject matter of the trust, even if the shares subject to the trust are not separately identified.

20-009 Whether the decision in *Hunter v Moss* is good law is not entirely clear, given, in particular, the decision of the Privy Council in *Re Goldcorp Exchange Ltd*.[23] A company in receivership had dealt in gold and other precious metals, and agreed to sell unascertained bullion to its customers for future delivery. Each customer received an invoice or certificate signifying his ownership. The company did not, in fact, keep sufficient bullion to satisfy all of its customers' contracts, and there was no appropriation of any of the bullion to any of those contracts. The company got into financial difficulties, and receivers were appointed. The judgment of the Board was delivered by Lord Mustill, who explained why a contract for the sale of unascertained goods could pass no title to any such goods. A buyer could not acquire title to goods unless and until it is known to what goods that title relates. Notwithstanding that both parties might agree and intend that property to goods shall pass, from "the very nature of things" property cannot pass until the goods are

[19] *R. v Clowes (No.2)* [1994] 2 All E.R. 316 (CA), 325, per Watkins LJ; cf. *Re Kayford* [1975] 1 W.L.R. 279. See also *Qimonda Malaysia Sdn Bhd v Sediabena Sdn Bhd* [2012] B.L.R. 65 (CA Malaysia), and the commentary under para.20–003 above. In the context of a statutory trust of client money under the Financial Services and Markets Act 2000, the terms of the trust contemplate the mingling of funds, in that it is permissible for the trustee to receive clients' money into its own account (from which point, under the terms of the trust, the money is trust money) and subsequently to segregate it. See further paras.20-026 to 20-034 below.

[20] *Re Lehman Brothers International (Europe) (In Administration); Pearson v Lehman Brothers Finance SA* [2010] EWHC 2914 (Ch), [255]–[260]. An appeal to the Court of Appeal was dismissed: *Re Lehman Brothers International (Europe) (In Administration)* [2011] Bus. L.R. 277. The judgments cast no doubt on this aspect of the judgment of Briggs J at [2010] EWHC 2914 (Ch).

[21] *Hunter v Moss* [1993] 1 W.L.R. 934; affirmed by the Court of Appeal, [1994] 1 W.L.R. 452 (CA) with abbreviated reasons on the point in question. As far as one can tell from the reports, the facts did not involve insolvency.

[22] *Hunter v Moss* [1993] 1 W.L.R. 934 at 940.

[23] *Re Goldcorp Exchange Ltd (In Receivership)* [1995] 1 A.C. 74 (PC).

ascertained.[24] This reasoning was held to apply equally to an argument that a title in equity could be created by the sale.[25] Hence, the reasoning in the *London Wine Co* case was expressly applied and approved by the Privy Council.[26]

20-010 There is little doubt that the reasoning of the Board in *Goldcorp* sits uneasily with the decision in *Hunter v Moss*. Lord Mustill explained that neither legal nor equitable title can pass until it is clear to which title, hence which goods, the transaction is supposed to relate. That same reasoning would also dictate that no effective declaration of trust was made in *Hunter v Moss*, as the parties in *Hunter v Moss* could not possibly have known to which of the shares the trust related. The fact that all the shares were the same could not affect the logic of the reasoning adopted in *Goldcorp*.

20-011 The apparent tension between the two decisions was considered by Neuberger J in *Re Harvard Securities Ltd; sub nom. Holland v Newbury*.[27] That case also concerned title in shares which had not been appropriated to any contract of sale. After a thorough review of the relevant authorities and texts, Neuberger J concluded that *Hunter v Moss* was binding on him, and that, whilst "not particularly convinced by the distinction",[28] the reasoning in *Hunter v Moss* applied to shares and other intangibles, whilst the reasoning in *Goldcorp* applied to chattels. It appears that, unless and until the issue is raised before the Supreme Court, this distinction represents the law.[29]

20-012 *Hunter v Moss* was considered and distinguished, without adverse comment, by the Court of Appeal in *Re Lehman Brothers International (Europe)*,[30] where certain clients of the firm contended that a trust arose in respect of obligations owed by the firm to those clients, but prior to any appropriation of funds in respect of such obligations. The court held that no trust could exist without property to which the

[24] *Re Goldcorp Exchange Ltd (In Receivership)* [1995] 1 A.C. 74 (PC), [89E-90G] (see now Sale of Goods Act 1979 s.20A, inserted by the Sale of Goods (Amendment) Act 1995).

[25] *Re Goldcorp Exchange Ltd (In Receivership)* [1995] 1 A.C. 74 (PC), [90G].

[26] *Re Goldcorp Exchange Ltd (In Receivership)* [1995] 1 A.C. 74 (PC), [100A]. On this basis, there is not always a trust where specific performance of a contract for the sale or supply of a commodity is available, for specific performance may be available in respect of goods which are neither specific nor ascertained if there are no alternative sources of supply: see *Chitty on Contracts*, 32th edn (London: Sweet & Maxwell, 2015), Vol.1, para.28.017–28.018.

[27] *Re Harvard Securities Ltd (In Liquidation); sub nom. Holland v Newbury* [1998] B.C.C. 567.

[28] *Re Harvard Securities Ltd (In Liquidation); sub nom. Holland v Newbury* [1998] B.C.C. 567, 577.

[29] See *Re CA Pacific Finance Ltd (In Liquidation)* [2000] 1 B.C.L.C. 494 (CFI (HK)), 509; and *Re Harvard Securities Ltd (In Liquidation)* [1998] B.C.C. 567, 575 where reliance is placed on the distinction and it is pointed out that leave to appeal was refused in *Hunter v Moss* after the report of the Privy Council decision in *Goldcorp*. In *White v Shortall* [2006] NSCW 1379, the Supreme Court of New South Wales rejected the reasoning of Dillon LJ in *Hunter v Moss*, in upholding a trust over a partial holding of intangibles (instead holding that a single trust had taken effect over the entire shareholding, and the trustees had a power to elect which of those shares were held for the claimant). Campbell J also commented, at [245]–[247], that there could be a valid trust over part of a debt. Compare *Goode on Legal Problems of Credit and Security*, 5th edn (eds Goode & Gullifer, London, Sweet & Maxwell, 2013), para.2–06; and the discussion in *Hunter v Moss* [1993] 1 W.L.R. 934 at first instance before Colin Rimer QC, as to whether it is possible to declare a trust of part of a bank account balance prior to segregation or appropriation of the sum concerned. An ingenious justification for the decision in *Hunter v Moss* is suggested by Professor Roy Goode in *Goode on Legal Problems of Credit and Security*, above, paras 2-06 and 6-14. He there suggests that shares of the same issue by a company are not fungibles, but merely fractions of a single asset (the asset being the entire share capital of the issuing company); which asset is held in common by the shareholders. There is, therefore, no more difficulty in creating a trust of, say, 50 unidentified shares out of 100, than in creating a trust of a one-quarter interest in a racehorse.

[30] *Re Lehman Brothers International (Europe) (In Administration)* [2011] 2 B.C.L.C. 184 (CA).

trust could attach, thus distinguishing *Hunter v Moss*, where the shareholding was in existence and since the shares were fungible the trust property could be identified.[31] In *Re Lehman Brothers International (Europe)*; *Pearson v Lehman Brothers Finance SA*,[32] *Hunter v Moss* was accepted as authority for the proposition that a trust of part of a fungible mass without the appropriation of any specific part of it for the beneficiary does not fail for uncertainty of subject matter, provided that the mass is sufficiently identified and provided also that the beneficiary's proportionate share of it is not itself uncertain. Counsel described the principle embodied in *Hunter v Moss* as the basis upon which securities are intermediated in the modern world. Briggs J stated that the difficulty in applying *Hunter v Moss* to any case not on almost identical facts lies in the absence of any clearly expressed rationale as to how such a trust works in practice: the judge preferred the view that such a trust works by creating a beneficial co-ownership share in the identified fund, rather than the conceptually much more difficult notion of seeking to identify a particular part of the fund which the beneficiary owns outright.

20-013 The circumstances in which a company in receivership which had acted as a mercantile agent might hold the proceeds of book debts on trust for its principal were discussed by the Court of Appeal in *Triffitt Nurseries (A Firm) v Salads Ltd*.[33] The claimants were the producers of salad vegetables which were sold to supermarkets and wholesale markets by the company in receivership prior to the receivers being appointed. The claimants accepted that prior to the receivership the proceeds of the debts paid by the markets for the vegetables were owned by the company, since the company had the right to mix the proceeds of the book debts with its own monies, and to take its commission out of those proceeds. The claimants argued that upon the appointment of receivers and the cessation of the company's business, the proceeds of debts still outstanding at that time and collected by the receivers were subject to a trust in their favour, and that at the date of the receivership the claimants had been entitled to demand payment direct from the markets. The arguments were rejected by the Court of Appeal, on the basis that the company's title to the book debts was not somehow limited or defeasible, but absolute, and that the appointment of receivers and the cessation of business did not alter that fact. The claimants might have succeeded in claiming the proceeds from the receivers if the receivers had, after their appointment, accepted further consignments and sold further produce (whenever consigned)— in which case, the receivers may have been deemed personally to have adopted the contracts.

20-014 In *Associated Alloys Pty Ltd v A.C.N. 001 452 106 Pty Ltd*[34] the majority of the High Court of Australia recognised the effectiveness of an express trust of the proceeds of sale of goods supplied under a retention of title clause. The trust applied to the proceeds of sale of all products which were made using steel supplied by the sellers, the beneficial interest of the sellers being stated to be equal to the amount owing from the buyers to the sellers at the time of receipt of the proceeds. It was held that the absence of any express requirement on the buyer to keep the proceeds separate from his own assets did not affect the existence of the trust, since the trust itself was express and hence the obligation to keep the proceeds separate existed by necessary implication in any event.[35] The High Court of Australia was prepared to imply a term that the debt owing from the buyer to the seller at the time of receipt of the proceeds was discharged pro tanto on receipt by the buyer of the proceeds, so that no equity of redemption vested in the buyer.[36] The case is discussed further in Ch.21.

20-015 A form of trust which arises in insolvency situations with some frequency is the so-called "Quistclose trust", named after the decision of the House of Lords in *Barclays Bank Ltd v Quistclose Investments Ltd*.[37] Where a loan to a borrower is made exclusively for a specific purpose, and the borrower is not free to apply the money for any other purpose, the borrower has fiduciary obligations in respect of the monies lent, which the court will enforce. Frequently, the cases concern a loan by the lender to the borrower to enable the borrower to pay his creditors, or some of them, but the principle is not limited to such cases.

20-016 The *Quistclose* case was followed in *Re Northern Developments (Holdings) Ltd*,[38] where a group of lenders paid a large sum into an account in the name of the company to be paid to the creditors of a subsidiary, which was in financial trouble. The subsidiary went into receivership when just over half the fund remained in being. It was held, following the *Quistclose* case,[39] that there was a "purpose trust"[40]

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31 *Re Lehman Brothers International (Europe) (In Administration)* [2011] 2 B.C.L.C. 184 (CA), per Arden LJ [171]; Neuberger LJ [235].

32 *Re Lehman Brothers International (Europe) (In Administration)*; *Pearson v Lehman Brothers Finance SA* [2010] EWHC 2914 (Ch), [225(iii)] and [227]–[235]. On appeal, the principle in *Hunter v Moss* was not challenged: *Re Lehman Brothers International (Europe) (In Administration)* [2012] 2 B.C.L.C. 151, (CA) at [69]–[77]. The Court of Appeal dismissed this aspect of the appeal with no adverse comment on *Hunter v Moss*, or the reasoning of Briggs J below on this issue.

33 *Triffitt Nurseries v Salads Ltd* [2000] 1 All E.R. (Comm) 737 (CA). Note that, following the decision of the Supreme Court in *Angove's Pty Ltd v Bailey* [2016] 1 W.L.R. 3179 (SC), a different result would pertain in circumstances in which the authority of the agent to recover debts is validly revoked by its principal.

34 *Associated Alloys Pty Ltd v A.C.N. 001 452 106 Pty Ltd* (2000) 171 A.L.R. 568 (High Court of Australia).

35 See further *Stephens Travel Service International Pty Ltd v Qantas Airways* (1988) 13 N.S.W.L.R. 331 (NSWCA); *Walker v Corboy* (1990) 19 N.S.W.L.R. 382 (NSWCA); and cf. *Re ILG Travel Ltd (In Administration)* [1996] B.C.C. 21.

36 See also *Re SSSL Realisations (2002) Ltd* [2005] 1 B.C.L.C. 1, [49]–[54].

37 *Barclays Bank Ltd v Quistclose Investments Ltd* [1970] A.C. 567 (HL). For commentary on the implications of these trusts for bankers, see further paras 24–027 to 24–028, below.

38 *Re Northern Developments (Holdings) Ltd* unreported 6 October 1978, per Megarry VC.

39 *Barclays Bank Ltd v Quistclose Investments Ltd* [1970] A.C. 567 (HL).

40 A purpose trust is a trust where the trust property is earmarked for use for a particular purpose, and is not available to be used for any other purpose. "Instances in the books are legion": per Dillon LJ in *Re EVTR* [1987] B.C.L.C. 646 (CA), [651c], a case where a special-purpose loan led to a constructive trust in favour of the lender. See also *Re Goldcorp Exchange Ltd (In Receivership)* [1995] 1 A.C. 74 (PC), especially at 140–135. For examples in which express purpose trusts been found not to have been created, see *Re Holiday Promotions (Europe)* [1996] B.C.C. 671; *Re Challoner Club Ltd (In Liquidation)*, *Times* 4 November 1997; *Box v Barclays Bank Plc* [1998] Lloyd's Rep. Bank 185; *Re Griffin Trading Co* [2000] B.P.I.R. 256; and *Re Farepak Food and Gifts Ltd (In Administration)* [2008] B.C.C. 22; and [2010] B.C.C. 735. The Court of Appeal in *Twinsectra Ltd v Yardley* [1999] Lloyd's Rep. Bank 438 (CA) in applying *Quistclose* suggested that in principle the degree of certainty with regard to the objects of a *Quistclose* type trust "need be no more than is necessary to enable the restriction on the recipient's use of the money to be identified and enforced," per Clarke LJ at [76]. In the House of Lords (reported at [2002] 2 A.C. 164), Lord Millett said (at 184) that it was "well established that a loan to a borrower for a specific purpose where the borrower is not free to apply the moneys for any other purpose gives rise to fiduciary obligations on the part of the borrower which a court of equity will enforce". He added that although, in earlier cases, the purpose was to enable the borrower to pay his creditors or some of them, "the principle is not limited to such cases" (see [68]). He further stated (at [74]) that the question in every case was whether the parties intended the money to be at the free disposal of the recipient and such freedom was necessarily excluded by an agreement that the money remains the property of the lender unless and until applied in accordance with his directions and insofar as not so applied it must be returned to him. See

affecting the monies enforceable by the lenders and by the creditors of the subsidiary.

20-017 A further *Quistclose* situation occurred in *Carreras Rothmans Ltd v Freeman Mathews Treasure Ltd*[41] where monies were paid into a special account by the principal to enable its advertising agent, then in financial difficulties, to pay sums owed by the agent to certain creditors. The agent went into liquidation. It was held, following the *Quistclose* and Northern Developments decisions, that the monies were subject to a trust and that:

> "... the principle in all these cases is that equity fastens on the conscience of the person who receives from another property transferred for a specific purpose only and not therefore for the recipient's own purposes, so that such person will not be permitted to treat the property as his own and to use it for other than the stated purpose."[42]

20-018 For some time after the decision in *Quistclose*, there was debate as to the nature of the Quistclose trust, and in particular who owned the beneficial interest in the loaned monies. The debate has now been resolved by the decision of the House of Lords in *Twinsectra Ltd v Yardley*.[43] If A lends money to B, such monies to be used solely for a specific purpose and no other, then during the period that B holds the money prior to fulfilling the purpose, the monies are held on resulting trust for A, but subject to a power (or, indeed, duty) in B to apply the monies for the stated purpose. If the monies are paid by B for the stated purpose, title to the monies vests, of course, in the payees, and A has merely a contractual right in debt to repayment of the loan. If for some reason the purpose cannot be carried out (typically, because B becomes insolvent) then the monies remain held on trust for A, who is entitled to the return of the monies in specie as beneficiary by revoking the power or mandate to B to apply the monies for the stated purpose.

20-019 The underlying principles by reference to which a *Quistclose* trust will arise were summarised in *Bieber v Teathers Ltd*,[44] where it was contended that subscription monies paid by investors to the stockbroker managers of a collective investment scheme were held on trust for the investors. In rejecting this argument, the judge held that, once the subscription monies had been contributed as capital to a partnership constituted for the purpose of the investment in accordance with the terms of the partnership deed, they became part of the general assets of the partnership. Provisions in the partnership deed precluding the withdrawal of capital and specifying that capital did not bear interest were not consistent with the money continuing to be the equitable property of an individual investor; such money could not be both partnership capital and trust money.[45] It was held that it was implicit in the doctrine that it must be ascertainable, objectively, at the time of any payment of the trust monies in purported accordance with the specific purpose of the settlor whether that purpose had been achieved by the payment or not.[46] The principles applicable when considering whether a *Quistclose* trust arises were summarised by Norris J as follows:

> "[(1)] First, the question in every case is whether the payer and the recipient intended that the money passing between them was to be at the free disposal of the recipient: *Re Goldcorp Exchange* [1995] 1 AC 74 and *Twinsectra* at [74].
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> [(2)] Second, the mere fact that the payer has paid the money to the recipient for the recipient to use it in a particular way is not of itself enough. The recipient may have represented or warranted that he intends to use it in a particular way or have promised to use it in a particular way. Such an arrangement would give rise to personal obligations but would not of itself necessarily create fiduciary obligations or a trust: *Twinsectra* at [73].
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> [(3)] So, thirdly, it must be clear from the express terms of the transaction (properly construed) or must be objectively ascertained from the circumstances of the transaction that the mutual intention of payer and recipient (and the essence of their bargain) is that the funds transferred should not be part of the general assets of the recipient but should be used exclusively to effect particular identified payments, so that if the money cannot be so used then it is to be returned to the payer: *Toovey v Milne* (1819) 2 B&A 683 and *Quistclose Investments* at 580B.
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> [(4)] Fourth, the mechanism by which this is achieved is a trust giving rise to fiduciary obligations on the part of the recipient which a court of equity will enforce: *Twinsectra* at [69]. Equity intervenes because it is unconscionable for the recipient to obtain money on terms as to its application and then to disregard the terms on which he received it from a payer who had placed trust and confidence in the recipient to ensure the proper application of the money paid: *Twinsectra* at [76].
>
> [(5)] Fifth, such a trust is akin to a "retention of title" clause, enabling the recipient to have recourse to the payer's money for the particular purpose specified but without entrenching on the payer's property rights more than necessary to enable the purpose to be achieved. It is not as such a "purpose" trust of which the recipient is a trustee, the beneficial interest in the money reverting to the payer if the purpose is incapable of achievement. It is a resulting trust in favour of the payer with a mandate granted to the recipient to apply the money paid for the purpose stated. The key feature of the arrangement is that the recipient is precluded from misapplying the money paid to him. The recipient has no beneficial interest in the money: generally the beneficial interest remains vested in the payer subject only to the recipient's power to apply the money in accordance with the stated purpose. If the stated purpose cannot be achieved then the mandate ceases to be effective, the recipient simply holds the money paid on resulting trust for the payer, and the recipient must repay it: *Twinsectra* at [81], [87], [92] and [100].
>
> [(6)] Sixth, the subjective intentions of payer and recipient as to the creation of a trust are irrelevant. If the properly construed terms upon which (or the objectively ascertained circumstances in which) payer and recipient enter into an arrangement have the effect of creating a trust, then it is not necessary that either payer or recipient should intend to create a trust: it is sufficient that they intend to enter into the relevant arrangement: *Twinsectra* at [71].
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> [(7)] Seventh, the particular purpose must be specified in terms which enable a court

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also *Barnabas Hurst-Bannister v New Cap Reinsurance Corp Ltd* [2000] Lloyd's Rep. I.R. 166. cf. *OT Computers Ltd (In Administration) v First National Trinity Finance Ltd* [2007] W.T.L.R. 165; and *Re Margaretta Ltd (In Liquidation)* [2005] B.P.I.R. 834, [16]. In *Kingate Global Fund Ltd v Knightsbridge (USD) Fund Ltd* [2009] SC (Bda) 39 Civ (CA (Bermuda), the Court of Appeal of Bermuda concluded that subscription monies paid by intending subscribers in a Madoff feeder fund were held on a "*Quistclose*" trust for the benefit of the intending subscribers pending the issue and allotment of shares. The Court held that there was no principle or rule of law deriving from *Moseley v Cressey's Co* (1865) L.R. 1 Eq. 405, whereby monies paid to a company for the purchase of shares in the company were presumed to form part of the assets of the company prior to issue and allotment, absent some extraordinary special term (such as the term in *Re Nanwa Gold Mines* [1955] 1 W.L.R. 1080, where the prospectus stated that application monies would be held in a separate account pending issue).

41 *Carreras Rothmans Ltd v Freeman Mathews Treasure Ltd (In Liquidation)* [1985] Ch. 207, per Peter Gibson J.

42 *Carreras Rothmans Ltd v Freeman Mathews Treasure Ltd (In Liquidation)* [1985] Ch. 207 at 222B.

43 *Twinsectra Ltd v Yardley* [2002] 2 A.C. 164 (HL), especially per Lord Millet at [68]–[103].

44 *Bieber v Teathers Ltd* [2012] 2 B.C.L.C. 585, per Norris J, [16]–[22].

45 *Bieber v Teathers Ltd* [2012] 2 B.C.L.C. 585 at [77].

46 *Bieber v Teathers Ltd* [2012] 2 B.C.L.C. 585 at [23]–[26].

to say whether a given application of the money does or does not fall within its terms: *Twinsectra* at [16].

... It is in my judgment implicit in the doctrine so described in the authorities that the specified purpose is fulfilled by and at the time of the application of the money. The payer, the recipient and the ultimate beneficiary of the payment (that is, the person who benefits from the application by the recipient of the money for the particular purpose) need to know whether property has passed."

The decision was upheld on appeal,[47] where Patten LJ applied the principles from *Quistclose* and *Twinsectra Ltd v Yardley* and added[48] that, in deciding whether particular arrangements involve the creation of a trust and the retention by the paying party of beneficial control of the monies, proper account needs to be taken of the structure of the arrangements and the contractual mechanisms involved.[49]

20-020 In *Bellis v Challinor*,[50] a group of investors seeking to invest in a property investment scheme paid funds into the client account of a firm of solicitors representing the investment vehicle which had acquired the land. The solicitors' firm paid the funds to its client's bankers in reduction of short-term borrowings extended by the bankers to the investment vehicle. The investment scheme failed and the investors sought to recover their money from the solicitors' firm. At first instance, Hildyard J held that the money had been held by the solicitors' firm for the investors on the basis of an implied resulting trust analogous to a *Quistclose* trust. The decision was reversed on appeal. So far as relevant, the Court of Appeal held that the money had been paid to the solicitors' firm as immediate loans to the investment vehicle and the solicitors firm held the money solely on trust for the investment vehicle and not on resulting trust for the investors.[51] The investment monies had been advanced by the investors on the basis of offering documents inviting the making of an investment by way of immediate loan to the investment vehicle. No restrictions were placed on the solicitors' use of the monies and the investors did not seek any undertaking in that respect. Apart from the payment of the investment monies, there had been no dealing between the investors and the solicitors' firm. The Court of Appeal stated that the risk the investors took of the scheme being unsuccessful did not permit the offering documents to be interpreted as proffering something completely different from what they described. Briggs LJ identified the following factors as being critical to the creation of a *Quistclose* trust[52]:

"There must be an intention to create a trust on the part of the transferor. This is an objective question. It means that the transferor must have intended to enter into arrangements which, viewed objectively, have the effect in law of creating a trust..."

20-021 Where a lender advances monies to a company in financial difficulties for the payment of creditors or, as in *Quistclose* itself, to pay declared but unpaid dividends, then if the borrower enters formal insolvency proceedings, the purpose behind the loan can, in a sense, still be achieved: as the monies belong to the lender and not

47 *Bieber v Teathers Ltd* [2013] 1 B.C.L.C. 248.
48 *Bieber v Teathers Ltd* [2013] 1 B.C.L.C. 248 at [15].
49 *Quistclose* and *Twinsectra* were also applied, and the Court of Appeal judgment in *Bieber* considered, in *Eleftheriou v Costi* [2013] EWHC 2168 (Ch), [40]–[72].
50 *Bellis v Challinor* [2016] W.T.L.R. 43.
51 *Bellis v Challinor* [2016] W.T.L.R. 43, per Briggs LJ at [13(a)], [13(c)] and [67]-[92].
52 *Bellis v Challinor* [2016] W.T.L.R. 43 at [57]. Briggs LJ added, at [59], that "A person creates a trust by his words or conduct, not by his innermost thoughts". See also *Gabriel v Little* (2013) 16 I.T.E.L.R. 567; and *Gore v Mishcon de Reya* [2015] EWHC 164 (Ch).

the insolvent company, no preference would result if the creditors were paid notwithstanding insolvency. But typically the lender will have some motive beyond ensuring payment to creditors as such–normally, the survival of the company. If the lender's object in giving the power or mandate is frustrated, as often by formal insolvency, the lender is entitled to revoke the mandate and demand return of the money. Insolvency will not always frustrate the lenders' object. In *Re Margaretta Ltd*,[53] a company sold a property and the VAT element of the price was paid into a separate account pending determination of what VAT, if any, was payable. The subsequent insolvency of the company prior to payment did not frustrate the object of the payment, and hence payment was directed to be paid to Customs and Excise. It was there noted that, although normally the beneficial interest under a *Quistclose* trust will remain—at all times prior to payment—in the lender, there may be circumstances where the third party intended to benefit from the trust might acquire a beneficial interest, where the obvious intention of the transaction would be frustrated if the lender retained a power of revocation, or where the intended recipient gets to know of the existence of the trust, in which case he might acquire a beneficial interest by virtue of an estoppel, or perfection of an assignment.[54]

20-022 In *Du Preez Ltd v Kaupthing Singer & Friedlander (Isle of Man) Ltd*,[55] a disappointed depositor of an insolvent bank contended that it was entitled to priority over the other unsecured creditors of the bank by virtue of an alleged *Quistclose* trust. The depositor held a credit balance with the bank, and shortly before provisional liquidators were appointed, gave instructions that a substantial part of that credit balance should be transferred to a third party's account at an unrelated (and solvent) bank. At the time that provisional liquidators were appointed, the bank had made the requisite debit entry on the account balance in anticipation of the transfer being effected, but the transfer was never completed. The bank's liquidators contended that the depositor should prove for the account balance (including the sum intended to be transferred) as an ordinary unsecured creditor. The depositor contended that he was the beneficiary of a *Quistclose* trust, and hence entitled to payment in full of the sum he had sought to transfer. The sole basis for alleging the existence of a trust was the instruction to transfer (whereby, the depositor contended, the bank was instructed to use the money in the account for the sole purpose of making the transfer to the third party) and the provisional debiting of the account. The claim was dismissed. The Staff of Government Division (the Isle of Man equivalent of the Court of Appeal) held that it was an essential element of any *Quistclose* trust that the exclusive purpose for which monies are to be used by the trustee/recipient be communicated before or at the same time as the transfer of the money to that trustee/recipient. On normal banking law principles, money paid to a bank by a depositor is owned by the bank, and the relationship between the bank and its customer is merely that of debtor and creditor. Given that the depositor paid no new money to the bank at the time that it gave the bank instructions to transfer the money, but merely requested the transfer of part of its pre-existing credit balance, there could be no question of any *Quistclose* trust arising.[56] A further argument, based on the decision in *Re Kayford*, that the bank had declared itself a trustee of

53 *Re Margaretta Ltd* [2005] B.C.C. 506.
54 *Re Margaretta Ltd* [2005] B.C.C. 506, [24].
55 *Du Preez Ltd v Kaupthing Singer & Friedlander (Isle of Man) Ltd (In Liquidation)* (2010) 12 I.T.E.L.R. 943 (High Court of the Isle of Man).
56 In the course of its judgment, at [49], the Staff of Government Division commented that if the depositor had paid monies to the bank on the express basis that such sum was to be paid forthwith to the