CDDA ALLEGATIONS – THE GOOD, THE BAD & THE UGLY

DEFENCE STRATEGIES – FAIRNESS & CLARITY

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1. The talk and this supporting paper were prompted by the *Farepak* debacle, which saw the SofS discontinue the high profile s.8 CDDA proceedings against various directors of *Farepak* and its holding company on day 15 of trial; the unprecedented judicial statement by Peter Smith J on 21 June 2012; the review report to the Insolvency Service concerning lessons to be learned from *Farepak* and other recent cases dealing with the duty of fairness that arises in CDDA proceedings. A working knowledge of the CDDA is assumed and this paper is principally aimed at providing the relevant case references referred to in the talk for those representing defendants in dealing with defence strategies relating to the duty of fairness and the particular procedural case law relating to the presentation of CDDA cases by the SofS.

2. The public interest nature of CDDA proceedings has led to a substantial body of procedural case law, which may in appropriate cases be used as part of a defence strategy for respondents. The circumstances in which it is appropriate to deploy such strategies will be explored in the talk itself.

A. Public Interest Proceedings

3. CDDA proceedings by the SofS or OR[1] are civil regulatory proceedings which are brought in the public interest to protect the public by prohibiting a defendant from being concerned in the management of a company in the future. There is a deterrent element and a public interest in maintaining and improving the standards expected of directors trading with the benefit of limited liability.

4. However as a consequence of the proceedings being brought in the public interest by the Insolvency Service, acting as a Government regulatory agency, a respondent can legitimately expect such proceedings (with the potential for consequential damage to his reputation and penal interference with his freedom to carry on business) to be commenced against him and continued only if it is in the public interest for such proceedings to be issued and continued through to trial. There is thus a flipside to the public interest filter in the proceedings being brought, which protects a defendant by placing duties on the SofS as claimant to which ordinary civil litigants are not subject.

B. Duty of fairness

5. A series of first instance decisions has established that there is a special duty on the SofS to present the case for a disqualification order in a fair and balanced manner. The SofS is subject to a higher standard of fair dealing than the duty owed by every civil litigant to the court to act fairly and appropriately. In appropriate cases, a defendant can properly complain to the court about non-compliance with the duty. Once the matter has been raised, the court has the power to deal with it in the proceedings in an appropriate way, to ensure the just, quick and cheap resolution of the real issues. The court's determination may well operate for the benefit of the party who has complained, including making unusual but appropriate orders for costs[2].

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[1] Section 16(2) CDDA 1986 allows an application for a DO to be made under sections 2 to 4 CDDA 1986 by the SofS, OR, the liquidator or any part of present member or creditor of the company being wound up. For an example of the rare use of this power by a liquidator against a former liquidator, see *Asegaai Consultants Ltd* [2012] EWHC 1899 (Ch); [2012] Bus LR 1607 where liquidators successfully applied under s.4 CDDA for a DO against a former liquidator.

[2] *SofS v Cockayne and Dixon* 15 March 2005 (HHJ Norris QC) (unreported) Lawtel 23/11/05 where the SofS was ordered to pay £50,000 immediately in respect of the defendants' costs on being granted leave to amend the charges; *SofS v Chohan* [2011] EWHC 1350 (Ch); [2012] 1 BCLC 138 where notwithstanding the application for further clarification was refused, the costs of that unsuccessful application were ordered to be set off against an immediate costs order against the SofS in respect of the costs of making 2 written requests for clarification.

6. The measure of similarity that civil penalty proceedings under the CDDA have to criminal proceedings arises from the fact that civil penalty proceedings are concerned with allegations of contravention of statute and the protagonists are a government agency and individual subjects of the Crown respectively. Successful prosecution of civil penalty proceedings leads to a determination of contravention of a public law, and may lead to a declaration of contravention which itself involves public condemnation, and the imposition of a disqualification order. The SofS as claimant is an agency of government not a private litigant, and like the prosecutor in criminal proceedings, is the guardian of the public interest with a responsibility to ensure that justice is done. There is the same kind of imbalance of power and resources that one finds in a criminal prosecution, and in particular, in the preparation of its case, the SofS can take advantage of the very substantial investigatory powers that he has under the CDDA primary and secondary legislation.

7. Elements of the special duty were summarised by Laddie J in *SofS v Swan; Re Finelist* [2003] EWHC 1780 (Ch); [2004] BCC 877 at p. 884 as follows :

> "19. Thus the case law establishes that there is an obligation on the SofS to set out clearly what are the essential facts on which she relies. Furthermore, because the SofS is acting in the public interest and not as a civil litigant, she is required not to overstate the case against the director. As it is put in Directors' Disqualification by Mithani (Butterworths), she is under an obligation to put before the court a balanced view. The need to do so was considered in the judgment of HR Judge Weeks in *Re Moonlight Foods Ltd., Secretary of State for Trade and Industry v Hickling* [1996] BCC 687, 690:
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> > "It is accepted that these are not ordinary adversarial proceedings but have an element of public interest and may entail penal consequences. It follows that there is a duty on the applicant to present the case against each respondent fairly. Many of these applications go by default or are defended by litigants in person, and the practice is for an official in the Department of Trade and Industry to swear a short affidavit referring to the charges, specified in a detailed affidavit sworn by the receiver or liquidator.
> > In my judgment, that second affidavit should not omit significant available evidence in favour of any respondent. It should attempt to deal with any explanation already proffered by any of the respondents. It should endeavour to apportion responsibility as between the respondents and it should avoid sweeping statements for which there is no evidence."
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> 20. Mr Green says that it is misleading to suggest that a duty of fairness is well established, as Mr Davies asserts. He argues that a "duty to act fairly" is somewhat nebulous and unspecific. The only clear and uncontroversial statement of the law is that a director facing disqualification must know the substance of the charges that he is to meet. He also says that *Hickling* does not appear to have been applied in any subsequent case (other than in another decision of HH Judge Weeks).
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> 21. Whether it has been applied or not, *Hickling* was cited with approval by Arden J in *Re Tech Textiles Ltd* [1998] 1 BCLC 256 and referred to on this point, without disapproval, by Hart J in *Re Landhurst Leasing plc* (unreported - 21/12/98). This is a matter on which we await the views of the Court of Appeal. For my part, I think its guidance is proportionate to the seriousness of the proceedings. I accept Mr Green's submission that a duty to act fairly can be described as nebulous and he was justified to rely on authority, including *Re Continental Assurance Co of London plc* [1997] 1 BCLC 48 and *Re Cubelock Ltd* [2001] BCC 523, for the proposition that this jurisdiction should not be hedged about with rigid rules which would allow directors to navigate around disqualification applications by taking fine points on the way in which the affidavits have formulated. No doubt the court should adopt a robust approach to criticisms of the affidavit evidence served on behalf of the SofS. But none of this removes from her the obligation to ensure that the evidence filed is balanced, that the particular evidence relied on in support of the allegations is properly identified and

that issues proved by direct evidence should be distinguished from matters of inference."

Attempt to expand the duty of fairness - Doffman

8. A recent attempt to extend the ambit of the duty of fairness, inappropriately left to shortly before trial, was made in *Re Stakefield (Midlands) Ltd, Secretary of State for Business Innovation and Skills v Doffman* [2010] EWHC 2518 (Ch); [2011] 1 BCLC 596. The court considered the extent to which the duty of fairness extended beyond the manner in which the SofS presented the evidence and whether that duty imposed an obligation on him to interview and/or obtain evidence from third parties. The defendants had (5 days before the scheduled start of the trial) applied for an order that the disqualification proceedings be struck out or dismissed on the ground that the SofS had breached their right to a fair hearing under the art 6 of the European Convention for the Protection of Human Rights and Fundamental Freedoms ('ECHR') and/or that he had breached his duty to act fairly towards them. The defendants contended that the SofS was obliged to ensure that a thorough and unbiased investigation was carried out into the allegations that he had made against them and that he provided them with full and proper disclosure of all the documents that were associated with the investigation. They alleged that the investigation undertaken on behalf of the SofS was flawed because it was controlled by Barclays Bank plc, a creditor, and that witnesses who might have been able to give information about the matters that were in issue in the proceedings were either not interviewed or, if interviewed, the information they had provided to the SofS was not made available by him to the defendants. It was further alleged by the defendants that disclosure of documents provided by the SofS was highly selective and, therefore, inadequate.

9. Newey J refused to strike out the proceedings for the following reasons:

   9.1. he accepted — as had rightly been conceded by the SofS — that it was incumbent on the SofS to provide a defendant with relevant documents in his possession regardless of whether any order to that effect had been made by the court. Although in the present case, there was scope for argument as to the extent of the SofS's obligations to disclose documents in his possession, there was no need for the judge to try to resolve that. However, the authorities that were referred to him did not establish any duty on the part of the SofS either to interview or obtain documents from third parties or to ensure that investigations were carried out. The authorities only dealt with evidence which the SofS had gathered. It did not deal with evidence or material which could have been assembled by the SofS but which had not been assembled by him. References in authorities to evidence that had been or *could be* collected, were made in the context of art 6(3), which is not as such directly applicable to disqualification cases (though nor is it necessarily irrelevant). Although it would be dangerous to lay down a general rule, it seemed to the judge that neither article 6 of the ECHR nor the SofS's duty to act fairly would normally extend to requiring him to obtain evidence or to ensure that investigations were undertaken.

   9.2. If the defendant took the view that the SofS had failed to investigate a case properly or sufficiently, it would, theoretically, be open to him to challenge, by way of judicial review, the decision of the SofS to institute or continue disqualification proceedings. However, more realistically, he could, in an appropriate case, apply to have the proceedings struck out as too weak to be allowed to proceed. In other cases, the defendant may wish to secure missing evidence himself (including, if necessary, by applying for non-party disclosure or serving witness summonses) and/or to draw attention at trial to the deficiencies in the SofS's investigations and evidence. What the defendant was unlikely, ordinarily, to be able to do was to have the proceedings struck out on the basis that the SofS had committed a breach of duty by failing to obtain evidence or to investigate a case properly or sufficiently. However imperfect the investigations may have been, where the SofS had, in fact, assembled evidence of a defendant's unfitness to be concerned in the management of a company, it was for the court to determine at trial whether the SofS had made out his case. If, in the event, the evidence proved to be sufficient to establish unfitness, the defendant should be disqualified even if the SofS had failed to obtain relevant evidence or ensure a thorough investigation. On the other hand, the defendant may be able to point to the absence of evidence or investigation to cast doubt on the SofS's case.

9.3. Where a defendant could demonstrate that the SofS had failed in his duties, it would not always follow that the proceedings should be struck out. A failure on the part of the SofS was unlikely to warrant the striking out of disqualification proceedings unless it threatened the fairness of the trial or, perhaps, was deliberate. In determining whether a fair trial had been put at risk, the court had to have regard to the ability of a defendant to obtain evidence in support of his case by invoking court procedures, for example, serving witness summonses or applying for non-party disclosure or for cross-examination on hearsay evidence. In the present proceedings, the defendants had made use of those procedures by making an application for non-party disclosure but the same have been compromised and not pursued by the defendants as it was not supported by the SofS.

9.4. It was clear that the relevant documents that formed the basis of the claim and which were in the possession of the SofS had already been disclosed despite complaints that the disclosure had been tardy. However, the application by the defendants to strike out the proceedings had effectively meant that there had been ample and extra time for the defendants and their lawyers to consider the documents that were disclosed to them. There could thus be no issue with regard to disclosure which could support the striking out of the disqualification proceedings against the defendants.

9.5. The arguments raised by the defendants, such as the complaints that the disclosure of the documents in the hands of third parties had been selective and that employees of Barclays Bank who could have given evidence were not interviewed, challenged the strength of the SofS's evidence. Such points could be invoked during trial to cast doubt on the SofS's case. However these matters did not relate to whether there could be a fair trial.

9.6. Despite the claims by the defendants that it was improper for the disqualification proceedings to be based on investigations carried out by a commercial entity, there was no prohibition on the SofS utilising the fruits of such investigations. Indeed, it was proper and appropriate to make use of materials obtained from such investigations even if they were controlled by, and undertaken in the interests of, a creditor.

9.7. While the SofS could have used CDDA 1986, s 7(4) to obtain documents from the administrators, that provision did not entitle him to insist on the production of much that a defendant could not have sought by means of an application for non-party disclosure. Indeed, it may have been difficult for the SofS to ensure that documents were produced by third parties.

10. There is, it is submitted, potential scope for unfairness and/or oppression in the judge's approach in Stakefield insofar as it sanctions anything other than an objective and thorough testing of information and material provided by others which is used as the basis for such allegations of unfitness as are ultimately made. Uncritical reliance by the SofS on material supplied by third parties (e.g. creditors or office holders who may be contemplating their own recovery proceedings) is or ought to be positively to be discouraged in the context of what are, after all, proceedings brought in the public interest. The inequality of arms between the SofS and defendant directors (in terms of relative financial and other resources) which already exists will arguably only be exacerbated if defendants are required to undertake their own investigations in consequence of a failure on the part of the SofS properly to follow up reasonable lines of enquiry.

11. Although it might be said that the apparent unfairness of the judge's approach to the application before him was mitigated by the attitude he adopted at the subsequent trial (where he found a number of the allegations made by the SofS unsupported by adequate evidence and accordingly rejected them[3]), the implications for other cases warrant further analysis of Newey J's reasoning.

12. In *Dombo Beheer B.V. v The Netherlands*[4] the European Court of Human Rights observed (at para 32) that the requirements inherent in the concept of 'fair hearing' are not necessarily the same in cases concerning the determination of civil rights and obligations as they are in cases concerning the determination of a criminal charge. That, said the court, was borne out by the absence of detailed provisions such as paragraphs 2 and 3 of article 6 applying to cases in the

[3] *In re Stakefield (Midlands) Ltd* [2010] EWHC 3175 (Ch); [2011] 2 BCLC 541 at paras 154-156 and 197.
[4] (1993) 18 EHRR 213.

former category. The court did, however, as Newey J expressly adverted to in *Stakefield*, refer to the relevance of paragraphs 2 and 3 outside the strict confines of criminal law, citing the decision of the European Court of Human Rights in *Albert and Le Compte v Belgium* (1983) 5 EHRR 533.

13. Before the court in *Albert and Le Compte* were applications by two doctors each of whom had had his right to practice suspended following disciplinary proceedings. After concluding (at para 28) that the right to practise constituted in the case of the applicants, a civil right within the meaning of art 6(1), went on (at para 30) to express the view that the civil and criminal aspects of art 6(1) were not necessarily mutually exclusive. In its opinion, the principles enshrined in those sub-paras of art 6(3) upon which one of the applicants relied[5], were, for present purposes, already contained in the notion of a fair trial as embodied in art 6(1) and fell to be taken into account accordingly[6].

14. Although the court in *Dombo* was of the view that Contracting States had (by virtue of the absence of minimum guarantees of the kind found in art 6(2) and (3)) greater latitude when dealing with civil cases concerning civil rights and obligations then they have when dealing with criminal cases[7], it was clear that the requirement of 'equality of arms' in the sense of a 'fair balance' between the parties applied in principle to civil cases as well as to criminal cases[8].

15. It is illuminating to consider in that context, the discussion by the European Commission of Human Rights in *Jespers v Belgium*[9] of the meaning of 'facilities' for the purposes of art 6(3) (right to adequate time and facilities for preparation of defence):

> "As regards the interpretation of the term 'facilities', the Commission notes firstly that in any criminal proceedings brought by a state authority, the prosecution has at its disposal, to back the accusation, facilities deriving from its powers of investigation supported by judicial and police machinery with considerable technical resources and means of coercion. It is, in order to establish equality, as far as possible between the prosecution and the defence that national legislation in most countries entrusts the preliminary investigation to a member of the judiciary or, if it entrusts the investigation to the Public Prosecutor's Department, instructs the latter to gather evidence in favour of the accused as well as evidence against him10".

16. In short, Art 6(3)(b) recognises the right of the accused to have at his disposal, for the purpose of exonerating himself or of obtaining a reduction in his sentence, all relevant elements that have been or could have been collected by the competent authorities[11].

17. In *Stakefield* Newey J noted the reference in *Jespers* to "elements that have been or could have been collected" but observed that was made in the context of art 6(3) which, he said, "is not as such applicable to disqualification cases" and the relevant complaint there was about a failure to disclose documents actually in the hands of the relevant authorities.

18. It is certainly arguable that Newey J thereby failed properly to (i) give effect to the content of the duty in art 6(1) (inherent in which were the minimum guarantees specified in art 6(3) even in proceedings concerned with the determination of civil rights and obligations) (ii) appreciate the parallels between a criminal investigation and one conducted for the purposes of disqualification proceedings (where those undertaking the investigation have access to significant resources and may rely on statutory powers of investigation).

C. Investigation by SofS, pre-action conduct and fairness

19. An obligation on the SofS to give a putative defendant a fair opportunity to explain his conduct pre-issue should involve interviewing him. In *Finelist*, Laddie J suggested [28] that the:

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[5] Being sub-paras (a), (b) and (d).
[6] See paras 30 and 39.
[7] See para 32.
[8] See para 33.
[9] (1982) 5 EHRR 305.
[10] *Ibid* at para 55.
[11] *Ibid* at para 58.

"best way of ensuring that the Secretary of State's evidence deals with "any explanation already preferred" by the director is to offer him an opportunity to proffer explanations."

20. In *In re Uno plc and World of Leather plc* [2004] EWHC 933 (Ch); [2006] BCC 725 Blackburne J stated:

> "171. Common sense suggests that, in a matter as grave to the professional reputation of a person as the prospect of a disqualification order, the courtesy of an interview or, at the very least, some kind of early warning of what is afoot should be afforded to the director in question if only to enable the director to take steps to preserve any relevant material and keep alive in his memory his recollection of relevant events. Not least is that desirable in a case such as this where there has been no suggestion of any kind of dishonesty or financial impropriety on the part of the five defendants; they were all persons of hitherto unblemished reputation."

21. As is pointed out at paragraph 7.51 of Walters and Davis-White[12]:

> "If operated and handled properly, the procedure adopted by the Secretary of State prior to the commencement of disqualification proceedings should itself provide such an opportunity, as well as complying with the principles underlying the pre-action protocol regime. This point is also reflected in the internal guidance of the Secretary of State as regards pre-issue meetings with prospective defendants [footnote: referred to in *Finelist* at [31]-[32])."

Those paragraphs in the judgment of Laddie J in *Finelist* demonstrate the importance of the DBIS's own internal guidelines in this respect:

> "31. Furthermore this approach is also consistent with the "Pre-Issue Guidance for Directors" produced by the DU. This document sets out the purpose of discussions between the DU and directors <u>before</u> disqualification proceedings are commenced and how they will be conducted. Throughout emphasis is placed on the importance of the SofS learning what the director has to say and what documents he has before a final decision is made to bring proceedings. It includes the following:
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> > "2. The purpose of the meeting [with the director] is to enable the director and/or his representatives to make any representations in connection with the proposed proceedings to the Secretary of State's representatives. It would be helpful if, prior to the meeting, the director could say if there are any specific issues he wishes to raise. ...
> >
> > 3. The director will usually have been provided with the allegations against him in the s16 letter and by a copy of a draft affidavit of the Secretary of State.
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> > 5. A date for the meeting will be agreed between the Secretary of State (or the OR) and the director which is mutually convenient to both, but subject to the need on the part of the Secretary of State (or OR) to take account of the two-year deadline within which proceedings under the CDDA 1986 need to be issued. That may mean that a date needs to be fixed for the proposed meeting sufficiently in advance of such a deadline to enable the Secretary of State (OR) to have the opportunity fully to consider all the representations which the director or his representatives make.
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> > 6. At the meeting the Secretary of State's representatives (which will always be the Secretary of State's solicitor and possibly

[12] Directors' Disqualification & Insolvency Restrictions (3rd Edn) (2010) Sweet & Maxwell

representatives from the Disqualification Unit also) will carefully listen to and note any representations the director wishes to make.

7. Frequently, at the stage of a meeting with a director, a decision has already been taken, on a preliminary basis, to bring proceedings against him. However, the Secretary of State (or the OR) will always very carefully consider any further information provided at the meeting by the director and any representations that he makes before reaching a final decision. Invariably, those present at the meeting on behalf of the Secretary of State (or the OR) will need time to take instructions in the light of what has been said at the meeting from the Secretary of State or the OR. ...

8. It is very much in the interests of a director that he brings with him any documents he may have to support any points he wishes to make at that meeting. It would be helpful if copies of those documents could be supplied in advance of the meeting wherever possible so they can be considered by the Secretary of State's representatives in advance of the meeting. ...

9. Depending on the matters raised by the director at the meeting, he may be asked for further particulars and evidence to enable the Secretary of State or the OR further to consider the points he makes after the meeting has concluded. Because of. the usual two-year deadline for the bringing of proceedings under section 6 of the CDDA 1986, it may be important that such further information be supplied by the director very quickly. This is to enable the Secretary of State to take account of any such further material before he reaches his final decision as to whether or not to commence proceedings. Where time is critical, the director will be advised of that fact."

32. All of this is, and particularly the statement in paragraph 7 that SofS will "always very carefully consider any further information provided at the meeting by the director and any representations that he makes before reaching a final decision", is consistent with basic concepts of fairness. If, as will invariably be the case, the director will have a better understanding and knowledge of what went on in the company and, according to Hickling, the SofS's evidence should attempt to deal with any explanation already proffered by any of the respondents, fairness requires that, save in special circumstances, explanations should be sought from the director before the balloon goes up."

22. The relevant internal guidelines in force as at May 2011 were those of the Insolvency Service entitled: "Pre-action protocols – Disqualification" (if needed and relevant, a request for the up to date internal guidance can be made of the Insolvency Service). They are in substantially the same form as set out above but have been updated to take into account the judgment of Laddie J in *Finelist*.

23. In so far as the SofS has issued proceedings without complying with the above principles, e.g. because of time pressure to issue prior to the expiry of the 2 year period within which proceedings have to be commenced, the defendant can consider requesting the SofS to stay the proceedings (which in effect have only been issued for limitation purposes) to enable the above protocol to be following, including if appropriate an opportunity to the defendant to respond to the charges and evidence, give his own explanations and mitigation, request and attend a meeting with the SofS and invite the SofS to re-consider, in the light of the explanations provided by the defendant, whether it is in the public interest that proceedings be pursued against that defendant.

D. CDDA procedure

24. There is well-established judicial guidance on procedure concerning CDDA proceedings, which is summarised below. All affidavits or reports served in support of section 6 CDDA applications are

drafted or vetted by the Disqualification Unit of BIS ("the **DU**"). As such, the DU is in an especially strong position to know and understand the special rules and guidelines relating to the presentation of the SofS's evidence and to ensure compliance with the same.

D (i) Rule 3 statement – clarity of allegations

25. The CDDA 1986, the Insolvent Companies (Disqualification of Unfit Directors) Proceedings Rules 1987 ("the **Rules**") and the Practice Direction – Directors' Disqualification Proceedings ("the **Practice Direction**") provide little by way of guidance save that:

25.1. Rule 3(1) and (3) of the Rules provide:

> "(1) There shall, at the time when the claim form is issued, be filed in court evidence in support of the application for a disqualification order; and copies of the evidence shall be served with the claim form on the defendant.
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> …
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> (3) There shall in the affidavit or affidavits or (as the case may be) the official receiver's report be included a statement of the matters by reference to which the defendant is alleged to be unfit to be concerned in the management of a company." ("the **Rule 3 Statement**")

25.2. The same is repeated in para. 9.2 of the Practice Direction:

> "In the affidavits or (as the case may be) the official receiver's report in support of the application, there shall be included: (1) a statement of the matters by reference to which it is alleged that a disqualification order should be made against the defendant".

26. The purpose of the requirement for a Rule 3 Statement is one of natural justice – a defendant is entitled to know the case that he has to meet and to have that case set out with clarity:

26.1. *Re Lo-Line Electric Motors Ltd*[13]

> "Since the making of a disqualification order involves penal consequences for the director, it is necessary that he should know the substance of the charges that he has to meet. The practice of the official receiver is to summarise the allegations of misconduct on which he is going to rely in the affidavit in support. This procedure is plainly both desirable and necessary."

26.2. *Re Sevenoaks Stationers (Retail) Ltd*[14], where Dillon LJ pointed out that such summary of the allegations was "not merely good practice; it is a requirement of the statutory rules".

26.3. *Re Rex Williams plc*[15]

> "In a case such as this it can be helpful in practice for an affidavit to spell out, concisely and lucidly, the inferences and conclusions a party will ask the court to draw from the evidence. Indeed, the Disqualification Rules require that the plaintiff's affidavits or the official receiver's report are to include a statement of the matters by reference to which the defendant is alleged to be unfit to be concerned in the management of a company (r. 3(3)). So the plaintiff's case must be stated clearly in the evidence. The defendant must know what case he has to meet."

27. The requirement for clarity of the allegations applies not only to the allegation or charge itself but also to the particulars of the allegation and the essential facts relied on, i.e. the link between the formal allegation or charge and the evidence, e.g. a bald allegation of causing or allowing a company to trade at the risk of creditors is itself insufficient – particulars are required concerning

[13] [1988] Ch 477 at p.486C-D per Browne-Wilkinson V-C
[14] [1991] Ch 164 at p.176G-H
[15] [1994] Ch 1 at p.14B-C per Nicholls V-C

(1) when and (2) how it is alleged that the defendants knew or ought to have known that the company was insolvent, (3) why there was no reasonable prospect of avoiding insolvent liquidation and (4) the detriment to creditors by such continued trading. This requirement is emphasised in:

27.1. *Re Sutton Glassworks Ltd*[16]

> "That procedure, and, in particular, the mandatory requirement in r 6, emphasises the importance to the respondent of being able to ascertain with clarity from the evidence filed on behalf of the applicant what are the criticisms laid against him, and upon what evidence the applicant intends to rely. It is on the basis of the applicant's initial affidavit evidence that the respondent is required to decide whether to advance any evidence of his own and, if so, what issues he must address by that evidence. It should not be open to the applicant, by making general allegations of misconduct, to require the respondent to put forward his own account of events, and then to rely upon the respondent's own account to support the case for a disqualification order."

27.2. *Re Finelist*[17] , Laddie J. para 17:

> "It is not sufficient for the director to know and understand the allegations he has to meet. There is an obligation on the SofS to set out in the affidavit or affirmation in support the main parts of the evidence on which she is to rely. This is all the more important because, as noted above, there is no particulars of claim which will identify the key facts upon which the court will be asked to exercise its powers. Fairness to the director demands that he knows not only the allegations of unfitness but also the essential facts which are to be relied on in support of them."

27.3. *SofS v Gill*[18], Blackburne J.

> "It is of course well known in disqualification proceedings that the respondents should clearly understand what the charges are which the Secretary of State seeks to establish against them. That involves a clear statement of the charge and a clear statement of the evidence which is relied upon in support of the charge."

27.4. *SofS v Chohan*[19], David Richards J

> "[6] The need for a clear statement of the grounds of unfitness relied on against a respondent to disqualification proceedings and of the essential facts relied on in support of those grounds is required by the rules and has been repeatedly recognised and amplified in authorities over the last 20 years.
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> [28] Finally I should say this: I am concerned about the delay in this case. These proceedings were issued over a year ago but Mr Walter has not yet filed any evidence in opposition. The responsibility for this delay is shared between the Secretary of State and Mr Walter. If the Secretary of State had included properly formulated grounds of unfitness in the original evidence, proper progress with the proceedings could then have been made. I have to say that I find it dispiriting that after so many statements made by judges in this court over the last 20 years about the need for a clear statement of grounds that one should find in a case of this seriousness, where disqualification orders are sought in the highest bracket and where the case raises matters of fact and law which are by no means straightforward, that no clear formulation of the grounds was contained in the affidavit. It seems to me that, particularly in cases of this importance, it is necessary that at least those parts of the

[16] [1996] BCC 174 at p. 176 E-F
[17] *Secretary of State for Trade and Industry v Swan* [2003] EWHC 1780 (Ch); [2004] BCC 877
[18] [2004] EWHC 175 (Ch), unreported, p. 1, para. 2
[19] [2011] EWHC 1350 (Ch); [2012] 1 BCLC 138 at para [6] and [28]

affidavit should be drafted by someone with close knowledge and experience of the trial process, who knows the way in which courts require these matters to be addressed and who can draft them in a way which will clearly assist the defendant in formulating his defence and will assist the court in seeing the nature of the case."

D (ii) Serious allegations of wrongdoing, dishonesty or fraud

28. Where the SofS makes a serious allegation of misconduct against a director, the Court has emphasised that it is all the more important that the duties of fairness and clarity imposed on the SofS are complied with. In *Finelist*, Laddie J commented:

> "22. Mr Davies says that the duty of fairness has to be applied with particular vigour in cases where the allegations made against the director are particularly serious. For example, where they contain assertions of fraud, it is more important that the SofS makes clear in the affidavit both the nature of the wrongdoing and the essential facts from which the court will be asked to make such a finding. On this point Mr Davies has referred me to a number of cases, the Chancery Guide and the rules which define Counsels' professional duties when pleading fraud.
>
> 23. To some extent this topic was obscured by a dispute between counsel as to whether in these proceedings fraud was alleged against Mr Swan. For present purposes, I think it is clear that the more serious the allegations made against the director, the more important it is for the case against him to be set out clearly and with adequate particularity. In my view this does not apply only to cases of fraud. It applies in all cases where serious wrongdoing is alleged, particularly where it is asserted that the director knew his acts were wrongful of improper. In this respect, reference can be made to *Palamisto General Enterprises SA v Ocean Marine Insurance Limited* [1972] 2 WLR 1425, in which Buckley LJ said:
>
> > "Where a party asserts his opponent's complicity in … criminal misconduct, the case is pre-eminently one in which not only the RSC (Ord. 18 r.12(1) and Ord. 72 r. 7(2)) but also fair treatment require that, so far as practicable, the matter shall be pleaded with particularity so that the party accused may know what case he has to meet.
> >
> > But even if allegations in the present statement of claim fall short of asserting criminal misconduct, they undoubtedly impute conduct of a gravely improper character which call for no less clear particularisation."(p.1440)
>
> 24. The Court of Appeal applied that approach to breach of confidence cases in *John Zink & Co. Limited v Wilkinson* [1973] RPC 717. Both *Palamisto* and *John Zink* were civil actions. No lesser obligation of clarity should apply to the SofS when seeking severe penalties in the public interest on the basis of allegations of serious wrongdoing."

29. Similarly in *Secretary of State v Goldberg*[20] Lewison J stated:

> "[53] If dishonesty is to be alleged against a director, the allegation must be fairly and squarely made in the affidavit, and must be fairly and squarely put in cross-examination. As Millett LJ said in *Paragon Finance plc v D B Thakerar & Co (A firm), Paragon Finance plc v Thimleby & Co (a firm)* [1999] 1 All ER 400 at 407, in the context of amendment of pleadings:
>
> > "It is well established that fraud must be distinctly alleged and as distinctly proved, and that if the facts pleaded are consistent with innocence it is not open to the court to find fraud. An allegation that the defendant "knew or ought to have known" is not a clear and unequivocal allegation of actual knowledge and will not support a finding of fraud

[20] [2004] 1 BCLC 597 at p. 615, para. 53

> even if the court is satisfied that there was actual knowledge. An allegation that the defendant had actual knowledge of the existence of a fraud perpetrated by others and failed to disclose the fact to the victim is consistent with an inadvertent failure to make disclosure and is not a charge of fraud. It will not support a finding of fraud even if the court is satisfied that the failure to disclose was deliberate and dishonest. Where it is expressly alleged that such failure was negligent and in breach of a contractual obligation of disclosure, but not that it was deliberate and dishonest, there is no room for treating it as an allegation of fraud."
>
> [54] I do not believe that proceedings for disqualification of a director are any different: *Secretary of State for Trade and Industry v Rogers* [1996] 2 BCLC 513."

D (iii) Rule 3 Statement – akin to pleading

30. CDDA procedure does not provide for pleadings. However, the r.3(3) Statement contained in the affidavit and the particulars concerning the allegations of unfitness in the affidavit have the character of a pleading, notwithstanding that the affidavit also contains evidence. They are in effect, the equivalent to a Statement of Case under CPR pt 16. See:

30.1. *In re Circle Holidays International plc*[21] per HHJ Micklem

> "The affidavit, or one of the affidavits, in support of an application has of necessity, therefore, something of the character of a pleading and is to that extent unlike an ordinary affidavit filed in county court proceedings"

30.2. *Re Finelist* - Laddie J at para. 14 approving the above statement by HHJ Micklem.

30.3. *Secretary of State for Trade & Industry v Cockayne*[22] where HHJ Norris QC held that the alteration or amendment of a Rule 3 Statement is like the amendment of a statement of case under the CPR (p.11, para. 19). Thus the general principles which apply when considering an application to amend a statement of case under the CPR equally apply to the alteration or amendment of a Rule 3 Statement (p.12, para. 22).

D (iv) The evidence in support – direct evidence and inferences

31. The SofS in presenting the case should also in the evidence in support distinguish between direct evidence and any inferences which are sought to be drawn from the evidence: *Re Pinemoor Ltd*[23] :

> "It would be preferable, for the future, if those preparing and swearing affidavits in support of applications under this Act were careful to distinguish between facts which they are able to establish by direct evidence, the inferences which they invite the court to draw from those facts, and the matters which are said to amount to unfitness on the part of the respondent. If those distinctions were observed, it might lead to respondents concentrating more closely on those factual matters to which they actually need to respond by affidavit evidence under r. 6".

32. Those comments were approved by Neuberger J *in Re Park House Properties Ltd*[24] as "salutary" and by Laddie J in *Re Finelist* at para. 21:

> "But none of this removes from her the obligation to ensure that the evidence filed is balanced, that the particular evidence relied on in support of the allegations is properly identified and that issues proved by direct evidence should be distinguished from matters of inference".

[21] [1994] BCC 226 at p. 235H
[22] 15 March 2005 (unreported)
[23] [1997] BCC 708 at p.710E
[24] [1997] 2 BCLC 530 at p. p.535 f-i

D (v) Alteration or amendment of charges by SofS

33. The Court has power to allow an alteration to the SofS's case if it is a minor matter or an amendment if it is a major alteration and provided that there is no injustice to the defendant. Whether it will do so will depend upon whether there is a substantive change in case, whether leave to amend has been sought (and the amended claim formulated and supported by a further affidavit from the examiner), the timing of the application to alter or amend and whether there will be any prejudice to the defendant.

33.1. *Re Sevenoaks Stationers Ltd*[25]

> "The court has a discretion to allow the official receiver to rely on the altered or additional allegation provided that can be done without injustice to the accused director. What justice requires must depend on the circumstances of the particular case. In some cases it would be necessary for the official receiver to have given prior notice of the new allegation before the effective hearing of the disqualification application, and to raise it for the first time in the course of the hearing would be too late. In other cases, when a new allegation is raised for the first time in the course of the hearing, it may be appropriate to allow an adjournment for further evidence to be obtained. In yet other cases, particularly where the director is represented by experienced counsel, counsel may be able to take a new or altered allegation in his stride without any adjournment. But the paramount requirement on this aspect is that the director facing disqualification must know the charges he has to meet."

33.2. *Re Cubelock Ltd* [2001] BCC 523 in which Park J refused to allow the SofS to alter its case on wrongful trading and preference allegations in circumstances where such case was only developed in the closing submissions of the counsel for the SofS, no prior warning had been given, such case had not been put to the directors in cross examination and the directors had had no opportunity to respond to the same.

33.3. *SofS v Cockayne*[26] where HHJ Norris QC held that the alteration or amendment of a Rule 3 Statement is like the amendment of a statement of case under the CPR (p.11, para. 19). Thus the general principles which apply when considering an application to amend a statement of case under the CPR equally apply to the alteration or amendment of a Rule 3 Statement (p.12, para. 22).

34. Where however a request has already been made by a defendant for clarification of the allegation and case put by the SofS, which has been given by the SofS, even in the form of a letter, then the defendant may seek directions of the Court confirming the scope of the allegation and case he has to meet and preventing the SofS from seeking to resile from the clarification or amend the r. 3 statement. See *SofS v Gill* [2005] BCC 24 where the court held that the allegation did not include the wider allegation that "the defendants caused or allowed the Companies to trade at the *unreasonable* risk of cash paying customers" and refused permission to amend the allegation:

> "The point in essence is whether the complaint as explained in the letter of 17th June and to which I have referred is to be qualified by reference to the concept of unreasonableness, so that the complaint should read as follows:
>
> > "The allegation is that in the period 8 November 1999 until 7 March 2000 the Defendants caused or allowed the Companies to trade at the unreasonable risk of cash paying customers …"
>
> In my view, that is an impermissible inclusion into the complaint as it stands and has stood from the inception of these proceedings because, as counsel have submitted on behalf of the defendants, to introduce the concept of reasonableness into the

[25] [1991] Ch 164 at p. 177 B-E
[26] 15 March 2005 (unreported)

nature of the complaint is to alter significantly the nature and scope of the complaint. In my judgment, that ought not to be permitted, not least because, in common with counsel, I have considerable difficulty in understanding what is an unreasonable risk if it is not in substance that there was no reasonable prospect of avoiding an insolvent liquidation, which is the very matter which, by the letter of 17th June, the Secretary of State made clear was no part of her case..

The evidence is concerned with the fact, as it seems to me, that the companies traded at the risk of cash-paying customers in circumstances where, if what has been referred to as a corporate solution was not forthcoming, those cash customers would suffer loss. It is not, as I understand it, any part of the complaint that the conduct of the directors is to be judged according to the degree of risk and the reasonableness of the degree of risk to which cash-paying customers were subjected during those four months.

In those circumstances, I take the view that the case at trial should be confined strictly to the complaint as clarified in the letter of 17th June, and, accordingly that cross-examination of the defendants and the other witnesses should be confined to that complaint"

E. Farepak Food & Gifts Ltd

E (i) Facts

35. Farepak operated a Christmas savings scheme under which customers could spread their Christmas savings over a year. Small contributions could be made month by month so that by the end of the year enough had accumulated to buy a shopping voucher (redeemable through retailers such as Argos and the like), or a hamper, or other goods. Monies were paid by the customers to a network of some 26,000 "agents". An agent typically had 6 or 7 customers, mostly friends or colleagues. The agents forwarded the collected money on to Farepak.

36. The monies, once received by Farepak, were used as working capital (in fact, swept into the account of Farepak's parent company, European Home Retail ("**EHR**"), by its bankers, HBOS); Farepak did not (and was not obliged contractually or otherwise to) ring-fence the customers' payments.

37. Until early 2006 the supplier of vouchers to Farepak was Choice. Choice did not require payment from Farepak for the relevant vouchers until they were due to be redeemed, thus affording Farepak a significant 3-4 month cash-flow advantage.

38. In late 2005 it became apparent to Farepak/EHR that it would have a £5m deficiency when it became due to pay Choice for the previous year's vouchers, at the end of January 2006. HBOS refused to fund the deficiency and Farepak defaulted on its obligation to pay Choice. Choice duly went into administration.

39. Although Farepak/EHR ultimately paid the monies due to Choice's administrators, it was forced to reach accommodation with Choice's supplying retailers who had been left unpaid. It was also necessary to identify an alternative voucher provider. All other voucher suppliers in the industry at that time required payment up front, something which would have an immediate and detrimental impact on the cash-flow of Farepak/EHR, which would cause a cashflow spike in October, which could not be met within the existing bank facilities (an excess of £17M was forecast).

40. HBOS, who were fully secured in respect of their exposure (some £40m) refused to assist.

41. The directors faced a choice of between an immediate insolvency procedure and attempting to pursue a solvent solution. The directors chose the latter, first attempting an ultimately unsuccessful rights issue to generate more capital, then seeking finance from various prospective providers in sequence (ABN, Goldman Sachs, Numis). Their efforts came to nothing and the relevant businesses were the subject of pre-pack sales prior to administration. HBOS made full recovery of its indebtedness (save for some outstanding costs).

42. At the time of its collapse in October 2006, Farepak owed customers and agents some £37m.

43. EHR and Farepak were the subject of a Companies Act s 447 investigation between October 2006 and May 2008. Disqualification proceedings were commenced under s 8 of the CDDA in January 2011.

44. The substance of the Secretary of State's case against the defendant directors was that the solutions pursued by them to the funding crisis were too little too late and that they should have been pursued in parallel and not sequentially. No positive case was advanced that liquidation was inevitable prior to October 2006. Nor was the practice of continuing to receive monies from customers and using them to reduce the group liabilities to HBOS criticised.

45. The claim was discontinued by the SofS on 19 June 2012 following a testing by cross-examination of the claimant's witnesses during which it emerged that none of the main players who were witness to the relevant events supported the criticisms of the directors' conduct. Rather they accepted that the directors could have done nothing more.

E (ii) Statement by trial judge

46. Following the decision to discontinue the claim, the judge (Peter Smith J) felt moved to issue a statement (on 21 June 2012) explaining why he considered that state of affairs had come about and to seek to explain to the customers who really was responsible for the loss of their monies.

47. According to the judge (see para 72 of his statement), the case against the directors failed because the witnesses who were called (at least those who were witnesses to the relevant events) ultimately said that they had no criticisms of the directors' conduct over the relevant period. That led the judge to review the claimant's processes in gathering and presenting their written evidence:

    47.1. he criticised (at para 39) the Secretary of State's written evidence (which included a lead affidavit running to some 1087 paragraphs over 435 pages, with thousands of pages of exhibited material) as unnecessarily oppressive. It was also apparent that many of the claimant's deponents did not know what was in the exhibits to their affidavits;

    47.2. further, at least some of the evidenced failed to identify which parts of the exhibited material were intended to relate to which allegation of unfit conduct;

    47.3. the written evidence, in certain vital respects, contained an emphasis which was unfairly slanted against the defendants. Instances were found of witnesses only being shown selective parts of the defendants' affidavits, witnesses not being shown relevant contemporaneous documents, and large exhibits being assembled without the witnesses either having read them or understanding their significance;

    47.4. he concluded (paragraph 73) that the way the affidavits were put together caused "possible unfairness and oppression, both to the witnesses and the defendants.";

    47.5. the judge was particularly critical of the giving of secondary evidence using appendices to statements or affidavits prepared by members of the insolvency service; when cases are contested, the Secretary of State should generally make sure that all people who provide statements which one way or another are found in the main statement or affidavit should be made available for cross-examination by the defendants.

E (iii) Insolvency Service Response

48. In December 2012 the Insolvency Service published its *Review of Disqualification Proceedings Taken in the Case of European Home Retail plc and Farepak Food and Gifts Ltd*. The review specifically considered, in light of Peter Smith J's statement, whether the duty of fairness is likely to be developed so as to require changes to be made to the approach to obtaining and producing evidence in disqualification cases.

49. Having satisfied itself that the judge's statement did not have "any sort of binding force" and "represented the views of the judge himself", the review went to conclude that (among other things):

49.1. for both legal and resourcing reasons there is not a need to obtain direct evidence (as opposed to hearsay evidence) of all relevant matters at the outset of a case, regardless of whether it is contested;

49.2. the practice of relying in the first instance on hearsay evidence is not in any way discriminatory against unrepresented defendants;

49.3. a “one size fits all” approach to the preparation of evidence in disqualification proceedings in likely to give rise to difficulties. Sometimes fairness will require that the entirety of documents relating to a particular aspect of the company’s operations or on a particular issue be exhibited (to ensure material is not unfairly selective). In other cases, such an approach may be oppressive and overwhelming for a defendant.

Jeremy Bamford
Richard Ascroft
Guildhall Chambers
February 2013