

## Liability of insolvency practitioners questioned by High Court

The High Court was recently asked to decide issues regarding the potential liability of a firm of licensed insolvency practitioners retained to advise two companies, (ICM and MCE – the "Companies") and their directors at a time when the Companies were, or indeed were about to become, insolvent.

The case raises important questions regarding the potential scope of a professional adviser's liability in connection with claims made under sections 212, (misfeasance/breach of duty), 214 (wrongful trading), 238 (transactions at an undervalue) and 239 (preferences) of the Insolvency Act 1986 (the "1986 Act").

### **The Facts**

The Companies were in the corporate hospitality business. In particular, they contracted to supply a number of corporate hospitality packages for the FIFA World Cup in France in 1998.

Shortly before the tournament was due to kick off, the Companies were informed by their supplier that ticket orders for the opening games could not be fulfilled.

The supplier offered to reimburse the Companies for the cost of purchasing replacement tickets from other sources. It also promised to provide the Companies with tickets for the final at discount.

Tan, a firm of Insolvency Practitioners, was retained to advise the Companies and their directors (the "Directors") as to the financial position of the Companies, whether the Companies should cease to trade and what the implications and consequences of continuing to trade were for the Companies and the Directors.

Tan's advice was that the Companies could continue to trade if the Directors believed that tickets could be obtained to fulfil the orders.

Subsequently, the Directors were informed by a supplier that tickets for further games could not be made available to fulfil orders. Tan's advice upon learning of this was that the Companies should cease trading, which they did immediately with effect from 23 June 1998. Resolutions for the voluntary liquidation of the Companies were then passed.

### **The Claims**

Following protracted director disqualification proceedings, the liquidator issued various claims against the Directors pursuant to the provisions of sections 212, 214, 238 and 239 of the 1986 Act.

In turn, the Directors sought to recover a contribution from Tan pursuant to the provisions of the Civil Liability (Contributions) Act 1978 (the "1978 Act"), claiming that Tan were jointly liable to the liquidator for the losses that the liquidator was seeking to recover from the Directors, by virtue of the advice that Tan had given (the "Contribution Claims").

### **The Issue**

The matter came before a Deputy Judge sitting in the Chancery Division of the High Court in April of this year, upon application by Tan to strike out the Contribution Claims. The main issue to be decided in relation to each claim was whether or not Tan shared a common liability to the liquidator with the Directors in respect of the damage, which formed the subject matter of each claim made by the liquidator against the Directors.

In support of their submissions that there was a common liability, the Directors argued that the various claims made by the liquidator amounted to claims for or on behalf of the Companies and as such, the Directors and Tan must “enjoy” a common liability for the loss suffered. Tan argued that the claims brought by the liquidator were not claims brought for or on behalf of the Companies.

### **The Judgment and its implications**

The Directors’ contentions in relation to the Contribution Claims regarding the allegations of wrongful trading, transactions at an undervalue and preference were rejected by the Court.

The Deputy Judge found, with the assistance of previous authorities, that the proceedings commenced by the liquidator were not brought by or on behalf of the Companies, nor were they proceedings to recover assets belonging to the Companies at the date of the winding up.

The Judge reached that decision as a company, (being a distinct legal entity), does not itself have the ability to make such claims. Proceedings under sections 214, 238 and 239 of the 1986 Act are not brought on behalf of the company nor are they brought in order to recover assets belonging to the company at the date of the winding up. Claims of this nature cannot be brought prior to the company going into liquidation. They can only be brought by a liquidator as a result of the powers conferred by statute. A distinction must be drawn between the property of a company at the commencement of the liquidation and property subsequently acquired by the liquidator through the exercise of the liquidator’s statutory rights, which is then held on trust for distribution.

In such circumstances, there can be no common liability between directors and professional advisers as is required to succeed in a contribution claim under the 1978 Act.

However, in relation to a contribution claim regarding misfeasance/breach of duty under section 212 of the 1986 Act the position is different.

Such a claim does not create a new liability; rather the statutory provision is designed to provide a simple recovery procedure during the winding up of a company’s affairs. Any sums recovered by the liquidator are the subject of a chose in action that vested in the company prior to its liquidation and are considered to be assets of the company.

Therefore, such a claim can be regarded as a claim brought by the liquidator for or on behalf of a company and it is conceivable in such circumstances that an insolvency practitioner, or other professional adviser, could have a common liability with a company’s directors in respect of the same damage.

In the present case, although it was not clear to the Deputy Judge on the materials before him that such a contribution claim could properly be brought, he declined to dismiss it summarily

upon Tan's application. Instead he gave the Directors an opportunity to formulate proposed amendments and make an application for permission to amend this part of their Contribution Claim.

Whilst we shall have to wait and see what the outcome of this discrete issue is, the general principle remains of useful application.

#### **Summary**

- Contribution claims commenced pursuant to the provisions of the 1978 Act, by those with primary liability under the statutory provisions relating to wrongful trading, transactions at an undervalue or preferences (namely sections 214, 238 & 239 of the 1986 Act) against professional advisers will almost certainly be misconceived.
- The reason for this is that it will not generally be possible to establish a common liability.
- Such claims are not claims for or on behalf of a company. Such claims can only be brought by the liquidator as a result of the powers conferred by statute.
- A contribution claim relating to misfeasance/breach of trust (section 212 of the 1986 Act) does have the potential to succeed, because such a claim does amount to a claim brought on behalf of a company.

#### **Postscript**

A word of caution to professional advisers who interpret the above to mean that they can never be found liable for advice given in circumstances where primary liability claims, pursuant to sections 214, 238 & 239, are made against the directors of a company.

In the present case, it was not open to the directors to pursue claims against Tan in negligence at common law, (as distinct from seeking a contribution under the 1978 Act) because the relevant limitation period had expired. Otherwise, in certain circumstances, there would appear to be no reason why such a claim cannot succeed, notwithstanding that a contribution claim pursuant to the 1978 Act may not.

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