Duties of administrators *in respect of company claims*

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Introduction

In recent years there has been a rise in litigation surrounding the steps taken by administrators while in office. In particular, there has been an increased level of creditor claims against administrators either arising from acts carried out by administrators while in office or, relevant to this article, the failure to take proper action.

This article focuses on the duties of administrators when considering whether to pursue or assign litigation and the practical steps that can be taken to minimise the risk of claims being brought against administrators. In this context the article reviews the principles that can be drawn from the decisions in *LF2 v Supperstone* [2018] EWHC 1776 (Ch) and *Brewer v Iqbal* [2019] EWHC 182 (Ch).

Duties of administrators when realising company property

An administrator owes a duty to the company over which he is appointed to take reasonable steps to obtain a proper price for its assets per *Re Charnley Davies Ltd* (No.2) [1990] *BCLC 760* in which Millett J held that:

> *"An administrator must be a professional insolvency practitioner. A complaint that he has failed to take reasonable care in the sale of the company's assets is, therefore, a complaint of professional negligence and in my judgment the established principles applicable to cases of professional negligence are equally applicable in such a case. It follows that the administrator is to be judged, not by the standards of the most meticulous and conscientious member of his profession, but by those of an ordinary, skilled practitioner. In order to succeed the claimant must establish that the administrator has made an error which a reasonably skilled and careful insolvency practitioner would not have made."*

The duties of administrators when acting as agents to sell the assets of a company in administration was reconsidered in the recent decision of *Davey v Money* [2018] *EWHC 766 (Ch)*.[1] In that case it was held that administrators owe a duty to the company to take reasonable care to obtain the best price which the circumstances of the case permit. They do not owe the more onerous duties of a trustee selling trust property and the relevant standard of care is that of an ordinary skilled practitioner.

Realising value from causes of action

Causes of action vested in an insolvent company are to be treated as assets in the same way as other property owned by the company. As a result, administrators have the same obligation outlined above to obtain a 'proper price'. The key question is how administrators should go about achieving a 'proper price'.

Administrators could, of course, pursue causes of action themselves on behalf of the company. This is the most obvious method of unlocking value – and is likely to be effective when dealing with relatively simple claims (e.g. debt claims).

Problems may emerge, however, when dealing with more complex claims. Complex claims are likely to take time to litigate and require significant investment – for example in the services of solicitors, barristers and other experts (e.g. forensic accounting experts to advise on quantum). Such claims are also likely to carry significant risk – not only in terms of the loss of any investment in the claim itself but also in terms of adverse costs awards in the event the claim is ultimately unsuccessful. Additionally, defendants to claims brought by insolvent companies may unscrupulously seek to deny liability and/or use tactics to drag out claims in the hope that administrators run out of patience. Litigating such claims may therefore be unattractive to administrators. That does not, however, mean that such claims do not hold value. Value in such circumstances may be realised by assigning the cause of action to a third party.

LF2 v Supperstone

It is well established that administrators have the power to sell causes of action as part of their general powers to sell the company's property pursuant to Schedule 1, Paragraph 2 of the Insolvency Act 1986; per the decision in *Re Park Gate Waggon Works Co (1881) 17 Ch. D. 234.*

Assignment can have a number of benefits for administrators:

1. Administrators can realise value from causes of action without incurring the costs and risks associated with litigation.
2. Litigation can be a lengthy process; assigning the claim can enable administrators to resolve matters in a timely fashion so that they can close the administration.
3. Assignees bring proceedings in their own name so they also bear the risk of adverse costs awards.

But what duties do administrators owe when considering whether to assign a cause of action? This question has recently been considered by the Court in *LF2 v Supperstone*.

The decision centred upon a conditional fee arrangement (CFA) which had been entered into by Pennyfeathers Ltd with its solicitors,

1. See the October 2018 edition of South Square Digest for further analysis of this decision by Tom Smith QC.

Fieldfisher LLP in relation to its claim in a real estate dispute. The claim was successful and the Court made a declaration in favour of Pennyfeathers and an order for costs. The costs order was insufficient to cover the costs of Fieldfisher. Pennyfeathers did not have sufficient funds to meet the shortfall and Fieldfisher subsequently applied for an administration order.

The directors of Pennyfeathers later sought advice from a solicitor on the prospects of a claim against Fieldfisher for professional negligence. The solicitor offered to act for the company in connection with that claim on a CFA basis or alternatively, to purchase the claim outright for £10,000. The administrators did not believe the claim had any real prospect of success and rejected the offer of £10,000 on the ground that it would not make a material difference to the unsecured creditors.

The solicitor took an assignment of a debt owed to one of the directors of Pennyfeathers and in turn assigned the debt to a company, LF2 Limited, of which he was sole director and shareholder. In doing so, LF2 became a creditor of Pennyfeathers and made an application under paragraph 74 of schedule B1 to the Insolvency Act 1986 to challenge the conduct of the administrators in refusing to assign the claim, alleging that it unfairly harmed LF2's interests.

The application was dismissed by Deputy ICC Judge Barnett who held that:

1. The claim against Fieldfisher was frivolous and vexatious.
2. He was not satisfied that LF2 had discharged the burden of showing that the creditors would derive any benefit from an assignment of the claim and there was no evidence that the creditors would suffer unfair harm by the administrators declining to assign the claim.
3. The applicable legal principles included the following:

a. officeholders are under a positive duty not to assign a cause of action that is without merit;

b. the court should not direct the assignment of a claim which is frivolous or vexatious, which includes a claim with no real prospect of success;

c. the applicant bears the burden of proving that the claim does have prospects of success; and

d. where the proposed assignee of the cause of action is unlikely to be able to meet an adverse costs order made against it, the court will need to be satisfied that there are clear and certain benefits for the creditors.

LF2 appealed against this decision, on the basis that the claim was not frivolous or vexatious. The appeal was dismissed by Morgan J. Although he agreed that, on the available evidence, it was not possible to say whether the alleged claim was frivolous or vexatious, for the claim to succeed it would need to have been shown that there was evidence of unfair harm to Pennyfeathers' creditors and LF2 had not appealed on this ground.

In dismissing the appeal, Morgan J took the opportunity to consider the approach administrators should take when considering whether to assign a claim to a third party. Morgan J disagreed with the proposition that when it is not clear whether the cause of action has merit, the administrator ought not to assign it and should instead place a burden on the party seeking the assignment to demonstrate that the claim is not frivolous or vexatious:

"The administrator's power to assign a cause of action is conferred by paragraph 2 of schedule 1 to the 1986 Act, as a cause of action is "property" within that paragraph. That paragraph is not limited by any words which require the administrator to satisfy himself as to the arguability of an alleged cause of action.

A viable claim by the company against a third party is an asset of the company. A claim which is arguably viable, is a potential asset of the company. In principle, an administrator ought to be ready to investigate whether such an asset should be preserved and pursued [...]

If the administrator has no funds to investigate a possible claim against a third party and he receives an offer from a potential assignee of the claim to pay for an assignment, that offer will potentially constitute an asset of the company. The administrator should normally wish to preserve and pursue that asset. If it is clear to the administrator that the claim would be hopeless and that the potential assignee is bent on pursuing a hopeless claim in order to harass the third party, then the administrator should normally decline to assign the hopeless claim. The administrator is an officer of the court and the court expects him to behave honestly and fairly [...]

But there will be other cases. One such case is where the administrator does not have a clear view that the proposed claim would be vexatious and he is offered a sum of money for the assignment of the claim. In such a case, the administrator should be prepared to obtain a proper payment for the assignment. If it is not clear that the offer reflects the true value of the cause of action, then the administrator may well be advised to conduct some process of inviting rival bids or to hold an auction of the cause of action. The receipt of a sum of money for the claim would be likely to benefit someone, whether it is the administrator (as a contribution to his expenses) or the creditors."[2]

Morgan J noted that the administrators had focussed their submissions on protecting a third party from the possibility of being harassed by unmeritorious litigation rather than – as they should have – on the administrators

2. See paragraphs 64-67.

3. See paragraph 69.

realising assets of the company for the benefit of creditors.[3] The Court's rules and procedures will protect third parties from being harassed by unmeritorious litigation. Defendants have the ability to apply to strike out or seek summary judgment in respect of frivolous or vexatious claims. Defendants can also protect themselves against the prospect of being unable to enforce an adverse costs award made against an impecunious Claimant by seeking security for costs.

How can administrators obtain a 'proper price' for causes of action?

One issue facing administrators will be the question of how to discharge their obligation to obtain a 'proper price' for the assignment of a cause of action. It is incredibly difficult to place a value on litigation – particularly at an early stage in the proceedings – due to the uncertainties associated both with measuring the prospects of proving primarily liability and also in calculating the quantum of recoverable sums.

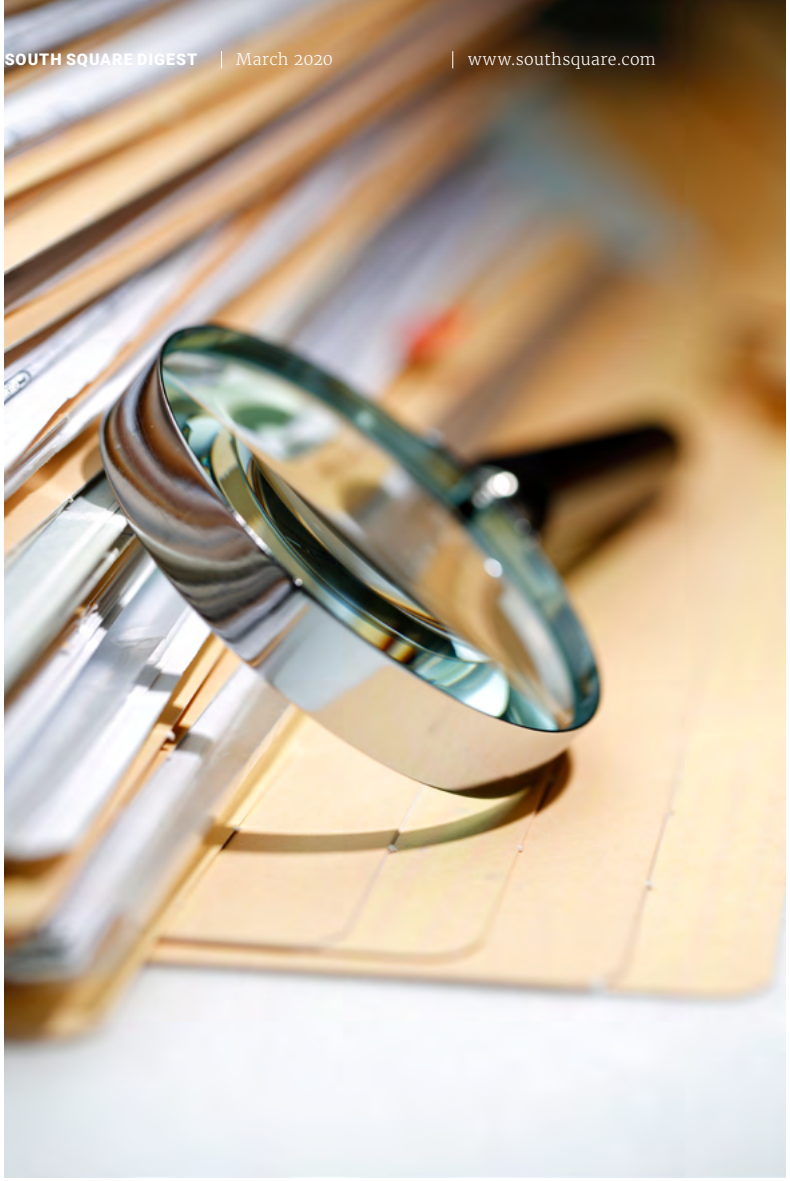
Valuing litigation claims is something that experienced lawyers find difficult – let alone insolvency practitioners. However, a lack of expertise does not excuse or discharge administrators' obligations. The recent decision in *Brewer v Iqbal*, although not a case in the context of assigning causes of action, is a helpful reminder that the Courts will not look kindly on administrators that fail to take specialist advice in order to obtain a proper price for a company's assets.

Brewer v Iqbal

In *Brewer v Iqbal*, Mr Iqbal was the former administrator of a company called ARY Digital UK Limited – a specialist broadcaster of Asian satellite television channels. Following his appointment in 2011, Mr Iqbal sought to sell the assets of the company rather than trade out of administration. The company's key assets were 'Electronic Programming Guides' (EPGs). The EPGs were licensed from British Sky Broadcasting (BSB) and, in essence, facilitated the broadcasting of content on certain digital channels.

After Mr Iqbal's appointment as administrator, the company continued to lose money. In particular, its debts owed to BSB were increasing and the directors of the company informed Mr Iqbal that BSB would *"switch off the signal within a week, as the Company had not been paying its fees"*. Mr Iqbal's view at the time was that if there was a "switch off" the EPGs, the main asset of the company, would be rendered worthless.

Mr Iqbal was advised by the company's accountant that the EPGs were worth approximately £10,000 and a director and shareholder of the company offered to purchase them for £35,000. Mr Iqbal instructed a third party to advertise the EPGs for sale for at least



£35,000. However, the EPGs were advertised on a website that was unlikely to attract potential purchasers of EPGs and the advertisement failed to refer to the EPGs themselves or provide significant detail about the EPGs. Mr Iqbal instructed the third party to remove the EPGs from sale three days later due to pressure from the company's management to sell the EPGs to them.

The EPGs were sold to the company's management for £40,000. After the sale, Mr Iqbal produced a report to creditors outlining his proposals for the administration. The creditors failed to approve his proposals, the Company entered insolvent liquidation and Mr Iqbal was discharged. The Claimants were appointed as joint liquidators and issued an application pursuant to paragraph 75(6) of Schedule B1 to the Insolvency Act 1986 to examine the conduct of Mr Iqbal.

The application was heard by Chief ICC Judge Briggs who held that Mr Iqbal had breached his duty of care to the company. The judge summarised that Mr Iqbal breached his duty of care by failing to exercise reasonable skill and care in that *inter alia* he:

- Failed to take specialist advice from a person in the EPG industry;
- Failed to obtain a proper valuation of the EPGs prior to sale;
- Failed to advertise in publications or websites likely to attract purchasers of EPGs;
- Failed to expose the assets to a proper market for a reasonable period of time; and placed too much reliance on the directors for: (i) a value for the EPGs; (ii) approval of advertising the EPGs on an inappropriate website; and (iii) dictating the timing of the sale of the EPGs.

How to avoid the same mistakes when assigning a cause of action

A few key (low cost) steps can help to avoid the same mistakes:

1. Obtain specialist advice: As much as it can be difficult to value litigation, solicitors and barristers can advise on the prospects of success and expert advice (e.g. from accountants) can also be sought on quantum.
2. Test the market: Directly approach a number of litigation funders or buyers. There are also an increasing number of specialist brokers who can test the market and solicit bids from third parties specialising in the assignment, funding or after the event insurance of claims. The process often includes assessing cases where there is limited information (which assists in obtaining comfort on point 1 above).
3. Consider deferring consideration: Consideration for an assignment may be paid in the form of a 'lump sum' upfront premium – but can also be deferred and structured in the form of a share of the proceeds. Taking a share of the proceeds can guard against the risk of missing out on the upside of a successful outcome. It is often possible to request a right of first refusal if the claim ultimately isn't pursued by the purchaser.

Conclusion

If an administrator is deciding what to do with a claim, in order to protect themselves from criticism they should consider claims as an asset unless it is clearly *"...a hopeless claim [used] in order to harass the third party..."* .[4] In considering this, administrators are reminded they are officers of the Court but the Court's rules and procedures are there to protect third parties from being harassed.

If there is doubt in the administrators' mind about merits and value of a claim they should obtain independent advice from solicitors and also test the market in the manner outlined above. Ultimately, the administrators should bear in mind that: *"...The receipt of a sum of money for the claim would be likely to benefit someone..."*[5] Whatever decision is reached, it will be important to document how that decision was reached to protect against the risk of future challenge. ■

4. See LF2 Ltd v Supperstone at paragraph 66.

5. See LF2 Ltd v Supperstone at paragraph 67.