DEFENSIVE STRATEGIES

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The Permission Gateway.

1. The provisions in the IA 1986 which provide for the court to grant relief in respect of the misfeasance, breach of duty and other wrongdoing of an office holder are:
   a. S 212 IA 1986 (liquidators);
   b. Para 75 of Schedule B1 to IA 1986 (administrators)[1]; and
   c. Section 304 IA 1986 (trustees in bankruptcy).

2. Each of these provisions can be invoked by a limited class of applicants and, in some circumstances, those applicants require the leave of the Court. In the first section of this paper we consider the questions of (i) who has standing to bring an application under these sections, (ii) the test for leave, when it is required, and (iii) some of the defensive strategies office holders may wish to consider when faced with an application for leave.

(i) Standing to apply

Liquidators

3. An application pursuant to s 212 IA 1986 may be made by
   a. the official receiver,
   b. the liquidator, or
   c. any creditor

   But they will require the leave of the court to make an application after a liquidator has had his or her release (see s 212(4) IA 1986).

4. An application may also be made by any contributory (notwithstanding that he will not benefit from any order the court may make on the application), but only with the leave of the court (see s 212 (5) IA 1986). Formerly a contributory had standing to apply without the leave of the court, but only when (s)he could show (s)he had an interest in the outcome of the proceedings. That is no longer a requirement.

[1] As originally enacted, s 212 also applied to administrators , but all references to administrators were removed by the Enterprise Act ("EA") 2002 schedule 17 para 18 which came into effect on 15.09.03, and at the same time a separate provision dealing with misfeasance by administrators was enacted in EA 2002 schedule 16 (which is now to be found in IA 1986 Schedule B1 paragraph 75), The old s 212 still applies (by virtue of a saving provision in art 3 of SI 2003/2093) in cases where a petition for an administration order was presented before 15 September 2003 and also in the administration of insolvent partnerships commencing prior to 1 July 2005, limited liability partnerships and bodies which are insurers under FSMA 2000 and SI 2001/2634.

Administrators

5. An application pursuant to Para 75 of Schedule B1 to IA 1986 may only be made by

    (a) the official receiver,
    (b) the administrator of the company
    (c) the liquidator of the company,
    (d) a creditor of the company, or
    (e) a contributory of the company.

    but they will require the permission of the court where the administrator has been discharged under paragraph 98 of Schedule B1 (para 75(5)).

6. In ***Angel Group Ltd*** [2015] EWHC 3624 (Ch); [2016] 2 B.C.L.C. 509; [2016] B.P.I.R. 260 the court considered an application by the incumbent liquidators to postpone the administrators' discharge under para. 98, to enable some complex possible claims against them to be investigated. One of the grounds for requesting a postponement was because it was not clear whether all the claims could be brought under para. 75 (particularly the possible claim of conspiracy to injure by unlawful means), and the administrators would be discharged from liability for any claims outside that section. Rose J held (at [46]) :

    > *"It is precisely in this kind of case, in my judgment, where it is important that some discipline is exercised over the conduct of the nominated liquidators to make sure that matters are investigated promptly and efficiently; that the liquidators conduct their investigation proportionately in terms of cost in time and money and that claims are not brought or threatened which have no proper foundation. The framework provided by paragraphs 98 and 75 of Schedule B1 is precisely the right framework for exercising that kind of control. I do not consider that the complexity of the claims or the seriousness of the allegations in the circumstances of this case justify such a significant departure from the court's usual practice as the Davey camp suggests*."

    And further (at [48]) that, if a proposed claim is not included in paragraph 75, "*then it is not right for this court to sidestep that exclusion by postponing indefinitely the administrator's discharge."*

7. There is no provision (corresponding to that in s 212(5) IA 1986) that requires a contributory always to obtain permission to make an application under para. 75.

Trustees

8. An application pursuant to s 304 IA 1986 may be made by:
    a. the official receiver,
    b. the Secretary of State,
    c. a creditor of the bankrupt

    but they will also require leave of the court to make an application after the trustee has had his or her release under section 299 IA 1986 (s 304(2) IA 1986).

9. In ***Oraki v Bramston*** [2015] EWHC 2046 (Ch) Proudman J emphasised that release discharges the trustee from all liability save for the matters specifically provided for in s 304 IA 1986 and (at [162]) "*It follows that only matters for the benefit of the bankrupt's estate can properly be the subject of any action so that mental distress, loss of income, loss of legal costs, payment out in repairs are in any event excluded*"

10. An application may also be made by the bankrupt him or herself (whether or not there is, or is likely to be, a surplus for the purposes of final distribution), but an application by the bankrupt will always require the leave of the Court.

A requirement for personal benefit?

11. Section 212(5) IA 1086 states in terms that there is no requirement for a contributory to a company in liquidation to show they will personally benefit from the application. Similarly, as 304 (2) IA 1986 makes clear that an application may be made by the bankrupt whether or not there is likely to be a surplus, and thus personal benefit to him/her (and in ***McGuire v Rose*** [2013] EWCA Civ 429 the Court of Appeal emphasised that it is wrong to require a bankrupt to show a surplus due to himself, as opposed to the estate generally, in order to obtain leave).

12. By contrast, in ***Re Coniston Hotel*** [2014] EWHC 1100 Morgan J held (in giving summary judgment) that, in order for a creditor or contributory to bring a claim under paragraph 75 of Schedule B1 (against an administrator or former administrator), they have to show not only a breach of a relevant duty which had caused loss, but also that they had a sufficient pecuniary interest in the relief which was sought (relying on ***Bentinck v Fenn*** *(1887) 12 App. Cas. 652* and ***Deloitte & Touche AG v Johnson*** *[1999] 1 W.L.R. 1605*). Thus a creditor or contributory would have no standing to claim if any recovery will end up being paid to a secured creditor, and nothing will be paid to the unsecureds - It is not clear why there should be such a difference in the position of contributories in administrations and liquidations.

13. Further, the reasoning relied upon by Morgan J in *Re Coniston* seems to be equally applicable to creditors in the liquidation and bankruptcy context.

(ii) The Threshold Test for Leave

14. The seminal decision is that of Hart J in ***Brown v Beat*** [2002] BPIR 421. The bankrupt (who was also subject to what is now referred to as a vexatious litigant's order) applied for leave to bring proceedings against his trustee under s 304 IA 1986 in respect of a number of allegations, including that the trustee had sold his former home at an undervalue and together with the contents, which he considered would have achieved £2,500 if sold separately.

15. The Bankrupt sought to argue he could make his application under s 303 IA 1986 (general control of the trustee by the Court), and thus bypass the leave requirement. This did not find favour with Hart J, who considered that s 303 IA 1986 was not the appropriate jurisdiction in the context of the relief sought, and in any event, should not normally be invoked in circumstances where there is unlikely to be a surplus (referring to the comments of Harman J in ***Re A Debtor, ex p The Debtor v. Doddwell*** *[1949] Ch 236*).

16. Hart J expressed the policy considerations behind the leave requirement as follows:

    " …*it seems to me that the requirement of leave under section 304(2) in the case of an application by the bankrupt, has almost certainly been included by Parliament in recognition of the fact that applications by bankrupts against their trustees may well have a tendency to be vexatious and therefore it is appropriate for there to be a filter in the form of permission by the court before the bankrupt is permitted to launch upon them; that also being particularly necessary given the fact that the bankrupt is accorded* locus standi *notwithstanding the absence of any financial interest to himself in the application being made."*

17. He went on to say:

    "*The factors which the court must bear in mind in deciding whether or not to grant permission, are first, whether or not a* ***reasonably meritorious cause of action*** *has been shown, and secondly* ***whether giving permission for its prosecution is reasonably likely to result in a benefit to the estate***."

18. As regards the second factor, he commented:

    "*Of course, in considering whether or not to authorise any litigation, except in the rarest of cases, it is impossible to be certain of what the outcome of litigation will be. Litigation always, to a greater or lesser extent involves a degree of speculation, and regard must therefore be had to the costs and potential benefits of litigation before authorising its institution*".

19. He also referred to the fact that a test has been described by Blackburne J in ***Re Hellier*** *[1998] BPIR 695* as being "***whether the application is one which a reasonable litigant would make****"* albeit, "*That criterion of reasonableness has, of course, to be stretched to include the factors which I have mentioned, that is to say, the likelihood of success, and the risks as to costs of the estate in the event of failure*".

20. On the facts in *Brown*, Hart J emphasised the fact that it was fundamentally unsatisfactory to bring an application which complained of a sale at an undervalue without supportive expert valuation evidence, in the absence of which, embarking on litigation would be foolhardy. Further, the claim that the trustee failed to raise £2,500 for the furniture was also unsupported

by evidence and "*in any event, if that matter stood alone and was properly vouched in evidence, the size of the claim in question, having regard to the size of the deficiency in this estate would be a matter which would, in any event, render the court extremely cautious in authorising proceedings*". He also criticised the bankrupt for complaints which amounted to a fishing expedition:

> "*It is not enough, in my judgment, to justify the commencement effectively of an action for misfeasance against the trustee that Mr Brown happens not to know the answer to various questions which, if answered in a particular way, might provide him with some support for an action against the trustee for breach of duty, but which if answered in another way, would show that there was no foundation for such an action. That is what I mean by a fishing expedition"*

21. Hart J's test was approved and expanded upon by the Court of Appeal in the context of an application for leave under s 212(4) IA 1986 in ***Parkinson Engineering Services plc (In Liquidation) v Swan and Another*** [2009] EWCA Civ 1366; [2010] B.P.I.R. 437. The Court referred to Hart J's two criteria and stated:

> "*Those are not exhaustive but they are certainly relevant and likely to be among the most important factors. They are relevant here, together with the question of* ***delay***." (para 34)

22. However, the Court refused to reverse the first instance's judge (Floyd J)'s decision to allow leave to proceed under s 212(4), considering there was "*force in Mr Hough's criticisms of the statement of case as not obviously very cogent, and in his comment as to the absence of explanation for the delay"* (over four years had gone by after the liquidator's statutory release before the first letter before action), because the question was one of discretion and decision was not one which no reasonable judge could have come to.

23. The Court of Appeal again considered the test for leave (in the context of a bankrupt's application under s 304(2) IA 1986) in ***McGuire v Rose*** [2013] EWCA Civ 429. The appellant bankrupt argued (on a second appeal) that, while the judge (Lewison J) had identified *Brown* as the right authority governing the application, he had then misapplied the test by (i) requiring the identification of a likely surplus in the estate arising from the proposed claim against the trustee and (ii) creating some additional conditions for the grant of leave which were not justified by the 2 factor test in *Brown*. These included considering the effect of both s23 of the Trustee Act 1925 and a limitation defence on the proposed claim against the trustee (matters which the bankrupt argued were not for the permission application, but rather were defences which were for the trustee to raise in due course in the course of the substantive application if permission is granted), and considering the likely manner in which the application against the trustee would proceed should permission be granted.

24. Laws LJ delivered the judgment of the Court. He held that:

a. The judge erred in principle in requiring the bankrupt to show there would be a surplus, but the likelihood of a surplus is still likely to be relevant to the question of permission even if its absence is not determinative (at [19]);

b. Hart J could not be taken as having laid down any particular test in *Brown: "It would not be appropriate for the court to lay down exclusive criteria by reference to which an application by the bankrupt under section 304(2) had, in all cases, to be judged. He was doing no more than identifying two central factors which have to be taken into account (and obviously so)."* (at [23]), Further later in his judgment (at page 427) Hart J had described another test under which his two more specific questions should be asked, being "*is there material produced on the application such as would justify a reasonable litigant pursuing the particular litigations proposed?".* As a sort of umbrella test that must be unobjectionable. Also, in *Parkinson,* Lloyd LJ expressly said that Hart J's two requirements were not exhaustive (albeit in the context of s 212 IA 1986). Thus Lewison J was right to **take into account Hart J's two criteria, together with such further other factors as seemed to be relevant**;

c. Since the policy behind the leave requirement is to apply a filter because of the risk of vexatious applications, the risk of vexation in the proceedings should also be taken into account, "*though a favourable answer to Hart J's two questions may well be sufficient in many cases to demonstrate that the particular course of action proposed by the bankrupt is worthwhile and not driven by vexation"* (at [23]);

d. A tribunal hearing an application for leave is also entitled to look at the matter in the round, and to take into account anything which would obviously be run as a defence. If it appears that limitation is likely to be one of those, then a reasonable litigant would have to bear that in mind, and, in presenting an application to the court, would have to indicate how the apparent defence would be dealt with. The court on that occasion would often not rule on the point in a definitive way, but if the applicant bankrupt has no apparent answer to it, then that is plainly something that the court may take into account in considering the leave application. In many cases it will be reasonable to expect the bankrupt actually to anticipate the point (at [28]);

e. Further, the question of whether the bankrupt would conduct the proceedings properly and proportionately is "*plainly a relevant consideration for any claim. The main purpose of imposing a leave requirement on bankrupts is to protect trustees from exposure to vexatious or unjustifiable litigation. In many cases the filter will concentrate on the merits of the claim for which leave is sought, but if the bankrupt has provided separate evidence of a tendency to disproportionate and inappropriate conduct in litigation then that seems to us to be potentially highly relevant. Its significance may vary with the strength and value of the claim — we can see that it would be a strong thing to shut out an apparently good*

and valuable claim because of fears about the manner in which it will be run – but it is still relevant." (at [38]).

25. The Court concluded (at para 39) that:

"*The history of this case, and the voluminous documents generated by Mr McGuire with which we have been supplied, demonstrate that Mr McGuire has a very strong sense of grievance and has been pursuing a very long campaign against the trustee because he considers that he should never have been made bankrupt in the first place and then considers, without any evidential justification, that the trustee has wrongly dissipated his estate. The figures demonstrate that he cannot personally benefit from the claim that he wants to bring, and his creditors are very unlikely to benefit either. All this is a recipe for litigation with the qualities described by Lewison J – disproportionate and improperly conducted. It is the sort of litigation against which trustees are entitled to be protected by the section 304 filter*".

26. Again the absence of expert evidence to support the allegation of sale of assets at an undervalue was described by Laws LJ as "fatal" (para 32) and a "fundamental flaw" in the bankrupt's application (para 36).

27. Until recently, there was no reported authority on the test to be applied under para 75(6) of Schedule B1 IA 1986. In the absence of such authority, Registrar Derrett accepted in ***Katz v Oldham*** [2016] BPIR 83 (although apparently without hearing any argument on the point) that the applicable test should be the same as that under s 212(4) and 304(2) 1986, and the same policy objectives as are set out for the requirement of leave in relation to claims against an office holder of an insolvent estate in *Brown v Beat* [2002] BPIR 421 (Set out above) apply also in relation to misfeasance claims against discharged administrators (with nothing turning on the use of the word 'permission' in para 75(6) as opposed to 'leave' in s 212(4) and 304(2).

28. The parties submitted that 'reasonably meritorious cause of action' is a lower threshold than that which is required for summary judgment ('a real prospect of success'). The Registrar's initial view was that it ought to be the same (at least where an application for permission is faced with a cross-application for summary judgment or strike-out, when the test to be applied would require there to be a reasonable prospect of success). However, that was not that case before her, and the grant of permission would not preclude an application being made for strike out or summary judgment, thus she concluded "*For present purposes, I accept that the test, as such, can be treated as a lower threshold"* (at [9]).

(iii) Defensive Strategies

29. Some practical tips an office holder should consider when faced with an application for leave/ permission to bring proceedings against them include:

a. Check that the applicant a member of the permitted class under the relevant provisions (see above, paras 3-10). Where the applicant is purporting to have standing by virtue of being a creditor/ contributory, this categorisation might be open to challenge.

   By way of example, in ***Fabb v Peters*** [2013] EWHC 296 (Ch); [2013] B.P.I.R. 264 Mr Fabb sought to bring a misfeasance claim against the administrators of a company of which he purported to be a creditor and shareholder. However, Mr Fabb had become bankrupt after the events complained of, and prior to making his application. He had obtained a direction from the court that this trustee assign to him a number of causes of action, including the misfeasance claim he wished to bring, upon payment of £10,000 but the assignment had not yet occurred. HHJ Purle QC struck out the claim because (i) both his interest in the company's shares and any indebtedness formerly due to him had also both vested in the trustee, and the putative assignment did not affect that position, and (ii) since Mr Fabb knew that the misfeasance claim vested in his trustee when he brought it, the claim was an abuse of process (applying the Court of Appeal's decision in ***Pickthall v Hill Dickinson LLP*** [2009] PNLR 31). The same applied to a further claim which Mr Fabb had brought in the name of a company which had been struck off the register and not restored at the date of the application.

b. In the case of a creditor, they must establish that they personally obtain pecuniary benefit from bringing the claim (similarly if they are a contributory of a company in liquidation, but not in administration). If there is a secured creditor who will be the only beneficiary of any recovery, the unsecureds will not have standing.

c. The bankrupt, or contributories to a company is administration or liquidation, always require leave to bring a misfeasance claim against an office holder, the rationale being the real risk of vexatious claims from these classes of applicant.

d. If the application is made post discharge/ release, first check whether the claim actually falls within s 212 IA 1986, 304 IA 1986 or para 75 Schedule B1. If it does not, it is too late to bring the claim. If it does, again the claim can still only be brought with leave (regardless of the identity of the applicant) – ensure that an application has been or is made. (NB there is no reported authority of which the authors are aware where the power to order retrospective permission in this context has been considered, but the general trend seems to be for the court to accept such a jurisdiction).

e. The applicant must demonstrate that they have a reasonably meritorious cause of action, taking into account the defences likely to be raised. The authorities suggest the

threshold for the applicant to pass may be lower than for summary judgment. The office holder can always cross apply for summary judgment (if it is considered the applicant has no real prospect of success), but should remember the burden is then on him or her to demonstrate the applicant has no real prospect and the court can consider not just the evidence filed, but also the likelihood of evidence supporting the claim materialising in the future;

f. Consider the nature of the claim carefully – is it really a criticism of the office holder's legitimate exercise of discretion about the administration of the bankruptcy with which he is charged? (see, in the bankruptcy context, ***Engel v Peri*** [2002] EWHC 799 (Ch) – the trustee's discretion of fix legal fees is of "*generous scope", **Oraki v Bramston*** [2015] BPIR 1258 at paragraph 134; and ***Borodzicz v Horton*** [2016] BPIR 24: "*The case - law makes clear that an applicant has a high hurdle to overcome to obtain permission to challenge decisions of a trustee*" per Chief Registrar Baister at para 40 – although, the authors' experience is that in practice, the hurdle is not set so high as these dicta suggest);

g. The court will look at the whole matter in the round, so don't forget cover any defences you may have in your evidence in response. Always check whether the applicant is within the limitation period for bringing the claim at the outset – this might be a knockout blow;

h. Pay careful attention to the evidence filed. Where the allegation is of a sale at an undervalue, supportive expert valuation evidence is crucial. On several occasions the court has held that an application for leave is doomed without it;

i. It is a more difficult question whether the applicant requires expert evidence from an independent professional office holder supporting the breach alleged at the permission stage (at least where it is not an obvious breach, and where the *Bolam* test would be applied). In the context of ordinary civil claims under CPR Part 7, the Court has emphasised the requirement for a claimant making an allegation of professional negligence to have obtained supportive expert evidence in advance of pleading their case in ***Pantelli Associates Ltd v Corporate City Developments NO 2 Ltd*** [2010[] EWHC 3189. It is suggested that there is no reason why this reasoning should not apply equally in the insolvency context.

j. The court should not embark upon a mini trial on the available documents without the benefit of full disclosure or hearing evidence. However, in a borderline case (where the merits are "shadowy") more 'peripheral' issues such as delay, or the risk of the

proceedings being conducted disproportionately or vexatiously by the applicant may sway the Court;

k. The other important matter the court must consider if whether the application reasonably likely to result in a benefit to the estate. Even an otherwise meritorious claim is very unlikely to be permitted if the answer is no (because of the cost/ benefit analysis, the size of the fees etc). Always consider the level of damages achievable on the claim and where they would go. It may be helpful to canvass the opinion of the creditors, given the dissipation of assets to defend the claim.

30. Beyond what substantive defences may be open to an office holder facing a misfeasance claim, there are various procedural and other steps which may be taken to inhibit or defeat such claims. Some of these turn on the fact that claims under s 212 and paragraph 75 are purely procedural and merely facilitate claims for causes of action vested in the relevant company.

Misfeasance claims by creditors

31. The proceeds of misfeasance claims against office holders belong to the relevant company (or fall into the bankruptcy estate as the case may be). Put another way, proceedings under ss 212, 304 and paragraph 75 are in substance by and for the benefit of the company and not individual creditors.

32. Ordinarily, an individual creditor may have little incentive to pursue such a claim if the only benefit to him will be an enhanced dividend. The position will be otherwise where:

(a) the creditor has the benefit of an appropriately worded charge, wide enough to catch the fruits of the claim (see, for example, *Re Anglo-Austrian Printing & Publishing Union* [1895] 2 Ch 891); or

(b) the misfeasance claim has been assigned to the creditor by the relevant office holder[2].

33. It follows that a creditor pursuing a misfeasance claim may be discouraged by a challenge to the validity of his security (e.g. under s 245 of the 1986 Act or otherwise) or any assignment upon which he relies and officeholders facing such claims should take care to make all appropriate enquiries in this regard.

[2] As to which see *Re Oasis Merchandising Services Ltd* [1998] Ch 170 (CA) (now to be read in light of s 246ZD of the 1986 Act).

Summary Judgment/Strike Out

34. Misfeasance claims are potentially susceptible to summary determination in appropriate cases (though usually successful applications are against the targets of such claims rather than against those bringing them).

35. In *Rawnsley and anr v Weatherall Green & Smith and anr* [2009] EWHC 2482 (Ch); [2010] 1 BCLC 658 a valuer and a former liquidator applied to strike out negligence claims brought against them by the principal director and major shareholder of the relevant company in liquidation. The claim arose out of the sale by the former liquidator, in reliance on advice from the valuer, of the principal asset of the company (commercial premises) at what was said to have been an undervalue. The claimant had brought two separate claims, one under CPR Part 7, the other under s 212 of the 1986 Act (later consolidated by order of the court). The claimant brought the claims in two capacities, as shareholder in the company and as an assignee of the company's claims (an assignment having been effected by a joint liquidator pursuant to permission given by court order).

36. The basis for the liquidator's strike out application was that the claimant's claim (qua shareholder) against him was bound to fail because such loss as was claimed was simply reflective of the company's loss (as to which see *Johnson v Gore Wood & Co (a firm)* [2002] 2 AC 1, at 62 per Lord Millett; *Gardner v Parker* [2004] 2 BCLC 554 at [33] per Neuberger LJ as he then was). In the event it was conceded that the rule applied and that the claim qua shareholder was bound to fail.

37. The liquidator also sought summary judgment in respect of the assigned misfeasance claim on the basis that such claim was bound to fail. Put shortly, it was contended that there was no real prospect of a court finding that the liquidator was in breach of duty in selling the relevant property at a price in excess of the valuer's valuation. The court (His Honour Judge Behrens – sitting as a Judge of the High Court) disagreed and considered the question of breach of duty to be well arguable on the facts and not suitable for summary determination. There were, the judge said, also triable issues on causation and the extent of any loss.

38. Insofar as reliance was also placed on the availability to the liquidator of relief under s 1157 of the Companies Act 2006 as a further basis for strike-out or summary judgment, that was also rejected by the judge. First it was, he said, seriously arguable that a liquidator was not within the scope of s 1157. Secondly, the question of relief under that provision was fact sensitive and should be determined at trial.

39. It will be apparent that applications for summary determination based on pure questions of law are likely to have the best prospects of success. Examples of these include defences based on limitation or the capacity in which the claims are brought. As to the latter, it is also important for an administrator facing misfeasance proceedings by a creditor (especially where the administration has come to an end) to satisfy him or herself that the claim is not being used to vindicate that creditor's personal rights (e.g. arising out of a breach of paragraph 71 of Schedule B1[3]). The remedy for an aggrieved creditor in those circumstances is under paragraph 74 of Schedule B1 (though when the application is made the relevant company must still be in administration: see *Re Coniston Hotel (Kent) LLP (in liquidation)* [2013] EWHC 93 (Ch); [2013] 2 BCLC 405).

40. Where a claim brought under s 212 or paragraph 75 relates in part to criticism of pre-appointment conduct, an application to strike out the relevant paragraphs may be refused: see *Re Automold Ltd* [2009] EWHC 3709 (Ch). Generally, however, relief sought in respect of pre-appointment conduct should, strictly, be the subject of conventional proceedings under CPR Part 7 relying breach of contract or the tort of negligence.

Security for costs

41. An order for security for costs can be a powerful interim remedy. CPR 25.12 provides as follows:

> (1) A defendant to any claim may apply under this section of this Part for security for his costs of the proceedings.
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> (Part 3 provides for the court to order payment of sums into court in other circumstances. Rule 20.3 provides for this section of this part to apply to part 20 claims).
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> (2) An application for security for costs must be supported by evidence.
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> (3) Were the court makes an order for security for costs, it will-
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> (a) determine the amount of security; and
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> (b) direct-
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> (i) the manner in which; and
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> (ii) the time within which
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> the security must be given.

[3] Which relates to the disposal by an administrator of charged property (where the charge is not a floating charge).

42. An office holder facing misfeasance proceedings brought by a creditor or contributory under s 212, 304 or paragraph 75 should, as a matter of preliminary enquiry, satisfy him or herself that the applicant is not vulnerable to such an order by considering the conditions specified in CPR 25.13(2)[4]. The most frequent basis for an application for security for costs is where the applicant is an impecunious company (CPR 25.12(2)(c)).

43. Satisfaction of the statutory condition in CPR 25.13(2)(c) means only that the court has the necessary jurisdiction to make an order for security for costs; the court must also be satisfied that the provision of security is, in all the circumstances of the case, just: see *Classic Catering Ltd v Donnington Park Leisure Ltd* [2001] 1 BCLC 537.

44. Jurisdiction is determined as at the date of the application but the court may have regard to evidence as to what may happen in the future: *Re Unisoft Group (No 2)* [1993] BCLC 532.

45. The phrase in CPR 25.13(2)(c) "the company will be unable to pay" requires more than simply that there is doubt whether the company will pay any order for costs ordered against it; otherwise the word "may" would have been used instead: see *Jirehouse Capital (an unlimited company) v Beller* [2008] EWCA Civ 908; [2009] 1 WLR 751 at para 24 per Arden LJ.

46. It is, however, not necessary for the court to be persuaded that the company will, on the balance of probabilities, be unable to pay the relevant costs: *ibid* at paras 25-29.

47. Ultimately the court is required on an application under CPR 25.13(2)(c) to look at the evidence put forward on the application as a whole (including evidence adduced by the company) and form an assessment on the basis of the evidence as a whole as to whether there is reason to believe that the company will not be able to pay costs ordered against it: *ibid* at para 34.

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[4] CPR 25.12 (and 13) apply to insolvency proceedings by virtue of r 7.51A of the Insolvency Rules 1986. The conditions are-

(a) the claimant is-
  (i) resident out of the jurisdiction; but
  (ii) not resident in a Brussels Contracting State, a state bound by the Lugano Convention, a state bound by the 2005 Hague Convention or a Regulation State as defined in section 1(3) of the Civil Jurisdiction and Judgments Act 1982;

(b) –
(c) the claimant is a company or other body (whether incorporated inside or outside Great Britain) and there is reason to believe that it will be unable to pay the defendant's costs if ordered to do so;
(d) the claimant has changed his address since the claim was commenced with a view to evading the consequences of the litigation;
(e) the claimant failed to give his address in the claim form, or gave an incorrect address in that form;
(f) the claimant is acting as a nominal claimant, other than as a representative claimant under Part 19, and there is reason to believe that he will be unable to pay the defendant's costs of ordered to do so;
(g) the claimant has taken steps in relation to his assets that would make it difficult to enforce an order for costs against him . . .

48. Inability to pay means to pay when the costs fall due for payment. That calls for an assessment of what the claimants (applicants) may be expected to have available for payment at the due date or dates in the form of cash or other readily realisable assets: *Longstaff International v Baker and McKenzie* [2004] 1 WLR 2917 at [17] - [18].

49. Where the claimant company is in liquidation (or another insolvency procedure) that is plainly relevant to the question of inability to pay but has been said not to be determinative: *Premier Motorauctions Ltd (in liquidation) and anr v PricewaterhouseCoopers LLP and anr* [2016] EWHC 2610 (Ch) at [39]. Such companies can have substantial assets and an adverse costs order made against a company in liquidation will rank for payment in the insolvency ahead of the claims of other creditors: *ibid*, citing *Norglen v Reeds Rains Prudential* [1998] BCC 44, at 56. Query, however, whether such an approach has sufficient regard to the requirement for realisable assets.

50. A misfeasance claimant faced with a security for costs application may seek to rely on ATE insurance cover to contend that the jurisdiction threshold is not met. The question (at least where the relevant policy is entered into before the application for security is made) is not whether the policy provides the same security as cash or a bank guarantee or as a deed of indemnity. Rather, it is whether, having regard to the terms of the policy in question, the nature of the allegations in the case, and all the other circumstances, there is reason to believe that the ATE policy will not respond so as to enable the defendant's costs to be paid: *Premier Motorauctions Ltd (in liquidation) and anr v PricewaterhouseCoopers LLP and anr* [2016] EWHC 2610 (Ch) at [41].

51. If the inability to pay threshold is satisfied, the court has a broad discretion whether or not to order security and if so, for how much. That discretion is typically exercised by reference to the factors (or some of them) identified by Lord Denning MR in *Sir Lindsay Parkinson & Co Ltd v Triplan Ltd* [1973] QB 609 as potentially relevant:

    (1) whether the claimant's claim is bona fide and not a sham;

    (2) whether the claimant company has a claim with reasonably good prospects of success;

    (3) the existence of any admission by the defendant that money is due;

    (4) whether there has been a "substantial" payment into court;

(5) whether the application for security is being used oppressively, to stifle a genuine claim;

(6) whether the claimant's apparent want of means has been brought about by the defendant's conduct;

(7) whether the application for security is made at a late stage of the proceedings[5].

52. Not all of these will necessarily be relevant to misfeasance claims against office holders.

53. Where it is contended that an order for security will have the effect of stifling a genuine claim, the onus is on the company being asked to provide security; see also *Keary Developments Ltd v Tarmac Construction Ltd* [1995] 3 All ER 534; *Spy Academy Limited v Sakar International Inc* [2009] EWCA Civ 985.

[5] An application for security for costs may be made at any time but delay is a factor in the exercise of the court's discretion. Proximity to the trial may mean any application for proximity is dismissed or, perhaps more likely, confined to security for future costs: see *Warren v Marsden and ors* [2014] EWHC 4410 (Comm).

Statutory Defence: s.1157 CA 2006

54. Section 1157(1) CA 2006 provides:

> *If in proceedings for negligence, default, breach of duty or breach of trust against*
>
> *(a) an officer of a company, or*
>
> *(b) a person employed by a company as auditor (whether he is or is not an officer of the company),*
>
> *it appears to the court hearing the case that the officer or person is or may be liable but that he acted honestly and reasonably, and that having regard to all the circumstances of the case (including those connected with his appointment) he ought fairly to be excused, the court may relieve him, either wholly or in part, from his liability on such terms as it thinks fit.*

Application to Office Holders

55. Section 1157 CA 2006 has its origins in s.32 of the Companies Act 1907 (which was based on s.3 of the Judicial Trustee Act 1896) and originally only applied to negligence and breach of trust by directors. The scope of the provision was subsequently extended[6] to include managers, officers and auditors.

56. Section 1173(1) CA 2006 provides that "officer" includes a director, manager or secretary. It will be noted that this definition does not expressly include an insolvency office holder. There are specific provisions of the CA 2006 which provide that a liquidator should be "treated as an officer" of a company for the purposes of that particular section: see ss. 30(4), and 36(5). This would suggest that a liquidator does not otherwise fall within the definition of officer in s.1157.

57. There is a divergence of judicial opinion as to whether the statutory defence applies to an insolvency office holder:
    a. in *Rawnsley v Weatherall Green & Smith North Ltd* [2009] EWHC 2482 (Ch), [2010] BCC 406, a claim was issued against a liquidator pursuant to s.212 IA 1986[7] alleging that he had caused the company to sell property at an undervalue. The liquidator applied for summary judgment and/or to strike out the claim arguing, inter alia, that he would be entitled to relief under s.1157 CA 2006. HHJ Behrens considered that it was "seriously arguable" that a liquidator is not within the ambit of that provision without setting out his reasoning for that conclusion. He went on to note that, on the facts of the case, the liquidator would have an "uphill task" in seeking to persuade any court to grant him relief under s.1157;

[6] By s.372 of the Companies Act 1929.
[7] The claim was issued by the former director and shareholder of the company, having taken an assignment of the cause of action from a creditor.

b. in *Top Brands Ltd v Sharma* [2014] EWHC 2753 (Ch); [2015] All ER 581 at [186]-[187], in determining a claim against a liquidator pursuant to s.212 IA 1986, HHJ Simon Barker QC considered whether she should be excused liability under s.1157 CA 2006 but concluded she had not acted reasonably. He did not refer to the decision in *Rawnsley*;

c. in *Re Powertrain Ltd* [2015] EWHC 3998 (Ch); [2016] BCC 216, the liquidators of MG the Rover Group applied for an order authorising them to make distributions to known creditors without regard to claims that, at least in theory, could yet emerge against the company (which would rank as administration expenses) and granting prospective relief from liability under s.1157 CA 2006. Newey J treated the decision in *Rawnsley* as per incuriam because the court was not referred to the decisions of Parker J in *Re X Co Ltd* [1907] 2 Ch 92 and Harman J in *Re Home Treat Ltd* [1991] BCC 165 or to passages in Keay, McPherson's Law of Company Liquidation (3rd edn., Sweet & Maxwell, 2015), at 444, and Lightman & Moss, The Law of Administrators and Receivers of Companies (5th edn, Sweet & Maxwell, 2011) at 12-065. He considered that these sources provide "substantial support" for the proposition that a liquidator is an "officer" for the purposes of s.1157.

58. Equally, various academic commentaries have taken differing views on the issues: compare the extracts from Lightman & Moss and McPherson set out above with *Mortimore: Company Directors Duties, Liabilities and Remedies at 3.82.*

59. It should be noted that in both *Home Treat* and *Powertrain* the court did not hear any adversarial argument. Accordingly, the precedential status of these decisions is somewhat limited: see Practice Direction (Citation of Authorities) [2001] 1 WLR 1001 para 6.

60. If those decision are correct, it would have the surprising consequence that the criminal liability imposed on the officers of a company in the event of breach of various provisions of the CA 2006 would extend to office holders.

Requirement to plead the defence

61. In *Re Kirbys Coaches Ltd* [1991] BCLC 414, Hoffmann J (as he then was) held that it was not necessary for a defendant to plead reliance on the statutory defence in what is now s.1157 CA 2006 in advance of trial. In this regard, he was bound by the earlier decision of the Court of Appeal in *Singlehurst v Tapscott Steamship Co* [1899] WN 133; (1899) 107 LTJo 347, in which it was held:

> "If at the trial the judge comes to the conclusion that the trustee has been guilty of a breach of trust, but thinks that the matter requires further investigation before he decides under that section that the trustee 'has acted honestly and reasonably and ought fairly to be excused for the breach of trust' … he can adjourn the case for evidence on the point."

62. It has been noted that these authorities predate the CPR and may be "ripe for reappraisal" (*Phillips v McGregor-Paterson* [2009] EWHC 2385 (Ch); [2010] 1 BCLC 72 at [36]).

Relevant principles

63. In *Re HLC Environmental Projects Limited* [2013] EWHC 2876 (Ch); [2014] BCC 337 at [108], John Randall QC approved the following summary of the relevant principles:

    a. in order to be relieved of liability a defendant must establish three things: (i) that he acted honestly, (ii) that he acted reasonably, and (iii) that having regard to all the circumstances he ought fairly to be excused. The first of these is a subjective requirement, the second an objective requirement: *Coleman Taymar Ltd v Oakes* [2001] 2 B.C.LC. 749 per Judge Reid QC at [85];
    b. the burden of establishing honesty and reasonableness lies on the defendant: *Bairstow v Queens Moat Houses Plc* [2001] EWCA Civ 712; [2002] B.C.C. 91 per Robert Walker L.J. (as he then was) at [58]; and
    c. it is only if both of the first two requirements of honesty and reasonableness are established that the court needs to consider the third requirement, that in all the circumstances the defendant ought fairly to be excused.

Honesty

64. The honesty referred to in s.1157 CA 2006 must be to honesty in relation to the conduct said to constitute the negligence, default, breach of duty or breach of trust the subject of the claim. Therefore any "collateral dishonesty" on the part of the defendant will be irrelevant (see *Cook v Green* [2009] BCC 204 at [45]).

65. It appears that a defendant is assumed to have acted honestly unless there is evidence to the contrary: see *Re Kirby Coaches* (supra).

Reasonableness

66. It is axiomatic that the test of reasonableness in s.1157 is not the same as that used for deciding whether the defendant is liable for breach of duty (see *Bairstow v Queens Moat Houses Plc* [2000] 1 BCLC 549).

67. In *Re Duomatic Ltd* [1969] 2 Ch 365, the test deployed by Buckley J was whether the director acted "in the way in which a man of affairs with reasonable care and circumspection could reasonably be expected to act in such a case".

68. One factor which is often of relevance in assessing the reasonableness of a defendant's actions (whatever the nature of the breach), is whether they obtained professional advice before acting as they did. The answer to that question is not, however, necessarily decisive: see *Murray v Leisureplay plc* [2004] EWHC 1927 at [121].

69. For examples where the failure to take advice was fatal see *In re Duomatic Ltd* [1969] 2 Ch 365; *Re DKG Contractors Ltd* [1990] BCC 903; *Re Ruscoe Ltd*, unrep Mr Registrar Jones, 7 Aug 2012.

70. Even where advice has been taken it is not necessarily a 'passport to relief'. The basis of the advice (including what the advisor was told by the director/company), the identity of the advisor, whether the advice was followed and the directors' actual knowledge and experience are all relevant factors.

71. It is also clear that complete inactivity on the part of the defendant cannot be reasonable: see *Lexi Holdings plc v Luqman* [2007] EWHC 2652 (Ch) at [224].

Fairness

72. Where the pre-conditions of honesty and reasonableness are met, it remains necessary for the court to consider whether it is appropriate to excuse a defendant from liability (in whole or in part).

73. The court has generally been reluctant to grant relief where the company is insolvent and the creditors will therefore be prejudiced (see *Re Marini Ltd* [2003] EWHC 334; [2004] BCC 172; *Queensway Systems Ltd v Walker* [2006] EWHC 2496 (Ch); [2007] 2 BCLC 577), although there is much force in Professor Keay's submission that the fact that the creditors will lose out if the defendant is excused is simply one factor for the court to take into account in the exercise of its discretion and should not trump all other factors (see *Keay, Directors' Duties (2nd ed)* at 17.76).

74. That said, the fact that an office holder will generally be entitled to a generous remuneration for his services is also likely to be a relevant factor in determining whether it is appropriate to excuse him or her for liability for negligence or breach of duty which has caused a loss to the creditors in whose interests he or she was appointed to act (see *National Trustees Co of Australasia v General Finance Co of Australasia* [1905] AC 373 at 381).

s.212 discretion

75. Section 212(3) IA 1986 confers on the court a discretion to make such order as just in all the circumstances.

76. It is therefore possible for the court to limit the relief granted under s.212 IA 1986 notwithstanding that it is not prepared to excuse the defendant from liability under s.1157 CA 2006 (see *Re Loquitur Ltd* [2003] EWHC 999 (Ch); [2003] 2 BCLC 442). However, such a case is likely to be rare in practice.