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REPRINTED FROM:
CORPORATE DISPUTES MAGAZINE
OCT-DEC 2018 ISSUE

CANDEY

Published by Financier Worldwide Ltd
corporatedisputes@financierworldwide.com

www.corporatedisputesmagazine.com

PERSPECTIVES

CREDITORS' CHALLENGES TO ADMINISTRATORS AND LIQUIDATORS – AN OVERVIEW

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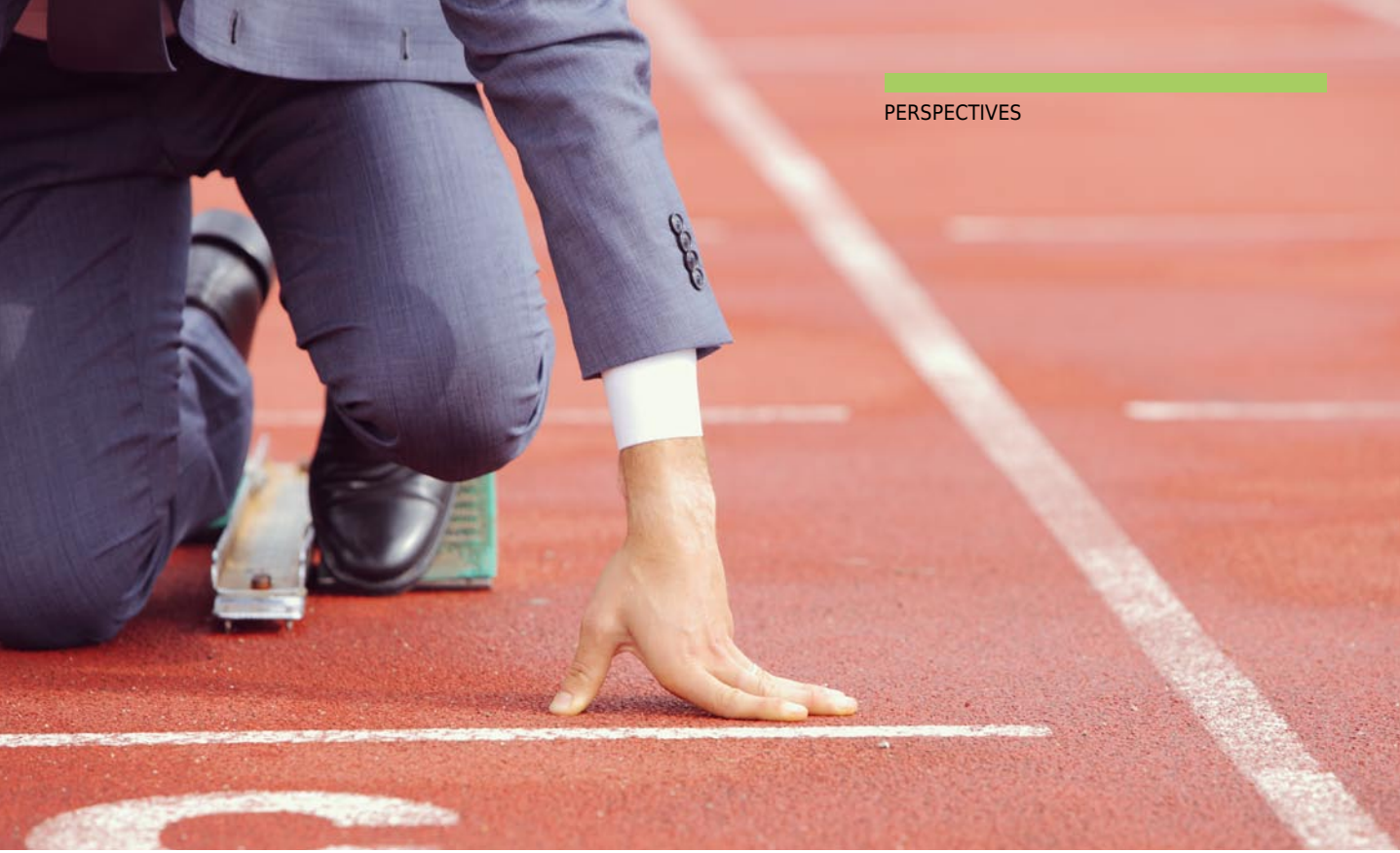
Insolvency practitioners occupy a powerful and responsible role in administrations and liquidations. They are often a major force for good, tackling those who have raided companies for their own personal benefit to the unlawful detriment of creditors and shareholders. Their decisions may be based on a misunderstanding of the law, and they could (rarely) be misfeasant or even in exceptional circumstances corrupt, and, as in any civilised society, they are subject to being challenged before the Court.

Where a creditor is unhappy about an office holder's decision on a proof of debt or the value of any security, an appeal lies to the court pursuant to Rule 14.8 of the Insolvency Rules 2016. The test applied by the Court is whether the decision was simply wrong, with the Court also having a general ability to interfere where office holders have misapplied the law as Neuberger J, as he then was, made clear in *CE King Ltd*.

As well as being the arbiter of their decisions at law, the court also has an inherent jurisdiction to control administrators and liquidators' conduct, as officers of the court. The court will be slow to exercise this jurisdiction.

The judiciary have no desire to regulate every question of office holders' conduct particularly where they are making business choices which the Court generally considers they are best qualified to undertake. In this respect the Court will give them substantial latitude, expecting them to be proactive



and expeditious. The bar to a challenge in respect of their conduct is high and an applicant will have to evidence unfair harm, bad faith, fraud or that the conduct was of a kind so absurd that no other reasonable liquidator would have taken it.

Removal

An application to remove an office holder will be heavily criticised by the court if made for purely tactical reasons as the recent decision in *TPS Investments (UK) Ltd* confirmed. Indeed, the court made clear that: "Such applications should never be made without careful consideration of the position and an attempt made, by both sides acting co-operatively, to proceed in a constructive and time and cost-efficient manner."

The relevant mechanisms for effecting removal are paragraph 88 of Schedule B1 of the Insolvency Act 1986 for administrators and ss. 108, 171 or 172 of the Insolvency Act for liquidators, depending on whether the winding up is voluntary or compulsory.

There is often a perception among practitioners that in order to remove an insolvency office holder, some sort of misconduct, bias or conflict of interest must be in evidence. Certainly, such cases are clear examples of where the courts will grant removal applications. In *Corbenstoke Ltd*, for example, Harman J granted a removal application on the basis that the liquidator was conflicted. He had a duty to investigate the actions of the former directors of the company but had himself been one of them. He was also a debtor of the company and the trustee in bankruptcy of a

creditor of the company. In fact, a far wider range of circumstances than these clear examples may give rise to the removal of insolvency office holders.

S.108(2) of the Insolvency Act sets out that the test for removal of a liquidator in a voluntary liquidation, which is also to be applied in a compulsory one, is 'cause shown'. The main authority for what 'cause shown' entails remains *Adam Eyton Limited* in which Bowen LJ made clear that the court was entitled to look beyond unfitness of the liquidator, such as that due to a conflict, and measure due cause "by reference to the real, substantial, honest interests of the liquidation and the purpose for which the liquidator is appointed". This will involve looking at the particular circumstances and purposes of an individual liquidation.

Millet J further confirmed in *Keypack Homecare Ltd* that it would be "dangerous and wrong for a court to seek to limit or define the kind of cause which is required. Circumstances vary widely, and it may be appropriate to remove a liquidator even though nothing can be said against him, either personally or in his conduct of the particular liquidation". In that case, a liquidator had been slow in investigating allegations of fraudulent trading in the lead up to the liquidation, leading the creditors to believe, justifiably, that the liquidator would not pursue the former directors with sufficient vigour. This was cause enough for the court to order his removal. Indeed, it is generally sufficient cause to remove a liquidator that the creditors, acting reasonably, have lost faith in him. Judges take the view that in most cases the parties in the best position to determine what is in the best interests of the liquidation are the creditors themselves. Although the impact on the liquidator's standing and reputation caused by being removed is also to be taken into account, it is not determinative. In addition, the cost of another liquidator being installed, wasting work which has already been done by a former liquidator, has relevance.

The discretion to remove an administrator under paragraph 88 of Schedule B1 will similarly only be exercised where there is "a good or sufficient ground or cause", according to *St George's Property Services (London) Ltd*. Whether there is a good or sufficient ground or cause in a given case is highly fact sensitive.

As Warren J pointed out in *Sisu Capital Fund Ltd v. Tucker*, while the paragraph 88 power confers an unfettered discretion, the 'cause' which must be shown for an administrator's removal is analogous to what is required in respect of an application to remove a liquidator. In *St George's Property*, the Court of Appeal did single out the question of whether the administrator was acting in accordance with the wishes of the majority of creditors as likely to be of relevance. The court also reemphasised the statements of David Richards J in *Clydesdale Financial Services Ltd v Smailes*, that similarly to applications to remove liquidators, grounds for the removal of an administrator "need not involve misconduct, personal

unfitness or imputation against the integrity of the administrator".

Challenging office holders' conduct under the provisions of the Insolvency Act

Paragraph 75 of Schedule B1 permits the court to examine the conduct of an administrator to ascertain whether company property has been misapplied, retained or whether the administrator is otherwise liable to account for it, whether the administrator has breached their duties, including their fiduciary duties, or been guilty of misfeasance. It is therefore simply a mechanism to enforce existing rights and duties, determined on the balance of probabilities. Any benefit will be for the entire class of creditors.

Paragraph 74(1), by contrast, creates a much broader freestanding right to apply to the court where an administrator has acted, is acting or proposes to act so as to unfairly harm the interests of the applicant as a creditor. Unfair harm is a high bar. The harm concerned may be suffered by the whole body of creditors, some portion of them or by the applicant alone. It must be suffered in the applicant's capacity as a creditor, rather than as, for example, a contractual counterparty, as was demonstrated in *BLV Realty Organisation Ltd v. Batten*.

The harm must also be 'unfair'. Whether this is the case is often dealt with by analogy with the concept of "unfair prejudice" under s. 994 of the Companies Act 2006 although the courts, for example Blackburne J in *Lehman Brothers International (Europe)*, have stressed that the situations are not identical and what is unfair in the context of administration may be different. Context is everything. Although it is normally necessary to show that a creditor's interests have been harmed by administrators as a result of being treated differently to other creditors or classes of creditors, this alone is insufficient. A creditor will fail if the harm to their interests is as a result of a reasonable commercial decision in the administration, justified by reference to the interests of the body of creditors as a whole and the interests of the administration. A creditor may also apply to the court under paragraph 74(2) where an administrator is not performing their functions as quickly or as efficiently as reasonably practicable. The remedy available upon a successful application under paragraph 74 is flexible and can be tailored to suit the interests of a particular creditor. This is part of its attraction as a tool in challenging administrators. Indeed, an administrator may even be removed following a successful application under paragraph 74 challenging their actions. Such applications are therefore often brought concurrently with those under paragraph 88 to remove the administrator for cause.

In relation to liquidation, broad powers are conferred on creditors by ss. 112 (voluntary liquidation) and 168(5) (compulsory liquidation) of the Insolvency Act to apply to the court to challenge the exercise, or proposed exercise, by the liquidators of a company of their powers or any other decision made or act done by them. Generally, however, the courts

are reluctant to intervene in relation to liquidators' decisions unless no reasonable liquidator with the facts before them and proper advice could have arrived at such a decision in the circumstances, as Nourse LJ set out in *Re Edennote Ltd*.

An example of an unreasonable decision taken by a liquidator was demonstrated in *Hamilton v. Official Receiver*. The court reversed a refusal by the liquidator to assign a cause of action whose merits were unclear, and which the liquidator did not wish to pursue, to the applicant. In circumstances where the only value to be realised from the asset was the sum to be paid for it by the applicant, there was no other reasonable decision open to the liquidator but to make the assignment. It must nevertheless be emphasised, as Robert Walker LJ put it in *Mitchell v. Buckingham International Plc*, that the court is reluctant to "substitute their judgement for a liquidator's on what is essentially a businessman's decision".

Other provisions which impact the rights of creditors seeking to enforce security are s.168(3) and s.212(1) of the Insolvency Act, with liquidators able to pre-emptively bring disputes with creditors before the courts by applying under s.168(3) for directions in relation to any matter arising in the winding up of the company. S. 212(1) (b) confers a power on the court to examine the conduct of liquidators in relation to misfeasance in a similar way as that conferred by paragraph 75 of Schedule B1 concerning administrators.

With the evolving political landscape in the UK, further statutory innovations to the insolvency regime are on the horizon. What is certain is that in any corporate insolvency a potential corporate dispute of some kind, whether by or against an office holder, is never far away: the office holders' wide powers to seek to turn around companies or realise assets for the benefit of creditors and be held judicially to account in proportionate manner is to the real benefit of any civilised society. Whether creditors or particular classes of creditors will be afforded new statutory rights of challenge remains to be seen. CD

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