Neutral Citation Number: [2022] EWHC 1801 (Ch)

Case No: CH-2021-000273

IN THE HIGH COURT OF JUSTICE
BUSINESS AND PROPERTY COURTS OF ENGLAND AND WALES
CHANCERY APPEALS (ChD)

ON APPEAL FROM THE INSOLVENCY AND COMPANIES LIST (ChD)

IN THE MATTER OF P G D LIMITED (IN LIQUIDATION)
AND IN THE MATTER OF THE INSOLVENCY ACT 1986

Rolls Building
7 Fetter Lane
London EC4A 1NL

Date: 14 July 2022

Before :

MR JUSTICE ZACAROLI

- -

Between :

MANOLETE PARTNERS PLC	**Appellant**
- and -	
(1) ALEX DAVID HOPE	**Respondents**
(2) LIAM EDWIN JONES	

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- -

Joseph Curl QC and Paul Wright (instructed by Squire Patton Boggs (UK) LLP) for the **Appellant**
The Respondents did not appear and were not represented
Hearing date: 10 June 2022

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JUDGMENT

If this Approved Judgment

I direct that pursuant to CPR PD 39A para 6.1 no official shorthand note shall be taken of this Judgment and that copies of this version as handed down may be treated as authentic.

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Mr Justice Zacaroli:

1. On 22 August 2014 the respondents, who were then the directors and shareholders of P G D Limited (the "Company"), entered into a transaction to sell their shares in the Company. To the knowledge of the respondents, the consideration for the shares was not to be paid by the purchasers (the "Buyers"), but was to be paid by the Company itself, to the extent that the Company was financially able to do so. By August 2015, the respondents had each been paid £393,819.74 by the Company, purportedly by way of instalment payments under the sale and purchase agreement.

2. On the same date, the respondents caused the Company to pay dividends to themselves, which cleared their directors' loan accounts.

3. The Company went into liquidation on 25 April 2016. The transactions entered into in August 2014 gave rise to at least the following claims against the respondents: breach of duty as directors of the Company, in causing all payments made by the Company to the respondents; transaction at an undervalue; receipt of unlawful dividends; and voidable preference. Some of these claims vest in the company, others vest in the liquidator.

4. Owing to a lack of funds in the estate, the claims of the Company and the liquidator against the respondents were assigned to Manolete Partners PLC ("MPP"). The assignment was on terms that required MPP to make an upfront payment of £20,000, and for the following payments to be made to the insolvency estate out of net recoveries (i.e. after MPP's legal costs, expenses and the deduction of the initial £20,000): 50% of the first £250,000 of net recoveries and 60% of any net recoveries in excess of £250,000.

5. In a judgment delivered on 22 November 2021, Insolvency and Companies Court Judge Prentis found (so far as relevant to this appeal) as follows:

    1) He concluded that the respondents were severally liable (either under s.847 of the Companies Act 2006 or at common law) in respect of the claims relating to the unlawful dividends, in the sum of £218,355 plus interest.

    2) He also concluded that the respondents were jointly and severally liable for breach of duty in respect of the payment of the unlawful dividends, in the amount of £436,710 (but this liability was in the alternative to, and not cumulative with, the liability for the unlawful dividends).

    3) As for the transaction at an undervalue claims, he concluded that the respondents were each severally liable to repay £336,738.89 plus interest. (The respondents retained the benefit of payments made to them prior to 4 November 2014, on the basis that these fell outside the look-back period for the transaction at an undervalue claims).

6. At §83-84 of his judgment, the judge considered whether, as a matter of discretion, he should make no order on the transaction at an undervalue claims, but rejected that possibility.

7. Having delivered judgment, the judge raised for the first time the proposition that the respondents' total liability should be limited to ensure that there was no possibility of a distribution in the liquidation to the Company's shareholders, i.e. the Buyers. The respondents' counsel had not pleaded or otherwise raised this issue. The judge invited counsel to formulate wording to give effect to his idea.

8. On 24 November 2021, counsel then acting for MPP provided a draft order to the judge, and in the covering email explained that the parties had been unable to come up with wording for the intended proviso:

> "The Judge asked us to include a proviso which would have the effect of preventing the current shareholders (the buyers) from receiving a return in the event that the liquidation became solvent. We (i.e. those acting for the Applicant, together with our client) have been unable to arrive at a satisfactory form of wording that would achieve that outcome without some other unintended consequence(s): we have come to realise that any formulation we could think of would have the effect of further reducing the amount that Manolete is able to retain as a result of the terms of the Assignment, in that any reduction in the amount recovered from the Respondents is shared between Manolete the company/the liquidator, such that in real terms a reduction in the amount going into the company would also result in a reduction in the amount ultimately retained by Manolete as well. As such we have been unable to devise wording which gives effect to the judge's desire to prevent the buyers from recovering sums in the liquidation as a result of their shareholding and which also respects (a) Manolete's right to retain that which it ought to retain even after a reduction to prevent a return to the buyers, (b) the terms of the Assignment as between Manolete and the company/the liquidator, in that reducing the company/the liquidator's share of the sum recovered alone does not accord with the terms of the Assignment, and (c) the rights that the Buyers (as shareholders) would have to receive any surplus in the liquidation (if recovery in full would lead to that result). For the same reasons, any formulation we might have arrived at would also result in uncertainty of the amount due from the Respondents in any enforcement action."

9. The judge then produced a supplemental judgment explaining why he nevertheless would include in his order a proviso (the "Proviso") to the effect that the total recoveries under the relevant paragraphs of his order:

> "…shall not exceed the amount required to pay off all liquidation debts, fees, remuneration and expenses, together with applicable interest, in full and without return being made to the members of the Company as such."

10. He said, at §8 of his supplemental judgment, that this was a case where it would be manifestly wrong if the Buyers were to receive any return as shareholders in the event that the liquidation became solvent because of payment of monies under the order. He

therefore decided that the amount of recoveries should be limited to the amount necessary to meet the fees, expenses and creditors in full, in other words to place the Company on the cusp of solvent liquidation. He described that as "not an uncommon order."

11. In response to counsel's objection that this would produce unintended consequences, he said, at §11:

> "I recognise that, the purpose of the limitation being to prevent unjust recovery by the buyers, it can be said that so long as that backstop remains there is no injustice. But the other side of that is that the Respondents may be called on to pay more than they would were the claim brought by the original holder of the causes of action, the liquidator, and not the assignee."

12. He considered that was, in principle, wrong. At §12 he said: "An assignee stands in the shoes of the assignor: a change in the identity of the claimant party ought not to result in any different recoveries. The turnout of recoveries as between the liquidator and the assignee is a matter for their negotiated agreement. For his part, the liquidator will have considered that an assignment on those terms represented the best exploitation of these assets for the benefit of creditors."

13. This appeal, brought with the permission of Joanna Smith J dated 23 March 2022, is concerned solely with the Proviso. MPP contends that the judge was wrong to impose it.

Preliminary matters

14. Since the judgment at first instance in this case, both of the respondents have been declared bankrupt, on their own applications. The court has a discretion to stay proceedings pending against a person who has been declared bankrupt: s.285(1) of the Insolvency Act 1986. Neither the respondents nor their trustee in bankruptcy seek such a stay. The appeal is concerned only with establishing the quantum of MPP's claims against the respondents. The appeal is in the circumstances of this case a more appropriate procedure for determining the quantum of MPP's claim than requiring MPP to start again via the proof of debt procedure in the bankruptcy. In those circumstances, I declined to grant a stay.

15. There is a possibility that the appeal is academic for two reasons. First, on the presently estimated figures in the liquidation of the Company, the cap referred to in the Proviso would not be engaged. Second, on the presently estimated figures in the bankruptcies of the respondents, recoveries are unlikely to be sufficient to meet the cap. Nevertheless, since the figures are at present only estimates, it remains at least possible that the cap might be engaged. Moreover, points raised on this appeal are of importance more widely to MPP (and to other funders of claims brought on behalf of an insolvent estate).

16. Finally, the appellant applied to adduce fresh evidence, in the form of the full, unredacted, assignment agreement between MPP and the Company and its liquidator. A redacted version was in evidence below. The unredacted version is relevant to the arguments on the Proviso. Since the Proviso was not raised as a possibility until after

judgment was delivered, there was no reason to produce the unredacted version prior to that point. For that reason, I permitted the appellant to rely upon the unredacted version of the agreement on this appeal.

The jurisdiction of the judge to make the Proviso

17. The appellant's principal contention is that the judge had no jurisdiction to make the Proviso. The judge did not identify the jurisdiction to do so, other than to say that it would be manifestly wrong if the Buyers received any return as shareholders, in the event that the liquidation became solvent as a result of the payment of monies under his order, and that this was not an uncommon order.

18. Mr Curl QC, who appeared with Mr Wright on behalf of the appellant, pointed out that the judge – in the main judgment – had already addressed such arguments as might have been available to the respondents as to the form of relief to be granted, the quantum of that relief, and any defences that might be available. Having done so, he reached conclusions (as I have noted above) as to the amount which it was appropriate to order against the respondents in respect of each of the heads of claim.

19. This is not a case, therefore, where the cap was based on principles inherent in the causes of action, for example, by reference to the principles of equity in arriving at the measure of compensation in respect of a claim for breach of duty, or by reference to the proper measure of relief for "restoring the position to what it would have been if the company had not entered into the transaction", pursuant to s.241 of the Insolvency Act 1986.

20. Nor was the cap based on any defence available to the respondents, for example, pursuant to s.1157 of the Companies Act 2006, under which directors may be relieved of liability, in whole or part, where the director acted honestly and reasonably.

21. The appellant accepts that there are authorities in which the court has placed a limit on the recoveries to be made against respondents to claims by liquidators, which have had the effect of preventing the proceeds of actions filtering through to shareholders. Recognising the absence of any opposition to the appeal, Mr Curl and Mr Wright pointed me to all of the cases they were able to locate in which this has been done. Their overall submission is that the only jurisdictional basis for making such an order is to be found in s.212 of the Insolvency Act 1986, or the predecessors to that provision in earlier Companies Acts. Section 212(3) provides that:

> "The court may, on the application of the official receiver or the liquidator, or of any creditor or contributory, examine into the conduct of [a person who is or has been an officer of the company, has acted as liquidator, administrator or administrative receiver of the company, or taken part in the promotion, formation or management of the company] and compel him:
>
> (a) to repay, restore or account for the money or property or any part of it, with interest at such rate as the court thinks just, or
>
> (b) to contribute such sum to the company's assets by way of compensation in respect of the misfeasance or breach of

fiduciary or other duty **as the court thinks just**." (emphasis added).

22. The appellant contends that s.212 has no application to the present case, because the proceedings are not brought by any of the persons specified in ss(3). MPP is neither the liquidator nor a creditor or contributory of the Company. Nor has the liquidator assigned any "claims" under s.212. Section 212 does not create any claims, as it is merely a procedural mechanism for pursuing certain claims within a liquidation.

23. The cases to which the appellant referred me are as follows.

1) *Re Home and Colonial Insurance Company Ltd* [1930] 1 Ch 102. In that case, the company was voluntarily wound-up, and the liquidator agreed a particular creditor's claim, and caused dividends to be paid on it. The company was then dissolved. A creditor brought a misfeasance claim against the liquidator under s.215 of the Companies (Consolidation) Act 1908, which contained a provision similar to the present s.212, on the grounds that the liquidator had negligently agreed and paid the creditor's claim. Maugham J found that the liquidator was liable, but capped the liability at "such an amount as will enable all the creditors of the company to be paid in full with interest at 5 per cent". He recognised (at p.335) that this would only be done in very exceptional circumstances, but considered it was appropriate here because the shareholders knew that the liability to the relevant creditor sounded only in honour, but allowed the liquidators to go ahead. At p.330-331, Maugham J's reasoning was firmly based on the specific wording of the section: "on the whole I think, and I am supported by the authority of the late Wright J, that the exceptionally able draftsman of the Companies Act 1862 had in mind the possibility that circumstances might arise which would make it unjust and inequitable to require payment of the total amount which the company might perhaps recover in an action against the director or other officer concerned."

2) *Liquidator of West Mercia Safetywear Ltd v Dodd* (1988) 4 BCC 30. In that case, a claim in misfeasance was brought by a liquidator against a director for having caused the company to pay a fraudulent preference in disregard of the interests of the general body of creditors. The relevant section was s.333(1) of Companies Act 1948, which contained similar wording to the present s.212. At p.33, Dillon LJ said: "the court has a discretion over the relief, and it is permissible for the delinquent director to submit that the wind should be tempered because, for instance, full repayment would produce a windfall to third parties or, alternatively, because it would involve money going round in a circle or passing through the hands of someone else whose position is equally tainted". The court tempered the relief so as not to over-burden the director, where the preferred creditor was entitled to be paid a dividend in any event on the £4,000. This was, in substance, a case of working out the true measure of loss caused to the company by reason of the director's breach of duty, as opposed to capping the quantum of the claim against the director for some extraneous reason.

3) *Re AMF International Ltd* [1996] 1 WLR 77. This case proceeded on the common ground that, under s.212(3), the former liquidator ought not to have to repay the full amount wrongly paid to a contributory, because that would result in an amount going back to the same contributory. The former liquidator had

wrongly made a distribution to a shareholder, before paying certain creditors. In ordering the liquidator to repay that sum, he was effectively given credit for the fact that – if after payment to creditors there would have been a surplus – the amount of that surplus would properly have been paid to the shareholder.

4) *Re Loquitur Ltd* [2003] EWHC 999 (Ch). In this case, a claim was brought by a creditor (HMRC) under s.212 against directors for misfeasance in relation to the payment of an unlawful dividend. It was common ground that the court had a discretion as to the precise amount to be awarded against the directors in order to do what was just in all the circumstances. The circumstances of that case, however, are far removed from this case. The amount to be recovered was reduced because, apart from a sum of £1.16m for which provision ought to have been made in properly drawn accounts, there was insufficient evidence to establish what sum ought to have been included in the accounts to reflect reasonably anticipated liabilities, and the judge had no reason to believe that it would be anything in the region of the balance of the £5.9 million dividend (and it was not in accordance with the overriding objective to order an inquiry of that issue).

5) *Re DCL Hire Limited* [2019] EWHC 2086 (Ch). This case does not provide any support for making the Proviso, since the reason the first instance judge limiting an award against the director to 75% of the full extent of the loss suffered was because it reflected the extent of the director's fault. In any event, that decision was overturned on appeal by Mann J.

6) *Paycheck Services 3 Ltd* [2008] EWHC 2660 (Ch). In this case a claim was brought under s.212 by a creditor (HMRC) against an alleged de facto director. At first instance, Mark Cawson QC, at §231, described the discretion under s.212(3) as being "…to reflect the fact that the remedy is capable of being pursued by a party other than the liquidator, and, in respect of a claim such as the present, to enable an award to be limited to what is required to make up any deficiency occasioned by the delinquency, the subject matter of the proceedings." In the Court of Appeal, Ward LJ – in considering the exercise of the discretion under s.212 – placed particular emphasis on the fact that the claim was brought by HMRC, who "…should receive no more than would have been coming into their coffers": see [2009] EWCA Civ 625, at §143. Had the claim been brought by the liquidator, then Ward LJ could see (again at §143) why they might possibly recover the whole of the payments improperly made. In the House of Lords, Lord Hope affirmed this view, accepting that the judge had a discretion under s.212 to limit the award to what was required to make up the deficiency of a particular creditor where the claim was made by a party other than a liquidator. I note that in both the Court of Appeal and the House of Lords, the comments on the extent of the discretion under s.212 were obiter because it was held that the defendant was not a de facto director.

24. I accept Mr Curl's submission that in each of the above cases, the discretion being exercised was that provided for in s.212 or its predecessor provisions.

25. I note that in *Bairstow v Queens Moat Houses plc* [2001] EWCA Civ 712, to which Mr Curl also referred me, the defendant directors (who were accountable to the company for dividends unlawfully paid) submitted that the amount recoverable from the directors

should be limited, to prevent an "unmerited windfall" if the amounts recovered caused the company to be solvent such that the amounts could be the subject of a further dividend to shareholders. This submission was made in the context of a claim by the company which was not in liquidation, so that no question of a discretion under s.212 arose. The Court of Appeal rejected the argument. Robert Walker LJ, having noted at §45 that a number of the present shareholders of the company were different to those that had been the recipients of the unlawful dividends in the past, dealt with those who had both received the unlawful dividend and remained shareholders at §46:

> "Even in relation to those long-term investors the objection taken by Mr Purle and the litigants in person is in my judgment misconceived. If there is any unfairness in the situation it does not arise from the so-called windfall which (if and so far as it occurs) will be a distribution lawfully made on the basis of properly prepared accounts for 2001 or some later accounting period. It will be made out of distributable profits which are disclosed in those accounts. Any unfairness would, on the contrary, arise from long-term investors not being required to account for the unlawful dividends which they received in the past."

26. On the basis of the authorities cited to me, it appears that the only jurisdictional basis for making the Proviso was s.212 of the Insolvency Act 1986, and that this does not appear to be available in the circumstances of this case.

27. I recognise, however, that I have not heard argument from those who would stand to gain from the Proviso (the respondents, who did not seek it before the judge), or from those who would principally be prejudiced by it (the Buyers, qua shareholders of the Company, who are not parties at all). For reasons which I set out below, I conclude that the Proviso was wrongly imposed because it prejudiced the interests of MPP for reasons other than that there was no jurisdiction to order any limitation on recoveries at all. In these circumstances, I do not need to, and do not, reach any conclusion on the broader question of jurisdiction. The question whether, following an assignment of a claim by a liquidator, the possibility still exists of limiting the recoveries made by reference to or by analogy with s.212 is something that is best determined in the context of a case where it is essential to do so and the relevant parties on either side of the argument are before the court.

Errors in the judge's approach assuming there is a jurisdictional basis for making such an order

28. MPP also contends that, even if the discretion exercised in the cases referred to above could apply in principle in this case, the judge was nevertheless wrong to impose the Proviso so as to prejudice persons (such as MPP) who were innocent of the wrongdoing which gave rise to the claim against the respondents.

29. I understood Mr Curl to submit that the Proviso had the effect of prejudicing creditors, as well as MPP, because the cap was set at the amount required to pay all debts and expenses in the liquidation. If the Proviso is to be construed as capping liability at an amount *equal to* the sum of the debts and expenses in the liquidation, then that would be correct. It would be an inevitable consequence of such a cap, where the proceeds of recoveries are split between the insolvent estate and the assignee of the claims, that the

level of the cap would be reached before all the debts and expenses of the liquidation had been paid.

30. I think, however, that the better reading of the Proviso is that the cap was intended to be set at such amount as would be sufficient in fact to pay off all debts and expenses of the liquidation. In other words, the cap is not reached until the liquidator is in sufficient funds to pay all such liabilities.

31. As Mr Curl submitted, it is very difficult to see how the Proviso could work in practice because at the point in time at which judgment is to be enforced against the respondents, it is highly likely that the amount required to satisfy all debts, costs and expenses of the liquidation will be unknown.

32. Mr Curl's principal submission, however, was that the operation of the cap would inevitably leave MPP out of pocket, and that the discretion to limit recoveries, if it applied at all, cannot be exercised so as to prejudice innocent third parties such as MPP.

33. It is correct that, if the cap were to be engaged, then it would leave MPP out of pocket. That is because MPP is entitled, pursuant to its agreement with the liquidator, to retain a portion of all recoveries for its own benefit. If the cap is engaged then, by definition, it will prevent further recoveries being made, in respect of which MPP is entitled to a share.

34. The judge's reason for imposing the Proviso, notwithstanding the difficulties pointed out by counsel, was that it was in principle wrong for the respondents to have to pay more – as a result of the claim being brought by an assignee – than they would have to have paid if the claim had been brought by the liquidator: "An assignee stands in the shoes of the assignor: a change in the identity of the claimant party ought not to result in any different recoveries."

35. That reasoning does not, in my judgment, justify his conclusion. While it is true that an assignee stands in the shoes of the assignor, that only means that the assignee can assert no better cause of action than the assignor. The discretion which the judge purported to exercise here, however, is not an element of (or defect in) the causes of action which were vested in the Company and the liquidator, and thus assigned to MPP. If it exists at all, it relates only to the *proceeds* of the cause of action, in that it limits the recoveries to be made because of where they would end up.

36. Moreover, the rationale for the discretion to be exercised is solely to deprive persons who are tainted by the wrongdoing which gave rise to the cause of action from receiving part of those proceeds. I accept Mr Curl's submission that it should not be exercised so as to prejudice innocent third parties to whom a part of the proceeds of the action would otherwise be paid.

37. Accordingly if, as here, a liquidator has, quite properly and in order to benefit the insolvent estate, assigned a cause of action on terms that require the proceeds to be divided with the assignee, then I consider it is wrong in principle to deprive the assignee of any part of those proceeds by the exercise of a discretion intended to prevent proceeds reaching someone tainted with the same wrongdoing as the defendants to the action.

38. Put another way, the price to the insolvent estate for recovering any proceeds from the causes of action is that a proportion of the proceeds are retained by the assignee. It could not be suggested that the discretion could be exercised so as to deprive the insolvent estate of the funds necessary to pay a debt or expense incurred in favour of someone innocent of the defendants' wrongdoing. I consider, equally, that the discretion cannot be exercised so as to deprive a similarly innocent third party of a right to share in the proceeds of the cause of action.

39. This conclusion is sufficient to dispose of the appeal, which should be allowed, and it is therefore unnecessary to consider any of the other supporting grounds of appeal.