EXTREME REMEDIES

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Introduction

1. This talk will concentrate on remedies of last resort, both within the commercial and personal context. Whilst the relevant sections of the Insolvency Act 1986 **("IA 1986")** relating the available remedies are contained within the relevant chapters, there is a substantial amount of cross over in the applicable principals and the case law.

2. These notes are set out as follows:

    2.1. Some general considerations to be thought about before any application is made and before the service of any order obtained, in particular in relation to information stored electronically;
    2.2. Search and seizure orders;
    2.3. Warrant for arrest;
    2.4. Provisional liquidation;
    2.5. The limits on the use to which an office holder can disclose any information obtained by him under a coercive order;
    2.6. Some concluding comments

Some general considerations

3. The most likely reason for an application of the kind referred to above is to recover information or property (for example cash or cars) that have been concealed from the office holder. Information may enable investigations to be made into after acquired property or simply preserving the position pending the making of a winding up order. In either case the information is likely to be stored electronically. There are 2 consequences of this. The first is that you need to plan in advance how to capture this information; the second is any order must be drafted in such a way as to require delivery up of sufficient details to enable the office holder to access the information.

4. In order to achieve this it will probably be necessary to work with IT experts. Normally one of the most important factors in seeking to recover information will be retrieval and examination of electronic storage devices. These come in many physical forms, the most obvious being computers (particularly laptops), mobile phones and data storage devices (for example external hard drives or USB sticks). There are other aspects to consider, in particular the office holder being able to access cloud based applications and blocking remote wipe applications now readily available on both mobile phones and laptops. Internet banking is another important consideration as is access to any off shore banking facilities. It is likely that any order will limit the time you have to image any devices recovered which the office holder does not have the right to retain, for example laptops belonging to third parties but which contain information relating to the insolvent entity. It is necessary, therefore, to have adequate IT support in place before the order is served. Logistically this requires prior liaison so everybody knows what they are doing.

5. It may be that the easiest way to deny access to bank accounts will be by prior service on the banks before the execution on the order. However, where offshore banking platforms are being used that is not advisable.

6. If the order enables access to premises, whether occupied by the respondent to an order or a third party, it has become common practice to employ an independent solicitor to accompany those executing the order. This is not the same as a supervising solicitor on the service of a search order. The functions of an independent solicitor are not to supervise the office holder, but to explain the terms of the order to any occupants and to quarantine any disputed items (for example personal information) until a process can be agreed for the independent examination of the disputed items to ascertain whether they can be released to the office

holder. The use of an independent solicitor is a relatively recent development, but at a practical level it assists both the office holder in that they have an independent record of their actions that are beyond dispute and also the third party in that they have the terms and consequences of the order explained to them. In some cases it may be possible to persuade the local police to help with the service of the order. That will depend upon the terms of the order and the willingness of the local force to assist.

7. Consider whether it is appropriate to combine any insolvency application with a further interim remedy, for example in a bankruptcy with an order pursuant to s.366 IA 1986 for disclosure. Be aware that if this was, for example, a freezing order an undertaking in damages would be required in the ordinary way. In the case of an office holder it may be possible to limit any undertaking to the net assets in the insolvency, as is frequently done.

8. It is also worth considering whether it is worth applying for the application be heard in private pursuant to CPR r.39 (3) (a) on the grounds that publicity would defeat the object of the hearing and if it is intended to pre-serve any third party such as a bank, the inclusion of anti-tipping off provisions to ensure that no advance warning is given.

Search and seizure orders

9. S.365 IA 1986 provides for the states (our underlining):

"(1) At any time after a bankruptcy order has been made, the court may, on the application of the official receiver or the trustee of the bankrupt's estate, issue a warrant authorising the person to whom it is directed to seize <u>any property comprised in the bankrupt's estate which is, or any books, papers or records</u> relating to the bankrupt's estate or affairs which are, in the possession or under the control of <u>the bankrupt or any other person</u> who is required to deliver the property, books, papers or records to the official receiver or trustee.

(2) Any person executing a warrant under this section may, for the purpose of seizing any property comprised in the bankrupt's estate or any books, papers or records relating to the bankrupt's estate or affairs, break open any premises where the bankrupt or anything that may be seized under the warrant is or is believed to be and any receptacle of the bankrupt which contains or is believed to contain anything that may be so seized.

(3) If, after a bankruptcy order has been made, the court is satisfied that any property comprised in the bankrupt's estate is, or any books, papers or records relating to the bankrupt's estate or affairs are, concealed in any premises not belonging to him, it may issue a warrant authorising any constable or prescribed officer of the court to search those premises for the property, books, papers or records.

(4) A warrant under subsection (3) shall not be executed except in the prescribed manner and in accordance with its terms."

10. There is no directly corresponding provision in relation to companies in liquidation. The closest is s.234 (c) IA 1986 which states:-

"Where any person has in his possession or control any property, books, papers or records to which the company appears to be entitled, the court may require that person forthwith (or within such period as the court may direct) to pay, deliver, convey, surrender or transfer the property, books, papers or records to the office-holder."

But that does not contain a power of arrest, so it is not directly comparable.

11. It should be noted that the order can extend beyond the person of the bankrupt or his property in permitting seizure of items in the possession of third parties. It also the search of premises not belonging to a bankrupt where the court is satisfied that the bankrupt might have concealed property, books and/or records relating to the estate or the bankrupt's affairs. That is a wide reaching power and one the court will exercise sparingly.

12. That it is an infrequently used section is demonstrated by the fact that there is very little authority on s.365 IA 1986. However the following general considerations apply. Any application should be made on notice, except in the most exceptional of circumstances *Re First Express Ltd* [1991] B.C.C. 782. It is probable that any pre-emptive application will fall into the exceptional circumstances category.

13. In relation to s. 365 IA 1986 the one reported case is *Williams (Trustee of the Property of Nassim Mohammed) v Mohammed (No 2)* [2012] BPIR 238 which in turn adopts the rationale of Mr Justice Norris in *Re Morrow (No 2966 of 2003)* (unreported) 11 November 2003, ChD. This summarises the principles as follows [at paras 3 – 7]:-

    13.1. The remedy of seizure must be treated as one of last resort, but the court may grant it if it is satisfied that there is a real risk that the bankrupt's possessions (including records) may be dissipated, destroyed or otherwise disposed of unless the warrant is issued;
    13.2. The value of the property liable to be seized must justify the grant of such a draconian remedy;
    13.3. The rights of third parties should be respected as far as possible and the task of the Court is to find a balance between those rights and the need to advance the bankruptcy in the interests of creditors.

14. He went on to say at paragraph 4:

> *'4. …His Honour Judge Norris referred to two particular considerations. First, that although the remedy is a draconian one, and to a degree a matter of last resort, it is nevertheless available where the taking of other steps may either be futile or counter-productive; futile in the sense that the known conduct of the bankrupt in relation to past events makes it extremely unlikely that he will co-operate with anything short of a compulsive order; counter-productive in the sense that the past conduct of the bankrupt indicates that, if alerted to the application, steps will be taken to put the bankruptcy estate beyond the reach of creditors. It is in that sense that the words 'dissipated or otherwise disposed of' are to be understood.'*

15. Dissipation goes beyond the general understanding within the context of a freezing order application. It includes the risk, by reference to past conduct, that if notice is given, steps will be taken to put assets beyond the reach of creditors.

16. Further:-

    16.1. A warrant may be executed at premises belonging to a bankrupt (s.365 (1) IA 1986);
    16.2. It can also extend to premises where anything the subject matter of the warrant is believed to be (s.365(2) IA 1986);
    16.3. Further a warrant may be issued in respect of premises not belonging to a bankrupt but where any books, papers or records relating to the bankrupt's estate or affairs are believed to be concealed (s.365(3) IA 1986).

Power of arrest

17. The insolvency legislation contains several instances when a court can issue a warrant for the arrest of a person to enforce compliance with statutory obligations to co-operate. The most common example is where a person fails to attend an examination[1]. Within the context of bankruptcy there is also a standalone provision providing for the arrest of a bankrupt and the seizure of books and records where there is a likelihood that the debtor may abscond, avoid a public examination or hide assets. So far as it is relevant s.364 IA 1986 states:-

[1] *See S.236(5) and s.366(3) IA 1986 – also note that these sections enable the court to order the seizure of books, papers, records, money or goods in that person's possession*

"Power of arrest

(1) In the cases specified in the next subsection the court may cause a warrant to be issued to a constable or prescribed officer of the court–

(a) for the arrest of a debtor to whom a bankruptcy petition relates or of an undischarged bankrupt, or of a discharged bankrupt whose estate is still being administered under Chapter IV of this Part, and

(b) for the seizure of any books, papers, records, money or goods in the possession of a person arrested under the warrant,

and may authorise a person arrested under such a warrant to be kept in custody, and anything seized under such a warrant to be held, in accordance with the rules, until such time as the court may order.

(2) The powers conferred by subsection (1) are exercisable in relation to a debtor or undischarged or discharged bankrupt if, at any time after the presentation of the bankruptcy petition relating to him or the making of the bankruptcy order against him, it appears to the court:-

(a) that there are reasonable grounds for believing that he has absconded, or is about to abscond, with a view to avoiding or delaying the payment of any of his debts or his appearance to a bankruptcy petition or to avoiding, delaying or disrupting any proceedings in bankruptcy against him or any examination of his affairs, or

(b) that he is about to remove his goods with a view to preventing or delaying possession being taken of them by the official receiver or the trustee of his estate, or

(c) that there are reasonable grounds for believing that he has concealed or destroyed, or is about to conceal or destroy, any of his goods or any books, papers or records which might be of use to his creditors in the course of his bankruptcy or in connection with the administration of his estate, or

(d) that he has, without the leave of the official receiver or the trustee of his estate, removed any goods in his possession which exceed in value such sum as may be prescribed for the purposes of this paragraph, or

(e) that he has failed, without reasonable excuse, to attend any examination ordered by the court."

18. The application of s.364 IA 1986 was examined in detail by the Court of Appeal in *Hickling v Baker* [2007] BPIR 346 from which the following principles can be drawn:-

18.1. Arrest under an order made under s.364 IA 1986 can be justified under Art 5(1)(b) of the of the European Convention for the Protection of Human Rights and Fundamental Freedoms 1950 (right to liberty);

18.2. The point of s.364 IA 1986 is not to punish the person in question but to prevent him from evading his obligations, or to encourage him to put right any evasion that he may already have effected;

18.3. Art 5 did not require that notice of an application pursuant to s.364 IA 1986 be given to the person to be arrested in all cases;

18.4. However, where an application is made without notice, the evidence in support of the application must make it clear why this is said to be justified as an exception to the normal rule that notice should be given;

18.5. If the order is made on an application without notice the order should provide that, once the arrest has been effected, the person arrested be brought before the court as soon as possible and that it should not be for the person arrested to apply to the court;

18.6. At that hearing the party arrested will have the opportunity to make representations as to the propriety of the order, and the court will be able to consider, among other things, whether the objective of the trustee in bankruptcy could be met, even on a temporary basis, by interim protection other than continued arrest. If the person in question is to remain in custody for the time being, directions could be given as to what is to happen either pending an application for discharge or with a view to ensuring that the obligations under the bankruptcy were properly fulfilled;

18.7. The order does not have to specify any particular obligation whose fulfillment was intended to be secured;

18.8. There are serious doubts as to whether the withholding of evidence could ever be justified on an application under s 364 IA 1986.

19. This is an extraordinary remedy only to be used in extraordinary circumstances it can be used where it is possible to demonstrate that other attempts have been made to ensure compliance with obligations and they have failed. In exceptional circumstances it is possible for the court to temporarily withhold evidence where to disclose it would enable the debtor to avoid the objects of the order.

20. It is always necessary for the warrant to be executed either by the tipstaff or a local police force. That itself may take some time. It is also imperative that the person arrested is brought before the court without any delay. That should, where possible be on the day of arrest. That will require liaison with the local police force and the court.

Provisional liquidation

21. Section 122 IA 1986 provides that a company may be wound up by the court if (amongst other grounds) *'the company is unable to pay its debts*'. So far as material, s 123 defines an *'inability to pay debts'* as follows:

22. A company is deemed unable to pay its debts:

22.1. if a creditor (by assignment or otherwise) to whom the company is indebted in a sum exceeding £750 then due has served on the company, by leaving it at the company's registered office, a written demand (in the prescribed form) requiring the company to pay the sum so due and the company has for 3 weeks thereafter neglected to pay the sum or to secure or compound for it to the reasonable satisfaction of the creditor, or

22.2. if, in England or Wales, execution or other process issued on a judgment, decree or order of any court in favour of a creditor of the company is returned unsatisfied in whole or in part, or

22.3. if it is proved to the satisfaction of the court that the company is unable to pay its debts as they fall due.

23. A company is also deemed unable to pay its debts if '*it is proved to the satisfaction of the court that the value of the company's assets is less than the amount of its liabilities, taking into account its contingent and prospective liabilities …'*

24. Section 124 provides that an application to the court for the winding up of a company shall be by a petition presented by (amongst others) *'any creditor or creditors'*. S.135 (1) provides for the appointment of provisional liquidators at any time after the presentation of a petition. Section 135(2) provides that in England and Wales:-

> *'… the appointment of a provisional liquidator may be made at any time before the making of a winding-up order; and either the official receiver or any other fit person may be appointed.'*

25. In *HMRC v Rochdale Drinks*, the Court of Appeal set out the basis upon which provisional liquidators may be appointed. Rimer LJ recognised that such an appointment is a most serious step for a Court to take in that it is almost inevitable that as a result of such an appointment the underlying business of the company is likely to cease, with the consequential loss of jobs. Such damage is likely to be irremediable. Rimer LJ set out the test as follows:

25.1. Has an applicant demonstrated that he is <u>likely</u> to obtain a winding up order on the hearing of the petition (in other words is there a genuine possibility of disputing the debt)?

25.2. In the circumstances of the case is it right that the court should appoint a provisional liquidator?[2]

26. In the context of the first part of the test the real question is whether a debt that is wholly disputed on substantial grounds. The approach of the court to this first question was summarised by Sir William Blackburne in *Re Parkwell Communications Limited* [2015] Bus LR 40 (at para 50) as follows:-

> *"In short, the task before the court is to decide whether on the evidence before it the petitioner demonstrates a likelihood that the court hearing the petition will and that, to the requisite extent, the petition debt is established. If the petitioner makes out a good arguable case that it is then, if the appointment of a provisional liquidator is to be avoided or the company seeks to have the petition stopped in its tracks, it is for the company, condescending to particulars rather than relying on bare denials or on hopes as to what might turn up at some later stage, to show that the debt is disputed on substantial grounds."*

27. If the Court decides that a winding up order is likely to be made, it will then address the second discretionary question; is it appropriate in the circumstances of the case to appoint provisional liquidators? In most, if not all cases, it will mean that the company ceases to trade. It is not possible to list all the circumstances where it is appropriate to appoint but generally they will involve serous misconduct. By way of example:-

27.1. A provisional liquidator can be appointed to prevent a company from trading or otherwise acting in some improper manner (*Namco UK LtJud v Seatruck Ltd* [2003] EWHC 989;

27.2. In *Re Latreefers Inc* [1999] 1 BCLC the court appointed a provisional liquidator on a creditor's petition to investigate whether there was a reasonable possibility that any liquidator appointed subsequently could recover contributions under s.213 (fraudulent trading) and/or s.214 (wrongful trading) IA 1986;

27.3. In practice the main reason for such an application will be where there is a real risk of dissipation of assets. Within the context of provisional liquidation dissipation has a wider meaning than in the traditional Mareva sense. In *Re a company (No 003102 of 1991), ex parte Nyckeln Finance Co Ltd* [1991] BCLC 539 (at 542c-d) Harman J described it as follows:

> *"If there is a risk of assets being dissipated – that is made away with other than by the rateable distribution amongst all the company's creditors at the date of presentation of the winding-up petition – there must be a good case for the court appointing its own officers, for that is what provisional liquidators are, to try and get in and secure the assets so that if, at the end of the day, the company is put into compulsory liquidation, as in this case at present appears reasonably likely, then there will be assets available and they will not have been dissipated. It is not a dissipation in the Mareva sense of simply deliberately making away with the assets but any serious risk that the assets may not continue to be available to the company."*

28. "Assets" within this context includes causes of action, including misfeasance and claw back claims against insiders, for which purpose the preservation of books and records is essential. In *Rochdale* Rimer LJ observed that the circumstances justifying the appointment of a provisional liquidator are not limited to cases where there is a risk of dissipation of assets in the narrow sense:

> *"In cases in which there are real questions as to the integrity of the company's management and as to the quality of its accounting and record-keeping function, it will be an important part of a liquidator's function to ensure that he obtains control of its books and records so that he can engage in all necessary investigations of its transactions. These will or may include investigations of those who have been managing the company with a view to considering the bringing of claims against them;*

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[2] For a concise summary of the relevant principles applied see the judgment of Mr Justice Norris in HMRC v Winnington Networks Limited [2014] EWHC 1259 (Ch).

and the consideration of whether any of the company's directors ought to be the subject of a report to the Secretary of State to the effect that it appears to the liquidator that they were unfit to be concerned in the management of a company. Such a report might then lead to an application to the court for their disqualification. If there is any risk that, pending the hearing of the petition, records may be lost or destroyed, that will also found the basis for the appointment of a provisional liquidator, who will be able immediately to secure them and commence his own inquiries into the affairs of the company and the conduct of its management."

Use of information

29. Generally in any compulsory order there will be a restriction on the use of the information obtained by coercive means. A typical undertaking will prohibit the disclosure of information obtained as a result of any order in any other civil or criminal proceedings other than those connected to that particular insolvency process. It is also, arguably, covered by the collateral undertaking contained within r.31.22 CPR which limits the use of documents to the proceedings in which they were disclosed. This applies not only to the disclosed documents themselves, but also their contents, that is to say, any information derived from them; see *IG Index Plc v Cloete* [2013] EWHC 3789 (QB). The result is that an office holder should be cautious about disclosing any information to third parties without the direction of the Court. The question of when a Court will give permission to disclose was addressed in the case of *Re France (A Bankrupt)* [2014] BPIR 1448. The following propositions can be drawn from this [para 20 -21]:

    29.1. Office holders have to use and exercise their statutory powers for proper purposes, which included potential proceedings against a bankrupt for a number of offences under IA 1986;
    29.2. Those purposes, as IA1986 Act envisages, may result in proceedings against a third party, for example a bankrupt, for a number of offences;
    29.3. Where disclosure is sough for the purpose of criminal investigation or prosecution there is an assumption that disclosure will be permitted;
    29.4. A third parties rights are protected to a limited extent by s 433 IA 1986 Act and in criminal proceedings by the requirements for a fair trial under Art 6 of the European Convention for the Protection of Human Rights and Fundamental Freedoms 1950 and by the judge's ability to exclude unfair evidence or material under s.78 of Police and Criminal Evidence Act 1984
    29.5. Disclosure does not prevent the third party raising such objects as he might be advised at any criminal trial whether and if so what information should be excluded under s 78 of PACE, it is for the criminal court to police the admissibility of the evidence before it.

30. The position is that a court will generally order disclosure where there is a public interest in doing so. However, this may raise questions of how the disclosure should take place, particularly where the volume of documentation is such that it is not possible for the office holder to be able to trawl through each and every document. Where, for example, disclosure is to be by way of an imaged disk, there may be documents contained on it that should not be disclosed. That would include, for example, information that is the subject of privilege. It will be necessary to establish a procedure whereby any privilege is protected.

Conclusions

31. The remedies discussed here are extreme, but each has a time to be used. Careful consideration is needed, but when used effectively they can lead to substantial recoveries.

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