Administrators' disposal of claim by auction (Re Meem SL Ltd (in administration); Goel and another v Grant and another)

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Restructuring & Insolvency analysis: Christopher Brockman, barrister at Guildhall Chambers, discusses Re Meem SL Ltd (in administration), which reaffirmed the reluctance of a court—in the absence of blatant unfair harm to an applicant—to interfere with the commercial decision of an office-holder to dispose of assets.

Original news

Re Meem SL Ltd (in administration); Goel and another v Grant and another (as joint administrators of Meem SL Ltd) and another [2017] EWHC 2688 (Ch), [2017] All ER (D) 114 (Dec)

Two shareholders and creditors of a company in administration applied under the Insolvency Act 1986 (IA 1986) to restrain the administrators of the company from selling, by auction, a proposed claim the company had against various parties. The basis of the proposed claim was an alleged conspiracy to put the company into administration and to dispose of its assets at an undervalue by way of a 'pre-pack' sale. In dismissing the application, the Companies Court held that the applicants had failed to establish that the administrators were contractually bound to sell the claim to them or that the proposed sale by auction would unfairly harm the applicants' interests.

What are the practical implications of this case?

This case reinforces the principle that a court will be reluctant to interfere with the decision of office-holders—in this case administrators—where they reasonably decide to realise a cause of action for breach of duty against directors by way of an auction between the interested parties.

It also demonstrates that an office-holder should not forget that a person who is a potential target of litigation may be willing to buy off that threat and should be offered the opportunity to do so.

What was the background to the case?

The applicants were the majority shareholders holding 67.5% of the issued share capital of Meem SL Ltd, and the second respondent was a minority shareholder of the company, holding just over 11%. The board of directors, comprising the second respondent and two others, had put the company into administration. The company's intellectual property was valued by specialist valuers at between £30,000 and £140,000. The administrators, by way of a pre-pack sale, sold the business of the company to a new company, MML, set up by the directors for £1,449,463, comprising £185,000 cash and agreement by MML to take over the liabilities of the company amounting to £1,274,643.

The applicants sent a letter of claim and draft particulars of claim to the second respondent's solicitors detailing a derivative claim to be brought on the company's behalf alleging an unlawful-means conspiracy by the directors to put the company into administration and to dispose of its assets to the new company at an undervalue, and claiming £11.8m in damages.

In email correspondence with one of the administrators, the applicants' solicitor discussed the option of assigning the claim to the applicants for £5,750. Alternatively, they proposed to take an assignment for a nominal consideration and hold the fruits of the litigation on trust for the company, subject to recouping their costs. The administrators decided to dispose of the claim by auction. The applicants' case was that auctioning the claim would cause them unfair harm within the meaning of IA 1986, Sch B1, para 74.

What issues arose for the court's consideration?

The first issue for the court was whether the administrators were contractually bound to sell the claim to the applicants. This is clearly a fact-specific question and will depend upon the factual matrix in any given case.

The second, and of more general importance, was whether the administrators' disposal of the claim by auction unfairly harm the applicants' interests.

What did the court decide, and why?

In relation to the first question, the court found on the facts of this case that the email correspondence was of a general nature and never morphed into an offer. The parties simply explored the basis of any agreement.

However, the court went further and held that had there been a binding agreement it would have set it aside on the ground of 'unfair harm', in that it would have allowed one creditor to buy the company's only remaining asset at a considerable undervalue, at a time when it was not known for certain whether there might be other creditors.

So far as the disposal of the cause of action by auction was concerned, the second question, the judge held:

- This did not cause the applicants' any unfair harm. The authorities showed that the paradigm case under IA 1986, Sch B1, para 74 arose where the administrator treated the applicant less favourably than other creditors. For that treatment to constitute unfair harm, the applicant had to show that the decision could not be justified by reference to the creditors' interests as a whole or in achieving the administration's objective. *Re Coniston Hotel (Kent) LLP (In Liquidation)* [2013] EWHC 93 (Ch), [2013] All ER (D) 36 (Feb) applied.
- The concept of 'unfair harm' in IA 1986, Sch B1, para 74 was not limited to differential treatment but could include an administrator's decision to sell an asset at an undervalue, thereby causing loss to all creditors—*Hockin v Marsden* [2014] EWHC 763 (Ch), [2014] All ER (D) 206 (Mar).
- A court would not interfere with that decision unless it did not withstand logical analysis, which probably meant the same as perversity—*Re Edennote Ltd* [1996] BCC 718.
- A cause of action was a difficult asset to value. If it appeared to have a substantial value, no reasonable administrator would sell it for a fixed price without properly considering its value, usually with expert assistance, or finding a sensible alternative. *Faryab (a bankrupt) v Smith (Trustee in Bankruptcy)* [2001] BPIR 246 considered.
- Whether the administrator acted unreasonably by selling an asset by auction depended on the facts of each case. In an appropriate case, the process of testing the market by holding an auction might make it reasonable to proceed without seeking valuation advice, particularly where the claim's valuation was difficult.
- Whether there was a public interest in preventing claims from being bought by defendants to stifle them was at best a marginal factor save in extreme cases.

In this case, the judge found that the applicants' offer to take an assignment of the claim and hold the fruits on trust for the company would lead to considerable uncertainty and delay—it was not clear that they had the financial means to pursue the litigation or that it would be successful or result in substantial recovery. By contrast, the proposed auction would achieve a fixed price without delay.

Further, the second applicant had the means to bid for the claim himself and, if the claim was a good one, there was no satisfactory explanation for the applicants' failure to obtain third-party funding. The judge gave little weight to the argument that it was in the public interest to ensure that substantial claims were not stifled. In any event, as the second applicant was able to offer a substantial sum to ensure that the second respondent did not pay an insubstantial sum to stifle the claim, the bidding process should be seen as akin to negotiations between claimants and defendants to compromise a claim.

To what extent is the judgment helpful in clarifying the law in this area?

This was always going to be a difficult case for the applicants. The courts have repeatedly emphasised that the threshold interference with the decision of an office-holder regarding the sale of an asset is high. It will generally give an administrator a wide measure of latitude and will only interfere where administrators are proposing to take a course which is based on a wrong appreciation of the law and/or is conspicuously unfair to a particular creditor or creditors or contractor of the company.

Indeed, as far back as 2005 Lightman J, in *Hopkins v TL Dallas Group Ltd* [2004] EWHC 1379 (Ch), [2004] All ER (D) 135 (Jun), emphasised that before any sale of a cause of action was concluded, an office-holder should seek bids for the cause of action from the party against whom a claim may lie. It will often be worth that party making a payment exceeding the proceeds otherwise obtainable from a third party to buy from and accordingly settle the claim with the liquidator or trustee.

The fact that a claim may be bought by defendants for the purpose of stifling a claim is of little relevance and of peripheral importance, and the court should not give much weight to the argument that it is in the public interest to ensure that substantial claims are not stifled, except in extreme cases of abuse.

What this case emphasises is the reluctance of a court, in the absence of blatant unfair harm to an applicant, to interfere with commercial decision of an office-holder to dispose of assets.

Chris Brockman's practice areas include asset recovery on behalf of insolvency office holders, opposing and obtaining administration orders, compulsory winding up, freezing orders, wrongful trading/breach of directors' duties claims, 236 applications to examine directors and examination of directors, defending trustees against claims for negligence/breach

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