CAUSES OF ACTION -
REALISING VALUE AND BALANCING THE PUBLIC INTEREST

A. Introduction

1. The aim of this paper is to highlight some of the practical points that arise in respect of the assignment of causes of action by office-holders, challenges to the same and issues considered in the recent Court of Appeal decision in *Wilson v Whitehouse*[1].

2. Quite often a company which is being wound up or a bankruptcy estate will have a cause of action which has accrued prior to the insolvency. Proceedings may or may not have been issued prior to the insolvency. The office-holder will have the option of taking over the conduct of existing proceedings or issuing proceedings on behalf of the estate. However to do so he will (a) require funding for his own legal costs or a formal or informal CFA, (b) in a corporate insolvency the liquidator will generally be required to provide security for costs under s.726 CA 1985[2], and (c) require insurance or funding to protect him as regards an adverse costs order[3].

3. If the office-holder is unable to fund the cause of action or is unwilling to do so because he is not optimistic as to the chances of success or such proceedings depend significantly upon the co-operation and oral evidence of the bankrupt/directors which is not forthcoming, then he may instead look to assign the cause of action to realise some value for the estate. Alternatively the office-holder may be approached by the bankrupt or directors/shareholders in respect of a cause of action that the office-holder has little or no intention of pursuing himself but which they wish to take an assignment of and pursue[4].

4. The assignment of causes of action generates a significant amount of litigation, as is apparent from the number of reported cases. In part this is due to there being an underlying dispute between the bankrupt/company and a third party, which may generate significant animosity and litigation by the third party to avoid the underlying dispute being pursued. In addition it is due to a number of technicalities and traps for the unwary office-holder.

---

[1] [2006] EWCA Civ 1688, the facts of which are summarised in the Schedule.

[2] Assuming it is a company claim and not an office-holder claim.

[3] Whilst a liquidator taking over conduct of a company's claim will not generally be personally liable for costs and a successful defendant's costs will be ordered to be paid out of the estate, such costs order will have priority to the liquidator's own costs, expenses and remuneration: *Norglen v Reeds Rains* [1998] 1 BCLC 176 at p. 191 per Lord Hoffmann. As a result the liquidator may, indirectly, bear the costs by being unable to claim remuneration or have to repay already drawn remuneration where there is a deficiency in the estate. Furthermore the priority for costs of a successful defendant cover the entirety of the defendant's costs in respect of the proceedings (which may be considerable if the litigation has been on-going for some time), not just those costs incurred after the liquidator took over conduct of the proceedings: *Norglen v Reeds Rains* p.191i. In bankruptcy a trustee taking over conduct of proceedings is personally at risk for the costs of the proceedings: *Ex p Angerstein* (1874) 9 Ch App 479.

[4] A significant historic purpose of assigning a cause of action to the bankrupt or an individual director/shareholder was to enable that individual to obtain legal aid to pursue the cause of action, which indirectly benefited the company if the terms of assignment provided for it to receive a % of the proceeds of the action: *Norglen Ltd v Reeds Rains* [1998] 1 BCLC 176, which held that such tapping of the resources of the legal aid fund by insolvent companies was valid. However that purpose and "abuse" was brought to an end by regulation 2, Civil Legal Aid (General) Regulations 1996 SI 1996/649.

B. Power to assign

5. An initial distinction needs to be drawn between[5]:

   (a) An assignment of a cause of action which is closely related to property which is the subject of a transfer from the office-holder to the assignee. A transfer of property will normally carry with it as a matter of course the right to prosecute any cause of action closely related to that property, e.g. the transfer of freehold land carries with it the right to sue on a tenant's covenants and the right to seek rectification of the register to correct boundaries. Furthermore, the assignment of a debt carries with it the right to sue to recover the debt[6].

   (b) The assignment of a bare cause of action or bare right to litigate, i.e. a right to claim damages divorced from any transfer of property.

6. The distinction has significance because the assignment of a bare right to litigate is, in general, contrary to public policy as it is characterised as the trafficking in litigation by those without a legitimate interest and hence falls foul of the rule against maintenance and champerty[7]. Where the cause of action relates to a transfer of property, there is no such problem.

7. However, notwithstanding the rules of maintenance and champerty, there is a long established exception to the same which allows a liquidator or trustee in bankruptcy to assign a bare cause of action. This exception allowing office-holders to assign bare causes of action arises from the recognition that they act on behalf of creditors in seeking to realise the property of the insolvent estate, often have no funds with which to litigate and that the only practical means to realise the cause of action is to assign it.

> "The position of liquidators and trustees in bankruptcy is however quite different. The courts have recognised that they often have no assets with which to fund litigation and that in such case the only practical way in which they can turn a cause of action into money is to sell it, either for a fixed sum or a share of the proceeds, to someone who is willing to take proceedings in his own name. In this respect they are of course no different from many other people. But because trustees and liquidators act on behalf of creditors, the courts have for the past century construed their statutory powers as placing them in a privileged position."[8]

---

[5] See *Trendtex Trading Co Ltd v Credit Suisse* [1980] QB 629 at p. 674.*; Re Oasis Merchandising Services Ltd* [1995] 2 BCLC 493 at p.498c-h.

[6] *Camdex International Lt v Bank of Zambia* [1998] QB 22.

[7] "In English law maintenance (the giving of assistance or encouragement to a litigant by a person with no interest in the litigation or any other motive recognised by the law as justifying interference) and champerty (maintenance of a plaintiff bringing an action in consideration of a share in the fruits of the action) are no longer crimes or torts. But the abolition of such criminal and tortious liability in 1967 has left unaffected any rule of law that a contract involving maintenance or champerty is to be treated as contrary to public policy or otherwise illegal (Criminal Law Act 1967, s.14(2))": *Re Oasis Merchandising Services Ltd* [1997] 1 BCLC 689 at p.691h-692a per Peter Gibson LJ. Whilst largely now obsolete, "In practice, they have maintained a living presence in only two respects. First, as the source of the rule, now in the course of attenuation, which forbids a solicitor from accepting payment for professional services on behalf of a plaintiff calculated as a proportion of the sum recovered from the defendant. Secondly, as the ground for denying recognition to the assignment of a "bare right of action"": per Lord Mustill, *Giles v Thompson* [1994] 1 AC 142 at p. 153.

[8] Per Lord Hoffmann *Norglen Ltd v Reeds Rains* [1998] 1 BCLC 176 at p. 182d-f. For the historic cases see e.g. *Seear v Lawson* (1880) 15 Ch 426; *Re Park Gate Waggon Works* (1881) 17 Ch D 234; *Ramsey v Hartley* [1977] 1 WLR 686; *Stein v Blake* [1996] AC 243; *Empire Resolution Ltd v MPW Insurance Brokers Ltd* [1999] BPIR 486

The means by which the bankruptcy court established this exception was by construing widely the statutory definition of "property" which vested in the trustee or which was under the control of the liquidator, such that it covered bare causes of action[9].

8. A liquidator has a statutory power under s.165(3) (voluntary) or 167(1)(b) (compulsory) IA 1986 and para. 6 of Sch. 4 IA 1986 without requiring sanction to realise the assets of a company, including a bare cause of action, by way of assignment. Section165(3) provides:

> "The liquidator may, without sanction, exercise either of the powers specified in Part II of Schedule 4 (institution and defence of proceedings; carrying on the business of the Company) and any of the general powers specified in Part III of that Schedule"

Section 167(1) provides:

> "Where a company is being wound up by the court, the liquidator may –
>
> (a) …
>
> (b) with or without sanction, exercise any of the general powers specified in Part III of [Schedule 4]"

Para. 6 of Sch. 4, Part III provides:

> "The liquidator shall have the Power to sell any of the company's property by public auction or private contract with power to transfer the whole of it to any person or to sell the same in parcels".

Section 436 provides that : ""Property" includes money, goods, things in action …"

9. Similarly as regards a trustee in bankruptcy section 314(1) IA 1986 provides

> "The trustee may –
>
> (a) with the permission of the creditors' committee or the court, exercise any of the powers specified in part I of Schedule 5 to this Act, and
>
> (b) without that permission, exercise any of the general powers specified in Part II of that Schedule."

Paragraph 9 of Sch. 5, part II provides:

> "Power to sell any part of the property for the time being comprised in the bankrupt's estate, including the goodwill and book debts of any business".

There is a slight twist as regards the trustee if the assignment provides for deferred consideration, in which case sanction is required as it falls within paragraph 3 of Sch. 5, part I, which provides:

> "Power to accept as the consideration for the sale of any property comprised in the bankrupt's estate a sum of money payable at a future time subject to such stipulations as to security or otherwise as the creditors' committee or the court thinks fit."

[9] *Empire Resolution Ltd v MPW Insurance Brokers Ltd* [1999] BPIR 486, para. 14 per HHJ Thornton QC.

C. Restrictions on assignment

Personal claims

10. In bankruptcy certain personal claims of a bankrupt unrelated to property, e.g. defamation or assault do not form part of the bankrupt's estate[10] and therefore do not vest in the trustee and cannot be assigned.

Office-holder claims

11. The ability of the liquidator or trustee to assign a cause of action arises because the cause of action is property of the company or bankrupt and the liquidator or trustee has an express statutory power to sell property of the company or bankrupt. The IA 1986 provides certain statutory remedies to the office-holder, e.g. s.214 IA 1986 (wrongful trading). Such office-holder claims cannot be assigned because they are not part of the property of the company or bankrupt but are instead part of the office-holder's statutory rights and powers.

12. Thus in *Re Ayala Holdings Ltd (No.2)*[11] the liquidator had purported to assign to a creditor the right to challenge transactions post presentation of the winding up petition as being void under s.127 IA 1986 and recover the relevant monies. Knox J. held that the assignment was ineffective as the right to assert that the transactions were void under s.127 was an incident of the office of liquidator, was not property of the company and therefore could not be assigned:

> "Mr. Menzies's submission to me is that all these rights are effectively rights and therefore property of the company which a liquidator can sell under Sch. 4, para. 6 of the 1986 Act. …
> In my judgment Mr Menzies's argument overlooks an important distinction between property of the company, on the one hand, and the rights and powers of a liquidator, on the other. The property of a company includes rights of action against third parties vested in a company at the commencement of the winding up and to that extent the principles in *Ramsey v Hartley* undoubtedly apply and such rights can, as I see it, be sold by a liquidator pursuant to para 6 of Sch 4. What are to be distinguished in my view are the statutory privileges and liberties conferred upon liquidators as such and indeed upon trustees in bankruptcy who are officers of the court and act under the court's direction.
> …
> Those passages, in my view, underline the fundamental distinction between the assets of a company and rights conferred upon a liquidator in relation to the conduct of the liquidation. The former are assignable by sale under para. 6 of Sch 4, the latter are not because they are an incident of the office of liquidator."[12]

13. That distinction and Knox J's reasoning between causes of action which are the property of the company (which are assignable) and office-holder claims which are an incident of the office (and are not assignable), was endorsed by the Court of Appeal in *Re Oasis Merchandising Services*

---

[10] See *Beckham v Drake* (1849) 2 HL Cas 579 at p.604; *Collins v OR* [1996] BPIR 552; *Lang v McKenna* [1997] BPIR 340; *Re Bell* [1998] BPIR 26.
[11] [1996] 1 BCLC 467
[12] at p. 480i-481a and p.483b. Although s.127 IA 1986 does not itself expressly confer any right or cause of action on the liquidator but merely provides that dispositions post petition are void, it appears to have been assumed that given the responsibility of the liquidator to get in the assets of the company, it therefore was a matter for the liquidator to raise the s.127 point (rather than a creditor or contributory) and to recover any monies/assets under a void disposition.

Ltd[13], which held that neither a cause of action for wrongful trading under s.214 nor the fruits of such an action[14] could be assigned because neither was the property of the company:

"The form of the agreement was no doubt governed by the fact that a claim under s214 is incapable of outright legal assignment because it can only be made and pursued by a liquidator."[15]

"…the distinction which we would draw between the property of the company at the commencement of the [liquidation][16](and property representing the same) and property which is subsequently acquired by the liquidator through the exercise of rights conferred on him alone by statute and which is to be held on the statutory trust for distribution by the liquidator."

14. Therefore a liquidator's claims under s.213 (fraudulent trading), s.214 (wrongful trading), s.238 (undervalue transactions), s.239 (preferences), s.244 (extortionate credit transactions) and s.245 (avoidance of floating charges) and the equivalent office-holder claims by a trustee in bankruptcy cannot be assigned.

15. The IA 1986 also provides certain procedural short-cut claims for a liquidator, e.g. s.212 IA 1986 (summary procedure for misfeasance) and s. 234(2) and s.237(1) (summary order for delivery of property). Whilst the statutory procedural short-cut claims themselves cannot be assigned, the company will have an underlying claim, e.g. for breach of director's duty or title to property, and such cause of action can be assigned by the liquidator.

16. There are differing views concerning whether a s.423 (transaction defrauding creditors) claim can be assigned by a liquidator or trustee[17]. It is submitted that the better view is that such a claim cannot be assigned by the office-holder. Whilst such a claim can be brought not just by the office-holder but also by a victim of the transaction, the company itself or bankrupt does not appear entitled to apply. As such the cause of action under s.423 does not appear to be property of the insolvent estate and therefore cannot be assigned.

Contractual prohibition on assignment

17. If the office-holder seeks to assign the benefit of a contract or causes of action arising under a contract, then consideration needs to be given to any contractual prohibitions on assigning the contract or its benefits, which may prevent assignment[18].

D. Bidding competitions

18. As with the sale of any property of the estate the office-holder will seek to maximise the value obtained on the assignment for the estate. Just because the office-holder does not have funds to pursue the cause of action himself and has received an offer from the bankrupt, director,

[13] [1997] 1BCLC 689
[14] The liquidator had in fact only sought to assign the fruits of the s.214 litigation not the cause of action itself.
[15] At p.694g per Gibson LJ.
[16] The report erroneously refers to "litigation".
[17] See e.g. Practical Insolvency, Chapter XI, Bompas QC and Boeddinghaus, para. 9 which treats it as an office-holder claims; cf. Transaction Avoidance in Insolvencies, Parry, para. 26.22 which suggests that such a claim can be assigned because the potential applicants are not restricted to the office-holder.
[18] See e.g. *Linden Gardens Trust v Lenesta Sludge Disposals Ltd* [1994] 1 AC 85*; Bawjem Ltd v MC Fabrications Ltd* [1999] BCC 157; cf. *ANC Ltd v Clark Goldring & Page Ltd* [2001] BPIR 568 in which the prohibition on assignment did not remain effective after termination of the contract and therefore did not prevent the assignment of the cause of action.

shareholder or creditor which will result in some return for the asset, the office-holder must obviously test the market for the asset. That will entail an approach to the defendant or proposed defendant in respect of the cause of action, or equally if an offer to compromise has come from the defendant to existing proceedings, the office-holder will need to approach the bankrupt, shareholders, directors and creditors to see if a better offer can be obtained.

19. A failure to make such an approach to other potential purchasers will render any assignment liable to be set aside: *Re Edennote Ltd*[19]. In that case the liquidator assigned the cause of action against Tottenham Ltd and Tottenham Plc to Terry Venables without seeking to negotiate a settlement of the extant proceedings with the Tottenham companies and Alan Sugar, although "the applicants had never given an inkling of their willingness to settle the Queen's Bench action and, moreover, were clearly relying on their anticipated order for security for costs against Edennote Ltd as a means of killing it off altogether"[20]. Even though the possibility of a settlement with the Sugar camp did not in fact occur to the liquidator, it would have done if he had sought advice:

> "…a reasonable liquidator must be taken to be one who has such advice where he needs it. … If Mr. Ryman had been properly advised, he would have been told that the applicants, once apprised of the possibility of an assignment to Mr Venables, would see that their application for security was likely to avail them nothing, and, as the judge observed, that Mr Venables would acquire a very considerable nuisance value in the settlement of the action as a whole. Thus it would have become obvious to a liquidator in Mr. Ryman's position, properly advised, that an approach should be made to the applicants."[21]

The court therefore approved the judge's finding that "By assigning the cause of action to Mr Venables without first doing so, he did something so utterly unreasonable and absurd that no reasonable man would have done it."[22]

20. Where, following such an approach, there are two or more interested parties offering to acquire the cause of action, the office-holder can get caught up in prolonged negotiation with the parties and their rival offers and counter-offers. To bring those negotiations to a conclusion and to enable the office-holder to make a final decision, he may well invoke a bidding competition for the cause of action with final bids to be received by a particular date. The terms are a matter for the office-holder to set but it is sensible to:

    (a) make it clear that it is a matter for the office-holder to decide which bid to accept and that he is not obliged to accept the highest offer;
    (b) reserve the right to reject all offers;
    (c) reserve the right to seek clarification of offers and enter into correspondence with a bidder;
    (d) summon a meeting of creditors or correspond with creditors if the office-holder thinks fit concerning the bids;
    (e) in the event of the office-holder considering that there is little difference between the offers, to invite further bids;
    (f) reveal the terms of the original bids if the office-holder decides on a further round of bidding;
    (g) reserve the right of the office-holder to apply to the court for directions and/or sanction as to which offer should be accepted.[23]

---

[19] [1996] 2 BCLC 389
[20] p.395i-396a
[21] p.396d-e
[22] p.395h
[23] See *Re Edennote Ltd (No.2)* [1997] 2 BCLC 89 at p. 91e-f; 93d-94h as regards various challenges made by Mr. Venables to the bidding competition, which were all rejected by the court.

21. Once the office-holder has received offers for the cause of action, it is a matter for his commercial judgment which offer is in the commercial best interests of the estate and maximises the return to the estate. If the offers are for immediate cash it is obviously an easy task for the office-holder. The difficulty usually arises where there is an offer for cash and/or agreement not to prove in the estate by one party (usually the defendant/proposed defendant) and an offer of cash and a share of the proceeds of the cause of action if successfully pursued by the bankrupt/shareholder/director.

22. The office-holder will, save in straightforward cases, require legal advice on (a) the merits of the cause of action and likelihood of success, (b) quantum if the cause of action is successful, (c) the merits of recovery of any judgment and (d) advice on the rival offers as to which is in the best interests of the estate.[24]

> "A reasonable liquidator must be taken to be one who is properly advised"

In *Faryab v Smith*[25] Robert Walker LJ emphasised the importance of obtaining legal advice in connection with the cause of action, even though in that case the trustee had no means of funding the obtaining of such advice:

> "…the realisation of a cause of action (especially a cause of action of some complexity) is a different matter and less obviously a matter for business commonsense than the realisation of more conventional assets such as freehold or leasehold property, stock in trade or other tangible moveable property".[26]

> "It seems to me that, in a case of this sort involving the evaluation of a complex claim, he badly needed independent legal advice, and, through no fault of his own, he was unable to obtain it."[27]

23. It will usually be sensible for the office-holder to consult the creditors concerning the rival offers and seek the views of the creditors. In order to be able to do so and for the creditors to form an "informed" view as to the merits of the rival offers and prospects of success of any proposed proceedings, the office-holder will normally have to provide details of the legal advice that he has obtained on the merits of the cause of action.

24. In considering the views of the creditors the office-holder may have to discount the views of interested parties, e.g. the rival bidders if they are creditors and other creditors connected to them.[28]

25. If one of the offers is to take the assignment for a share in any recoveries, the office-holder can reasonably require an indemnity from the proposed assignee[29].

26. Once the office-holder has made a decision as to which offer is in the best interests of the estate and which he would like to accept:

---

[24] *Edennote Ltd* [1996] 2 BCLC 389 at p.396
[25] [2001] BPIR 246
[26] p.252, para. 32
[27] p.255, para 44
[28] *Re Edennote Ltd (No.2)* [1997] 2 BCLC 89 at p. 94c-d referring to "disinterested creditors"; *OR v Davis* [198] BPIR 771 at p. 779B-780A
[29] *Hamilton v* OR [1998] BPIR 602; *Osborn v Cole* [1999] BPIR 251, although such is not required or reasonable where there is an outright assignment for cash with no retained interest in the cause of action or its proceeds.

(a) in a straightforward case he will enter into an assignment, which will normally be by way of deed[30]. Sanction is not required to be obtained by a liquidator or by a trustee, unless in the latter case the consideration is deferred. It appears that the office-holder may assign the cause of action to the defendant or proposed defendant, rather than entering into a compromise of any existing proceedings[31];

(b) if there are already existing proceedings[32] and the defendant's offer is the highest, the office-holder may decide to enter into a compromise of those proceedings rather than an assignment of the cause of action to the defendant, in which case sanction will be required under Sch. 4, Part I, para. 3 (liquidator) or Sch. 5, Part I, para. 8 (trustee)[33].

(c) if there is a fine balance between the rival offers as to which is in the best interests of the estate, the views of creditors on the offers are mixed, there will be no return to creditors from acceptance of the offer or in an acrimonious case to pre-empt a challenge by the dissatisfied bidder, the office-holder may apply to the court for directions[34].

27. Even if the period for making offers has expired and even if the office-holder has made a decision, it will usually still be possible for a party to make a further bid and for the office-holder to then accept that further bid[35].

E. Challenges to office-holder's decision

28. If the office-holder decides to assign to bidder A and/or has entered into an assignment, then bidder B may seek to challenge the decision and/or transaction. In a compulsory liquidation this can be done under s.168(5) or s.167(3) IA 1986, in a voluntary liquidation under s.112 IA 1986 and in a bankruptcy under s.303(1) IA 1986. Unless bidder B is the bankrupt or a creditor, then there may be an issue as to their locus standi to apply even if they are a contributory[36].

F. Relevant test – sanction, challenge, directions

29. Whether the office-holder decides to:

---

[30] Section 136 LPA 1925 only requires a legal assignment of a thing in action to be in writing under the hand of the assignor. A deed will usually be used.

[31] *Faryab v Smith* [2001] BPIR 246 where there were existing proceedings and the trustee had decided to assign the cause of action to the defendant, which was met by a s.303 IA 1986 challenge by the bankrupt. The Court of Appeal accepted that what was proposed was an assignment and that sanction was not therefore required: "The judge referred to the statutory provisions which were in point and observed that Mr Smith was wrong to take the view that the relevant power was contained in Part I (rather than Part II, para 9) of Sch 5. The trustee in bankruptcy was therefore to a degree misdirecting himself as to the need for approval by the creditors' committee or by the court": p.252, para. 30; "Mr. Smith also referred to the decision of this court in *Re Greenhaven Motors (In Liquidation)* [1999] 1 BCLC 635. That was, as Potter LJ pointed out in his short judgment, a very unusual case and had the feature not present in the instant case that it was a compromise." cf. *Whitehouse v Wilson*, para. 24 "… the transaction plainly contained (at the least) an element of compromise. Indeed, in substance, that [is] what it was" per Chadwick LJ.

[32] The office-holder could in fact decide to enter into a compromise of proposed proceedings.

[33] e.g. *Re Edennote Ltd (No.2)* [1997] 2 BCLC 89; *Re Greenhaven Motors Ltd* [1999] 1 BCLC 635.

[34] s.112 (voluntary liquidator); s.168(3) (compulsory liquidator); s.303(2) IA 1986 (trustee).

[35] *OR v Davis* [1998] BPIR 771 where a revised offer made between the initial directions hearing, at which the court had directed an assignment to the bankrupt, and the proposed defendant bank's appeal was allowed and the appeal court directed an assignment to the bank.

[36] *Edennote Ltd* [1996] 2 BCLC 389; *Re Greenhaven Motors Ltd* [1999] 1 BCLC 635.

(a) assign the cause of action (which does not require sanction),
(b) if he is a trustee and assigns the cause of action for deferred consideration (which requires sanction),
(c) compromises proceedings with a defendant or proposed defendant (which requires sanction), or
(d) applies for directions

has considerable significance because of the relevant test applied by the Court in considering the application, i.e. (1) the sanction test or (2) the business judgment/perversity test.

Sanction test

30. The essential difference between the sanction test and the business judgment/perversity test is that the decision whether to grant sanction is not entrusted by the legislation to the office-holder:

> "The decision whether or not to sanction the exercise of a power which falls within Part I or Part II of schedule 4 of the Act is a decision for the court or for the liquidation committee. It is not a decision which the liquidator can take. If the exercise of the power is sanctioned, the liquidator, in the absence of a direction from the court, can decide whether or not actually to exercise it. The court may think it sensible in an appropriate case to leave that decision to him. That is a different matter. It is because the decision whether or not to sanction the exercise of the power is a decision which is not entrusted to the liquidator that it is wrong in principle for the court to approach its task on the basis that the liquidator's wish to exercise the power should prevail unless it is satisfied that the liquidator is not acting bona fide or that he is acting in a way in which no reasonable liquidator should act."[37]

31. The question whether to sanction the exercise of a power by the office-holder rests with the court taking into account the relevant factors as to what is in the best interests of the estate. The appropriate test was described by Lightman J. as follows in *Edennote (No.2)*[38]:

> "Where a liquidator seeks the sanction of the court and takes the view that a compromise is in the best interest of the creditors, in any ordinary case, where (as in this case) there is no suggestion of lack of good faith by the liquidator or that he is partisan the court will attach considerable weight to the liquidator's views unless the evidence reveals substantial reasons why it should not do so, or that for some reason or other his view is flawed".
>
> p.95a:
>
> "The question is the commercial best interests of the company reflected prima facie by the commercial judgment of the liquidator, a judgment in my view which, in the circumstances and in the light of the evidence in this case, ought to be given full weight".

32. This was expressly approved as the correct approach in sanction cases by Chadwick LJ in *Re Greenhaven Motors Ltd*[39]. In other words, in sanction cases, there is a process of review of the various facts and matters which the office-holder has taken into account in support of his application for sanction and, in that process, the views of the office-holder are given substantial weight.

[37] *Re Greenhaven Motors* [1999] 1 BCLC 635, per Chadwick LJ at p.642h-i
[38] [1997] 2 BCLC 89 at 92g-h
[39] [1999] 1 BCLC 635 at p.643a – 644a

The business judgment/perversity test

33. In *Greenhaven* Chadwick LJ contrasted the sanction test with the jurisdiction to review a business judgment :

> "Nothing that I have said is intended to cast doubt on the correctness of the approach in *Leon v York-o-Matic Ltd* [1966] 3 All ER 277, [1966] 1 WLR 1450 in cases under s 167(3) of the Act. In cases of that nature the court is asked to control the exercise of a power for which the liquidator does not require sanction or, exceptionally, for which he has obtained sanction from the liquidation committee. The liquidator has taken a decision which under the Act he is entitled to take. It is right that the court should not interfere in such a case unless the liquidator is acting mala fide or his decision is one which no reasonable liquidator could take."

34. The approach in *Leon v York-o-Matic Ltd* was adopted by the Court of Appeal in *Re Edennote Ltd*[40] , in which Nourse LJ stated :

> "Mr. Rayner James accepts and asserts that those authorities propound the **correct test, namely (fraud and bad faith apart) that the court will only interfere with the act of a liquidator if he has done something so utterly unreasonable and absurd that no reasonable man would have done it**. His complaint is that the judge then proceeded to apply an unwarranted gloss which had the effect of lowering the test.
> …
> I sympathise with Mr Rayner James' submissions to the extent that it is unnecessary, rather it may be confusing, to introduce into the court's control of the acts and decisions of liquidators the language of its control of administrative action. In the latter case the court is usually concerned with the supervision of public servants performing statutory functions; in the former with the supervision of persons who must, in most of what they do, act as prudent businessmen. In general there seems to be something unrealistic in judging the propriety of the acts and decisions of a businessman by asking whether he took into account something he ought not to have taken into account or failed to take into account something he ought to have taken into account.
>
> That said, it is certainly possible for a liquidator to do something so utterly unreasonable and absurd that no reasonable man would have done it, simply by selling an asset of the company without taking into account the possibility that a third party might well have made a better offer than he to whom it was sold."

35. This approach was described by Peter Gibson LJ in *Mahomed v Morris*[41] as the "perversity test". By reference to this test as described by Nourse LJ in *Edennote*, in *Re Buckingham International plc (No.2)*[42], Robert Walker LJ concluded that: "the court will be very slow to substitute its judgment for the liquidators' on what is essentially a businessman's decision".

36. *Faryab v Smith*[43] concerned a decision by a trustee in bankruptcy to assign a cause of action. The bankrupt challenged the assignment under s. 303(1) IA 1986. Robert Walker LJ again applied the test expounded by Nourse LJ (above). The perversity test was satisfied because this Court found that the trustee had misdirected himself as to the nature of the power he was exercising, should not have made a decision without the benefit of legal advice and had been operating under a conflict of duty and personal interest.

---

[40] [1996] 2 BCLC 389 (at 394b-i)
[41] [2001] BCC 233 (at 241D)
[42] [1998] BCC 943 (at 961A)
[43] [2001] BPIR 246 (at 252, para. 31)

37. Similarly in *Osborn v Cole*[44], the Official Receiver (as trustee in bankruptcy) had refused to assign a cause of action to the bankrupt, who sought to challenge that decision by an application under s.303 IA 1986. The court applied the perversity test :

> "It follows that it can only be right for the court to interfere with the decision the official receiver has taken if it can be shown that he has acted in bad faith or so perversely that no trustee properly advised or properly instructing himself could so have acted, alternatively if he has acted fraudulently or in a manner so unreasonable and absurd that no reasonable person would have acted in that way."

Directions – relevant test

38. What then of an application by the office-holder for directions where he has decided that he wishes to assign a cause of action, let's say to a proposed defendant, does not as such require sanction but wants, in effect, the protection of the Court to pre-empt what he regards as a likely subsequent challenge by the other bidder? If the office-holder were sufficiently robust not to need that protection, he could assign without sanction and any challenge by the disgruntled bidder would face the business judgment/perversity test, rather than the lower sanction test.

39. Just that situation occurred in *Whitehouse v Wilson*[45]. The liquidator after a bidding competition decided he wished to accept the offer from Mr Munro but, given the acrimonious background and likely challenge by the outbid shareholder Mr Whitehouse, the liquidator applied under s.112 that he "be at liberty to accept the offer of Andrew Munro in the sum of £110,000 for the assignment of the rights and actions of Vol-Mec Limited in accordance with the attached draft Deed of Assignment". The liquidator was not proposing to compromise proceedings or proposed proceedings and did not seek sanction. As such on the face of it, a decision had been made by the liquidator and the court should have approached the directions hearing on the basis that if that decision were opposed by Mr Whitehouse (which it was), then the court should apply the higher business judgment/perversity test, i.e. *Edennote Ltd*, rather than the lower sanction test, i.e. *Edennote Ltd (No.2)*.

40. HHJ Langen QC at first instance inclined to the view that on a directions hearing the correct test was the lower sanction test, rather than the business judgment/perversity test, however even on that lower sanction test he found that the liquidator's decision was correct and offer by Mr Munro was to be preferred:

> "The Liquidator asks the Court to sanction that acceptance. At worst (?) from the Liquidator's point of view, the test to be applied by the court must be that in *Re Edennote (No.2) Ltd* [1997] 2 BCLC 89."

41. The Court of Appeal considered that the judge treated the directions application as an application for sanction to compromise the proposed proceedings and that the relevant test was therefore the sanction test[46]:

> "It is, I think, reasonably clear that the judge took the view that the application before him, although expressed to be made under section 112 of the 1986 Act, should be treated as an application for the sanction of a compromise with Mr. Munro; that is to say, an application for sanction under section 165(2)(b) of the Act. That appears from the reference, at paragraph 11 of the judgement which he delivered on 18 November 2005, to the decision of Mr. Justice

[44] [1999] BPIR 251 (at 255 F-H)
[45] [2006] EWCA Civ 1688
[46] para. 24

Lightman in *In re Edennote Ltd (No.2)* [1997] 2 BCLC 89 – itself an application for sanction. That explains, also, the reference in the judgment and in the order of 18 November 2005 – to the judge's readiness to "sanction" the liquidator's acceptance of "the best cash offer". Given that the liquidator was not (formally, at least) asking the court to decide which offer he should accept – but, rather, was seeking directions that he be at liberty to accept Mr Munro's offer – it seems to be that that view was correct. Although it could, perhaps, be said that the form of the proposed transaction was such that Mr Munro would take an assignment of the company's claims against Vol-Mec UK and Q&M as well as the claims against himself, the transaction plainly contained (at the least) an element of compromise. Indeed, in substance, that [is] what it was".

42. This decision raises 2 problems:

(a) If *Whitehouse v Wilson* has general application and does not depend upon its particular facts, so that one is required to look at the substance of the transaction, an office-holder arguably cannot assign a cause of action to a defendant or proposed defendant without sanction. Such a transaction must, inevitably, in substance, be a compromise of the proceedings or proposed proceedings. An office-holder would always therefore have to apply for sanction if the defendant/proposed defendant is the highest bidder and the office-holder wants to assign the cause of action to him. That appears to conflict with *Faryab v Smith*[47].

(b) It would appear that the test on a directions hearing may vary depending upon whether the office-holder wishes to assign to the bankrupt/director/shareholder rather than assign to the defendant/proposed defendant. If the former, then there is no compromise and it would appear that the business judgment/perversity test should apply if the defendant/proposed defendant contested the directions application.

G. Stifling of claims – public interest

43. If the office-holder assigns a cause of action to a prospective defendant or compromises proceedings or proposed proceedings with a prospective defendant, rather than assigning the cause of action to a shareholder, creditor or the bankrupt, then there will obviously be a stifling of the claim or proposed claim. Whilst such assignment is in the best commercial interests of the creditors of the estate, the question arises as to whether, notwithstanding the interests of the creditors, it can be argued that the public interest in not stifling a claim can and should be taken into account and whether the public interest can override the interest of creditors.

44. The mere fact that an assignment or compromise with a defendant/proposed defendant has the effect of stifling a claim or potential claim, does not of itself mean that such assignment cannot be made or compromise sanctioned. That necessarily follows from the requirement that an office-holder should consider and invite offers from a defendant/proposed defendant prior to making a decision to assign the cause of action: *Edennote Ltd*[48]. Similarly the motivation of the defendant/proposed defendant in wanting to stifle the action/proposed action is not of itself objectionable:

[47] [2001] BPIR 246 at p.252, para. 30 where the trustee was criticised for thinking that sanction was required for an assignment to a defendant; at p.255, para. 43 expressly held that the case before them was not a compromise case, unlike *Greenhaven Motors* and applied the business judgment/perversity test.

[48] [1996] 2 BCLC 389, the failure to consider approaching the defendants in that case being so utterly unreasonable and absurd that no reasonable man would have done so. Following a bidding competition the court subsequently sanctioned the compromise of the company's proceedings against Tottenham Ltd and Tottenham Plc: *Edennote Ltd (No.2)* [1997] 2 BCLC 89.

> "Not altogether surprisingly in such circumstances, the bank apparently takes the view that its commercial interests are best served by paying the official receiver £10,000 and waiving its rights to prove, so as to ensure that Mr Davis is not able to pursue what it sees as worthless claims against it. In this sense Mr Adair is, I think, entirely justified in saying that what the bank is trying to do is to stifle the action. I emphasise that, in using this language, I am not in any way criticising the bank for taking what, judged from its perspective, is an entirely legitimate decision. The point, however, is that in arriving at this decision the bank, as it seems to me, was quite obviously motivated not in any way by its interests qua creditor but solely by its interests qua prospective defendant in the threatened litigation. That is a stance which the bank, I accept, is fully entitled to adopt"[49].

45. However it was suggested by Robert Walker LJ in *Faryab v Smith*[50] that there may be a public interest in not allowing an assignment to stifle an action, which may be a relevant consideration.

> "I also think (although I do not attach much weight to this) that there is a public interest element in such cases. Bankruptcy should not be too readily available as a means of stifling claims which may have substance. Sometimes, indeed, it may be proper and the only sensible course open to a trustee in bankruptcy who has no funds at all to assign a claim to the defendant to the claim, even knowing that that means that the claim will meet a sudden death".

46. In that case at the time of the bankruptcy the bankrupt had extant proceedings against a firm of solicitors ("PR&Co") for damages for breach of professional and fiduciary duty, which the bankrupt estimated at between £2-5 million[51]. The bankrupt had issued an application under s.303 IA 1986 for a direction that the trustee assign the cause of action to the bankrupt. PR&Co offered £17,000 cash to take an assignment which the trustee wished to accept and with whose decision Neuberger J refused to interfere, describing the £17,000 as "a rather small bird in the hand". The Court of Appeal overturned that decision and directed an assignment to the bankrupt on the basis that the decision of the trustee had been flawed as he had not sought legal advice on the merits of the claim and that the sum of £17,000 was derisory and would result in no appreciable benefit to the creditors. The public interest argument therefore was not significant.

47. In *Whitehouse v Wilson* the relevance of the public interest in assignments/compromises was considered in greater detail. The public interest aspect in this case had the additional feature that a claim against an allegedly misfeasant director (rather than an outsider – as in *Faryab v Smith*) would be stifled. At first instance HHJ Langen QC concluded that the public interest argument did not carry Mr. Whitehouse any distance at all, given that (a) Walker LJ in *Faryab v Smith* placed little weight on the public interest point and (b) whilst in that case what was proposed was the buying off of a claim for a derisory sum, in the present case Mr Munro's offer of £160,000 could not be regarded as derisory.

48. Each of the judges in the Court of Appeal accepted that in considering whether to sanction the compromise of proposed proceedings against Mr. Munro, it was relevant to consider the public interest aspect of the winding up of companies. They each relied upon the observations of Lord Walker in *In re Pantmaenog Timber Co Ltd*[52]:

---

[49] *Official Receiver v Davis* [1998] BPIR 771 at p. 779G-H.
[50] [2001] BPIR 246 at p.254, para. 40.
[51] The precise details of the claim are not reported beyond Robert Walker LJ's comment (p.247, para. 4) that they included "allegations of international arms deals of the utmost political sensitivity, of sexual intrigue, of blackmail and other lurid matters".
[52] [2003] UKHL 49; [2004] 1 AC 158.

"…winding up has, and has had almost throughout the history of company law, a dual purpose. One purpose is the orderly settlement of a company's liabilities and the distribution of any surplus funds, prior to the company being dissolved. The other is the investigation and the imposition of criminal and **civil sanctions** in respect of misconduct on the part of persons (especially directors of an insolvent company in compulsory liquidation) who may be shown to have abused the privilege of incorporation with limited liability. The first function is primarily a concern of a company'' creditors and shareholders; the second function serves a wider public interest."[53]

"There have been three principal procedures available on winding up for the protection of the public: the initiation of criminal proceedings, originating in section 167 of the Companies Act 1862; summary proceedings for misfeasance or some other breach of duty in the course of the winding up, originating in section 10 of the Companies (Winding Up) Act 1890; and proceedings for disqualification, originating in section 75(4) of the Companies Act 1928 (but only in respect of a director found guilty of fraudulent trading. The modern forms into which these three procedures have evolved are now found respectively in section 218 of the Insolvency Act 1986, sections 212-214 of the Insolvency Act 1986 and the Disqualification Act. … Ever since the 1862 Act the court has made clear that these procedures exist for the protection of the general public, not in the interests of the creditors or shareholders of the particular company which is in liquidation. Indeed it may be contrary to the financial interests of the creditors and shareholders for these procedures to be invoked."[54]

"Having identified the three main public elements in winding up as prosecution, remedies for misfeasance and disqualification …"[55]

The highlighted sections in the above quotations show that the public interest extends beyond criminal and disqualification sanctions to civil sanctions for misfeasance, wrongful and fraudulent trading.

49. However the judges' views as to the significance of the public interest in the court considering sanction varied markedly. Chadwick LJ who delivered the leading judgment, having referred to *Pantmaenog*, emphasised that as regards criminal liability there was an obligation on the liquidator to draw attention of the Secretary of State to such conduct under s.218(4) IA 1986 and as regards conduct which appeared unfit to report such conduct to the Secretary of State under s.7(3)(b) CDDA 1986. As regards the third element of the public interest identified by Lord Walker, Chadwick LJ analysed the issue in the following stark terms[56]:

"The relevant question, as it seems to me, is whether the public interest in the imposition of civil sanctions – in this context, the recovery for the benefit of the company's pre-liquidation creditors of funds or commercial opportunities said to have been misappropriated or misdirected by the actions of a director – should lead to the conclusion that litigation to achieve that end should be pursued at the expense and risk of the post-liquidation creditors whose interests would be best served by a compromise with the alleged wrongdoer."

50. Lord Justice Chadwick did not consider that the references by Walker LJ in *Faryab v Smith* assisted Mr. Whitehouse because[57]:

[53] para. 77; [2004] 1 AC 158 at p. 180G.
[54] para. 79; [2004] 1 AC 158 at p. 181B-D
[55] para. 83; [2004] 1 AC 158 at p. 182G
[56] para. 53
[57] para. 55

> "On a proper understanding of the judgments in *Faryab v Smith* it is plain, if I may say so, that the decision did not turn on a perception that the public interest required meritorious claims to be pursued at the expense of the creditors; the decision turned on the Court's view that the trustee in bankruptcy, in that case, had failed properly to identify where the best interests of the creditors lay.
>
> [56] That is not this case. For the reasons which I have sought to explain, the liquidator and the judge were correct in their assessment of where the best interests of the post-liquidation creditors lay. Mr. Whitehouse – whose wholly proper concern was to promote his own interest as the sole pre-liquidation creditor (other than, perhaps, Mr Munro) – needed to persuade the liquidator and the judge that he could do that without putting the interests of the post-liquidation creditors at risk. The obvious way to do that was to ensure that his immediate cash offer was of no less value to the post-liquidation creditors than the offer made by Mr Munro; or (in the alternative) that his immediate cash offer was sufficient to satisfy the post-liquidation creditors. The judge's order of 18 November 2005 gave him the opportunity to out-bid Mr Munro; or to make an immediate cash offer which would meet the post-liquidation expenses. He did not take that opportunity. I can see no public interest reason why he should now be able to disturb the decision reached by the liquidator in accordance with the order of 18 November 2005."

51. Mr Justice Lindsay on the other hand, whilst accepting that the appeal should be dismissed, did so not on the basis that the judge's conclusion concerning the public interest was correct (as Chadwick LJ held) but on the basis that the judge's conclusion as to the public interest could not be described as unreasonable and that:

> "whilst, for my part, I might have concluded otherwise than did the liquidator and the Judge, I would not be able to describe either's determination as outside that broad band within which decisions could be described as reasonable".

As will be considered below Lindsay J. attached considerably greater weight to the public interest point, he set out in detail the failings as he saw it both of the liquidator and the judge at first instance in their consideration of the public interest and provided guidance as to what points should have been considered.

52. The significance of Linsday J's judgment as regards the public interest arises because Wilson LJ aligned himself with Lindsay J. on the superficiality of the evaluation of the public interest point[58]:

> "…I disagree with none of what Lindsay J. will say but wish actively to associate myself with his criticisms of the trial judge (who seems to have received little assistance in this respect) rather than with those of the liquidator. It seems to me that [on what was in effect a sanction application] the public interest in the proper pursuit of anyone who appears to have defrauded it should have received a more profound judicial evaluation than it received before sanction was granted. I am however clearly of the view that no more profound evaluation of it should – in this case – have led the judge to withhold his sanction."

53. Mr Justice Lindsey described the public interest element in wider terms than Chadwick LJ:

> "When a director and majority shareholder in a position such as Mr Munro is able in the winding up to buy his way out of a possible misfeasance clam professionally appraised as of the order of £500,000 for a payment of £160,000 (and without his proving that recovery above

[58] para. 60

that was improbable), then, it seems to me, there is a public interest that broadly derives from considerations as to good corporate governance and commercial morality.

…

Lord Hope at para. 15 of the Report [*Pantmaenog*] mentioned that the public interest was not served if commercially culpable conduct went unpunished; I would expect him to say the same if its fruits, without sufficient reason, were left with those responsible for it. Lord Millett at paragraphs 47,48 and 74, referring at one point to *In re Paget ex p. Official Receiver* [1927] 2 Ch 85, drew attention to a public interest that required a look beyond the interests of creditors and spoke of the exposure of serious misconduct with the view to the promotion of higher standards of commercial and business morality. Lord Walker … underlined that there can be a public interest that is contrary to the financial interests of creditors and shareholders – paras 79 ad 80 – and, by reference to *In re London & Globe Finance Corporation Ltd* [1903] 1 Ch 728, illustrated how the principles of winding up are not invariably to be concerned only with pecuniary benefit to be obtained for shareholders and creditors – see also para 82 an its reference to a public interest in dealing adequately with dishonesty or malpractice on the part of company directors."[59]

54. The liquidator was criticised for not giving any real consideration to the public interest beyond his comment that he appreciated that, if there was an assignment to Mr Munro, that would prevent Mr. Whitehouse from pursuing the action, which was "less an evaluation by him of the public interest element than a statement of the glaringly obvious"[60]. The judge was also criticised[61] for limiting his consideration of the public interest to *Faryab v Smith* and addressing the question of whether the offer from Mr Munro was derisory. A proper consideration by the Court of the public interest was required to look more widely at the issue:

> "To deny force to the public interest element, as the Judge did, simply on the basis of Robert Walker LJ's brief comment as to its weight in *Faryab* and on the further basis that, unlike the position in *Faryab*, here the price to be paid for the assignment could not be described as derisory, seems to me to be too superficial a response to the public interest element. It cannot be that nothing more is required than a debate as to whether an offer is "derisory" as there is ample room for offers which, whilst not derisory, are nonetheless plainly unreasonable."

55. Having criticised the superficiality of the consideration of the public interest that had occurred, Lindsay J. went on to set out "what an adequate consideration [of the public interest element] might have required or have led to", which included:

    (a) An assessment by the liquidator of the conduct of the director, the seriousness of that conduct and an assessment by the liquidator of whether such conduct could be proven.

    (b) Whether the liquidator had reported on the director's conduct to the SofS either as regards unfitness or criminal prosecution and if not, why not.

    (c) An acknowledgement by the liquidator that the public interest and the commercial interest of the creditors might point in opposing directions and that he had considered the same in assessing the offers.

    (d) Whether there had been an evaluation of the defendant/proposed defendant's position and means, such that the issue of misfeasance proceedings would be likely to lead to an

[59] paras. 76-77
[60] para. 78
[61] Somewhat unfairly given the speed with which both the first and second hearings came on before HHJ Langen QC and the limited submissions and authorities that were cited to him by counsel for Mr Whitehouse!

increased offer. In addition, if proceedings were pursued was a greater recovery than the offer made practical.

(e) Whether the terms of the offer from the other party could be improved, e.g. in the present case whether Mr. Whitehouse would be willing to add security within the jurisdiction to support his personal guarantee of performance by his Dominican Republic company.

(f) An approach should have been made to either or both of Mr Munro and Mr Whitehouse to see whether they would fund the liquidator in taking counsel's opinion on what the liquidator should address in considering the relative merits of the offers and in evaluating the public interest[62].

56. The decision in *Whitehouse v Wilson* as regards the relevance of the public interest adds considerable complexity and uncertainty in cases where the assignment or compromise is with a director against which the company has claims[63]. The following points arise:

(a) Chadwick LJ appears to have attached little, if any, weight to the public interest in this case and instead to have concentrated on which offer was in the best commercial interests of the post-liquidation creditors. Mr. Whitehouse's claim as a pre-liquidation creditor and the public interest appear to have been entirely subordinated to the best interests of the post-liquidation creditors, such that the post-liquidation creditors could not be put at any risk at all.

(b) Whilst Lindsay J and Wilson LJ considered that there should be a "more profound judicial evaluation" of the public interest, it is entirely unclear what weight should be attached to the public interest and in what circumstances the public interest will act as a trump card over the best commercial interests of the creditors[64], thereby causing the Court to decline to sanction a compromise and/or direct that a lesser offer by another party be accepted for an assignment.

(c) The best that can perhaps be said is that the more serious the alleged misconduct and the closer together the rival offers are, then the more likely it is that the Court might consider that the public interest tipped the balance. The bidding party against whom the public interest point will be raised will therefore want to build into his offer sufficient margin to cover the public interest point.

[62] A suggestion which was unlikely to be warmly received by Mr Munro in the circumstances or even by Mr Whitehouse (given his complaints about the level of post-liquidation professional costs)!

[63] The case also provides some support for bankruptcy cases, albeit the public interest there is that "bankruptcy should not be too readily available as a means of stifling claims which may have substance": *Faryab v Smith* per Robert Walker LJ. Whilst the Court of Appeal in *Whitehouse v Wilson* explained the ratio of the decision in *Faryab* as being a failure by the trustee to properly identify where the best interests of creditors lay [para. 55], the fact that there was a public interest element of bankruptcy not stifling claims of substance and that it could be relevant was not doubted: para. 79 per Lindsay J. :"…the Court of Appeal in that case was able to come to a conclusion conducive to the public interest (a claim was not stifled but was enabled to be run and an assignment of it to the putative wrongdoer at a price that would have yielded nothing to creditors was stopped) without needing to rely upon it …"

[64] Whilst Lindsay J at para. 78 stated: "I would not be in the least surprised if experienced liquidators had views as to what did or did not conduce to good corporate governance and, whilst introducing such views into the balance might seldom tip a response to an offer one way or another, it would never be imprudent for a liquidator, when consulting the Court, to set out his reflections upon the public interest in the circumstances of the case", the highlighted wording appears to be a reference to the liquidator's views on the public interest seldom tipping the balance, rather than a wider statement that the public interest element would seldom tip the balance with the Court.

(d) The office-holder, if seeking directions or sanction to compromise, will need to address in his evidence and in his consideration of the offers or proposed compromise the "guidance" points raised by Lindsay J.

(e) The consideration of the guidance points in evaluating the public interest appears to contemplate that if certain of those points have not been considered by the office-holder (or possibly even if they have), the Court might decline to sanction the compromise on public interest grounds until further information had been obtained (e.g. as regards the defendant/proposed defendant's means) or until the office-holder had sought to persuade the parties to improve their offers (e.g. by Mr Munro increasing his or by Mr. Whitehouse proving security). Such a course would further extend any bidding process, increase the costs involved and not promote certainty or finality[65].

(f) Given the importance that was attached to consideration of the public interest, it might be argued that in any case where there was an issue concerning the public interest, the office-holder ought to apply to the Court for sanction (rather than seeking to obtain it from the liquidation committee or creditors under s.165(2) in a CVL or liquidation committee under s.167(1)(a) in a compulsory liquidation) or if sanction is not required, seek the directions of the Court.

Schedule

Whitehouse v Wilson [2006] EWCA Civ 1688; LTL 7/12/2006

[1.1] Vol-Mec Limited ("the Company") had been incorporated in 1981 by Mr Munro who was the majority shareholder and managing director. The Company traded in heavy plant and machinery for quarries and construction sites in particular Volvo earth-moving equipment. In 1984 two outside investors, a Mr Simms and a Mr Whitehouse) subscribed for 50% of the share capital in the Company under a written subscription agreement. The investors obtained a tax advantage under the Finance Act 1983 as regards business expansion schemes and neither sought to participate in the management of the Company or be appointed as a director. The Company's business was profitable, annual accounts prepared and delivered to shareholders and annual dividends were declared.

[1.2] By 1997 Mr Munro had bought out certain shares held by his family and also Mr Simms' shares, giving him a majority shareholding of 73.75% with Mr Whitehouse holding 25%[66]. Mr Munro wanted to buy-out Mr Whitehouse's shareholding and offered to purchase the shares for various sums or at a valuation determined by the Company's auditors. A protracted period of negotiation followed during which Mr Whitehouse for the first time started to question the accounts, Company transactions since 1984 and whether there had been breaches by Mr Munro of the subscription agreement and breaches of duty as a director.

[65] cf Chadwick LJ, para.39 "In deciding whether to sanction that compromise it was, of course, necessary for the judge to consider what other option or options was or were open to the liquidator; and to ask himself whether the liquidator had properly evaluated those alternatives. In the present case the only other option open to the liquidator other than doing nothing) was to accept the offers made by Mr Whitehouse or CF Whitehouse Ltd.". Also cf. *Re Greenhaven Motors Ltd* [1999] 1 BCLC 635 at p.643d-e per Chadwick LJ: "It is not for the court to speculate whether the terms of the proposed compromise were the best that could have been obtained; or whether the proposed compromise would have been better if it did not contain all the terms that it does contain. Unless it is satisfied that, if the company is not permitted to enter into the compromise on the terms which the liquidator has negotiated, there will then be better terms or some other compromise on offer, the decision is between the proposed compromise and no compromise at all."

[66] The remaining 1.25% shareholding was held by the Company's general manager.

[1.3] The relationship between Mr Munro and Mr Whitehouse had completely broken down during 1999 and a share purchase mechanism could not be agreed. As a result and following legal and insolvency advice, Mr Munro called a shareholder's meeting and placed the Company into member's voluntary liquidation, a Mr Chamberlain being appointed as liquidator. A declaration of solvency by Mr Munro disclosed an estimated surplus for distribution to members of £144,339. The Company ceased to trade, its business and assets being transferred by Mr Munro to another company Vol-Mec (UK) Ltd ("UK").

[1.4] Mr Whitehouse then took up his complaints with Mr Chamberlain, whilst at the same time objecting to the validity of his appointment. Mr Chamberlain applied to the Court and obtained directions (a) confirming the validity of his appointment (b) sanctioning his appointing a firm of surveyors to report on rents charged by Mr Munro as landlord to the Company and property improvements and (c) sanctioning his appointing a firm of accountants, Bentley Jennison ("BJ"), to produce a report as to remuneration and benefits in kind drawn by Mr Munro and whether there had been any diversion of business opportunities to connected companies. The cost of the BJ report was initially estimated at £8,685. Mr Chamberlain had sought directions because of the extent of the investigation that Mr Whitehouse was suggesting should be undertaken and given it was a solvent liquidation any investigation would reduce the return to members.

[1.5] The surveyors and BJ produced interim reports in August 2002. A final report by BJ was completed by April 2003 but was not signed off because BJ's fee had increased to £72,000. Mr Chamberlain had exhausted the recoveries in the liquidation and there were outstanding professional fees of £135,130 due to BJ, the surveyor, Mr Chamberlain's remuneration and solicitor and counsel's costs. Mr Whitehouse was not willing to provide funding to the liquidator to meet the outstanding professional costs, let alone further costs. In fact Mr Whitehouse objected vehemently about the level of costs which had been incurred.

[1.6] The BJ report was made available to Mr Chamberlain who instructed counsel to prepare draft misfeasance proceedings based on it against Mr Munro and a connected company Quarry & Mining Ltd. The quantum of the claim was put at £607,921 by counsel, albeit Mr Whitehouse remained of the view that the quantum was some £2-4 million. Mr Chamberlain invited offers from Mr Munro to settle the proposed proceedings or from Mr Whitehouse to purchase the claims. Both made offers and in June 2004 Mr Chamberlain indicated that he proposed to accept Mr Whitehouse's offer and to assign the claims to him, along with the books and records of the Company, information obtained from UK and Q&M and the BJ report.

[1.7] In response in November 2004 Mr Munro applied for an injunction to restrain Mr Chamberlain from disposing of the books and records, information from UK and Q&M and the BJ report. The order sought was granted by HHJ McGonigal along with a costs order against Mr Chamberlain.

[1.8] The order did not prevent any assignment of the claims from Mr Chamberlain to Mr Whitehouse, however for whatever reason Mr Whitehouse failed to complete the proposed assignment from Mr Chamberlain. Instead Mr Whitehouse, having lodged a proof of debt for £414,612 against the Company for breach of the subscription agreement, such claim being for 25% of the loss allegedly caused to the Company by Mr Munro's alleged misfeasance, persuaded Mr Chamberlain to call a creditors' meeting on 21 February 2005. At that meeting the MVL was converted into a CVL and a new liquidator of Mr Whitehouse's choice, Mr Wilson, was appointed as liquidator.

[1.9] The relationship between Mr Whitehouse and Mr Wilson quickly soured and was no better than that with the MVL liquidator. Mr Wilson had no funds, was not able to arrange any

funding mechanism to pursue the claims against Mr Munro, Mr Whitehouse was not willing to provide funding or complete the previously negotiated assignment. The MVL liquidator retained £36,000 with which to meet outstanding professional costs which had risen to £215,000 (and which were the subject of dispute by Mr Whitehouse and Mr Munro).

[1.10] Mr Wilson was spurred into activity by concerns over limitation periods and the possibility of claims against him by Mr Whitehouse. Therefore on 28 October 2005 Mr Wilson invited offers to be received within 7 days from Mr Munro and Mr Whitehouse for an assignment of the causes of action against Mr Munro, UK and Q&M in the form of a draft deed of assignment.

[1.11] Mr Munro made an offer of £110,000 to take an assignment in full and final settlement of all claims against Mr Munro, UK and Q&M. Mr Whitehouse made 2 offers: (a) by himself to guarantee settlement of all outstanding expenses of the liquidation within 3 years, save that the guarantee did not cover the costs of BJ except those necessary to obtain signature to the final report; the adverse costs order against Mr Chamberlain by HHJ McGonigal and any other sums due to Mr Chamberlain unless he assigned to Mr Whitehouse the deed of indemnity that Mr Munro had provided to Mr Chamberlain on his appointment concerning his fees; (b) an offer by CF Whitehouse Limited, a company registered by Mr Whitehouse in the Dominican Republic ("CFW Ltd") in similar terms to (a) but without requiring an assignment of the deed of indemnity.

[1.12] Mr Wilson wrote on 11 November 2005 to the parties indicating that he was minded to accept Mr Munro's offer but given the history of the matter he intended to seek the directions of the Court. He issued an application under s.112 IA 1986 seeking a direction that he be at liberty to accept the offer from Mr Munro for the assignment for the commercial reasons set out in a witness statement.

[1.13] The application came on for hearing on short notice on 18 November 2005 before HHJ Langen QC in Leeds DR. The evening before the hearing the BJ's final report had been disclosed to the parties. During the course of the hearing Mr Whitehouse sought to make a further offer to match Mr Munro's £110,000 and in addition to hold any surplus recovery from the claims (net of litigation costs and £110,000) upon trust for the creditors of the Company, although the liquidator still wished to accept Mr Munro's offer.

[1.14] The Judge adjourned the application because of the late disclosure of the BJ report to enable each side to consider the contents of the report and make a final offer in the light of the same, so that Mr Whitehouse was on a level playing field (Mr Munro obviously having knowledge of the facts of how the Company was run). The judge expressed the view that the liquidator was right to wish to accept an offer in term of cash payable in a reasonable period and that more complex forms of offer were liable to introduce uncertainty and delay. He therefore indicated that at the adjourned hearing the Court would sanction the liquidator's acceptance of the best cash offer which he had received.

[1.15] Mr Munro made an increased offer of £160,000 payable within 7 days. Mr Whitehouse made a more complicated offer on behalf of CFW Ltd in the following terms:

> "4. The Liquidator is not to pay expense claims to the extent that there exists a valid defence or right of counterclaim and set off, without the assignee's approval.
>
> 5. [CWF Ltd will pay] £110,000 within 28 days … plus such additional sums ("the additional sums") if any as will enable the Liquidator to pay all outstanding expenses of the liquidation (insofar as they are legally enforceable and after taking any defence o setting off any counterclaim which may be available to the Liquidator) including statutory interest at the statutory rate for judgments, from a date 30 days after the

Liquidator's receipt of invoices for same, the additional sums if any to be paid out at the time of the recovery mention[ed] at 6(b) below but in any case no later than 3 years from the date hereof; provided that the total payable under this clause shall not exceed £200,000 (i.e. the additional sums shall not exceed £90,000).

6. The assignee shall ensure that such claims for debts an rights of action as his/its legal advisers consider prudent to pursue are so pursued and to the extent that any recovery us made in respect of such debts an rights they will be held on trust and will be applied in the following order:

   (a) first, for repayment of the costs of the assignee incurred in connection with such recovery (with the exception of the costs referred to at (c) below);
   (b) secondly, for the benefit of the expense creditors (i.e. the post-liquidation creditors) to the extent that they have not been already paid as aforesaid;
   (c) thirdly, for the repayment of the costs incurred by the assignee under this agreement (with the exception of the costs referred to at (a) above);
   (d) fourthly, for the payment of the Creditors of the Company (i.e. pre-liquidation creditors);
   (e) fifthly, at the discretion of the assignee."

The offer also provided that CFW Ltd's performance of its obligations would be guaranteed by Mr Whitehouse and that there would be a VAT advantage in an assignment to a foreign registered company.

[1.16] To complicate matters further, Mr Whitehouse then sent a further offer on behalf of CFW Ltd deleting clause 4 as above and replacing it with a new clause providing: "The Liquidator will advise the amount of each expense claim when known".

[1.17] The liquidator indicated he wished to accept Mr Munro's offer on the basis that (a) it was certain, (b) the additional sums in CFW Ltd's offer were deferred over 3 years with no security, (c) the additional sums payable to creditors was dependent upon the success of the litigation and the only beneficiary would be Mr Whitehouse, (d) the offer from Mr Munro was not insubstantial and the stifling of the claim had been taken into account, (e) on commercial grounds the liquidator preferred the certain offer of £160,000 rather than £110,000, even taking into account any VAT advantage.

[1.18] HHJ Langen QC at the adjourned hearing sanctioned the decision by the liquidator to accept Mr. Munro's offer an assign the causes of action to him. He applied the *Edennote (No.2)* test, i.e. "The question is the commercial best interests of the company, reflected prima facie, by the commercial judgment of the liquidator, a judgment in my view which, in the circumstances and in the light of the evidence in this case, ought to be given full weight".

[1.19] The judge approached the question in two parts. First, he compared the two offers in terms of what the company would receive. He took into account the stated VAT advantage, which reduced the apparent difference between the cash sums. As regards the additional sums under the Whitehouse offer the judge concluded that the offer was heavily qualified as regards outstanding expenses and "appears to me to import into this offer a desire on the part of Mr Whitehouse to have considerable input into decisions of the Liquidator as to what expense creditors are in fact paid. … It is, in my judgment, wholly undesirable an a recipe for future argument and the running up of further litigation costs, that a offer should contain a provision of this kind." he concluded that the liquidator's view as to the certainty and finality of the higher offer from Mr Munro was really unanswerable.

[1.20] Secondly the judge considered whether the fact that an assignment and compromise of the claim with Mr Munro, against whom there was a claim for misfeasance as a director, would enable him to "buy his way out of further scrutiny" and was a matter which, in the public interest, should lead the court to refuse to sanction the compromise. Having referred to *Faryab v Smith*[67] and the comments by Walker LJ the judge concluded that the public interest point did not avail Mr Whitehouse given that little weight was attached to the same in *Faryab v Smith* and whilst in that case the proposed payment to buy off the claim was derisory, in the present case £160,000 could not be regarded as derisory.

[1.21] Mr Whitehouse appealed to the Court of Appeal, having obtained leave at an oral hearing. The grounds of appeal were in effect:

[a] insufficient weight given to the public interest that claims against a misfeasant director should not be stifled;
[b] insufficient weight given to the strength of the Company's claims against Mr Munro and Q&M, which led him wrongly to conclude that Mr Munro was not buying off the claims for a derisory sum;
[c] insufficient weight given to there being little difference in terms of immediate cash payment between the offers when the VAT advantage was taken into account;
[d] too much weight given by the judge to what he regarded as qualifications to the Whitehouse offer regarding payment of liquidation expenses;
[e] insufficient weight given to the views of the only creditor in the liquidation, namely Mr. Whitehouse.

[1.22] The Court of Appeal (Chadwick and Wilson LLJ and Lindsay J.] refused the appeal.

Jeremy Bamford, Guildhall Chambers
Peter Wiltshire, CMS Cameron McKenna LLP

17 April 2007

[67] [2001] BPIR 246