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Liquidators' duties and statutory misfeasance applications
Top Brands Ltd v Sharma
[2015] 1 B.C.L.C. 546

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Introduction

The victim of a VAT carousel fraud is usually HMRC although, in *Bilta (UK) Ltd v Nazir (No.2)* [2015] 2 W.L.R. 1168, it was argued that the company which was used to carry out the fraud was also a victim. In *Top Brands* the liquidator of the fraudulent company was added to the list of potential victims. The central issue was whether the defendant liquidator's payment out of £550k that had been fraudulently claimed had been a breach of duty in the context of an application by the claimant TBL, a creditor of the insolvent fraudulent company MML, under s.212 of the Insolvency Act 1986 (the 1986 Act) to restore that sum. Further issues were whether S, if negligent, had caused MML loss, what the discretionary relief under s.212 of the 1986 Act should be, whether relief should be granted to S under s.1157 of the Companies Act 2006 (the 2006 Act) and whether the claim for relief was barred by an illegality defence.

Facts

The applicant TBL was a creditor of MML, a company in creditors' voluntary liquidation whose business had been the bulk buying and selling of confectionary and toiletries. The real business conducted through MML, however, was VAT fraud. The defendant S, a licensed insolvency practitioner and described by the judge as "no newcomer to insolvency", had been appointed liquidator over MML. At the trial of the s.212 application the new liquidator had identified "acquisition" fraud, straightforward under-accounting for VAT to HMRC by MML, but was investigating whether the fraud was a more sophisticated missing trader intra-community or carousel fraud involving TBL itself and a related company SERT. S faced the misfeasance application because, while she had been liquidator, she had not been alive to any aspect of the fraudulent trading and because she appeared to have been the victim of a separate fraud when deceived into paying out the £550k. The £550k had been paid into MML's account prior to the liquidation by SERT, a customer, who claimed it was for goods which had not been supplied.

S's defence was that she believed, as a result of legal advice, that the sum was subject to a *Quistclose* trust (*Barclays Bank Ltd v Quistclose Investments Ltd* [1970] A.C. 567) in favour of SERT and that the actual transferees were nominees of SERT and that she had been entitled to rely on that legal advice.

The law

A liquidator's core duties are, subject to preferential creditors, to apply the company's property to satisfy unsecured liabilities rateably by gathering in and realising the non-monetary assets, aggregating the proceeds with monetary assets, ascertaining the liabilities and distributing the available moneys on an equal basis (s.107 of the 1986 Act).

Section 212 of the 1986 Act ("Summary remedy against delinquent directors, liquidators, etc.") is a procedural provision that gives the court power to compel a liquidator who has been guilty of any misfeasance or breach of any fiduciary or other duty in relation to the company in connection with carrying out their functions as liquidator to repay or contribute to the company's assets by way of compensation as the court thinks just. A liquidator owes a duty of care in the performance of his duties to the standard of a reasonably skilled and careful insolvency practitioner (*Re Charnley Davies Ltd (No.2)* [1990] B.C.L.C. 760, Millet J at 775). A high standard of care and diligence was required bearing in mind that a liquidator was entitled to take legal advice or to submit the matter to the court for guidance in every case of serious doubt or difficulty. A liquidator who exercised powers in good faith after taking proper advice would not be open to challenge but they would not have taken proper advice where the instructions to the adviser were flawed (partial or incorrect) because they had failed to identify relevant considerations or failed to use all proper care and diligence in obtaining information relevant to the instructions given or advice obtained.

A liquidator, whose task was to gather in the money and property of a company and to distribute it, owed all the hallmark duties of a fiduciary identified in *Bristol & West Building Society v Mothew* [1996] 4 All. 698, namely to act in good faith, not to make a secret profit out of dealings with the company's property and money, not to act out of self interest in the performance of their duties and not to earn unapproved reward.

The decision

The judge found that S had conducted the liquidation with a lack of thought and purpose tantamount to indifference as to ascertaining MML's true obligations. He said at [35] that the starting point for a liquidator should be one of neutrality, neither trusting nor distrusting directors and third parties but forming a judgment based on information available, information coming to hand, information gathered upon making careful and diligent inquiries and where appropriate, information obtained by probing further or using statutory powers. At [144] he characterised her approach as a conscious disclaimer or disregard of responsibility for the assets in her charge on a material scale which amounted to a breach of fiduciary duty. In relation to S's pre-liquidation dealings with MML, the judge found that any competent insolvency practitioner expecting to take on the role of liquidator would have realised that the information provided was unquestionably inadequate and very probably unreliable so that S's own deficiency statement was fundamentally flawed and meaningless and revealed a troubling lack of insight into and competence in the assessment of insolvency. She had failed to obtain MML's bank statements or engage with HMRC.

The judge also found that the instructions which S had provided to her solicitor had been materially inaccurate so that the advice that the sum could be refunded subject to an indemnity to protect against future claims by creditors was based on that inaccurate information. S had been advised by her solicitor to check the terms on which the sum was paid to MML and that it was for the customer to prove its case. Her failure to check MML's records which showed that payments were generally made for goods delivered rather than made in advance of delivery meant that she was duped by an impostor claiming to represent the customer. She also made the payment out in 16 separate transfers to overseas accounts of purported nominees of SERT.

In a rather bizarre nautical metaphor the judge, at [153], described S as at the helm of a vessel holed below the waterline; she had several times radioed the coastguard for directions to the nearest harbour but had not checked and had repeatedly misstated her position and her bearing, in consequence the course given was a course further out to sea. She was unaware of the state of the vessel because she had not looked below deck or noticed that it had an ever decreasing freeboard; rather, she continued to rely on the assurance of an owner, who had taken to a lifeboat, that the vessel was seaworthy.

In relation to the case that she had breached her fiduciary duty, he found that she had not acted for an improper purpose in the sense of denial or betrayal of a duty owed as a fiduciary. However, she conducted the liquidation with a lack of thought and purpose tantamount indifference as to ascertaining MML's true position that could be characterised as a conscious disclaimer or disregard of responsibility for the assets in her charge which crossed the border into the territory of breach of fiduciary duty.

Having found that S was in breach of duty he rejected her causation argument. She argued that she had been the victim of a sophisticated fraud committed by fraudsters in control of MML and SERT and, but for that fraud, the sum would not have been paid out. The judge disagreed and found that the loss was caused by S's conduct; had she acted competently her solicitor would have been differently instructed and was unlikely to have advised that the payment out could be made.

In relation to the relief under s.212 of the 1986 Act, the judge held that the purpose of the discretion was to enable the court to make an order which was just in all the circumstances, taking into account the consequences of ordering S to repay the sum of £550k to MML. In *West Mercia Safetywear Ltd (in liquidation) v Dodd* [1988] B.C.L.C. 250 the Court of Appeal held that the consequential circumstances that might be taken into account included a windfall to third parties, money going round in circles or money passing through the hands of someone who was tainted. He noted that HMRC, an unconnected third party creditor, was owed a very substantial sum. S again relied on the fraud which caused her to make the payment out, but the judge found that she had no one else but herself to blame so that the relief would not be limited. He also refused to grant relief under s.1157 of the 2006 Act because S could not demonstrate that she had acted reasonably in the conduct of the liquidation.

S's last argument was that the claim was barred for illegality, the illegality being the VAT fraud perpetrated by its directing mind and will and the fraud on the liquidator causing the sum to be paid out. In response the applicant argued that the court should adopt a nuanced approach to the issue of whether the fraudulent purpose of directors should be attributed to the company taking account of the circumstances and nature of the claim. The judge concluded at [204] that the illegality defence did not assist S because Parliament had provided a statutory procedure by which a creditor could claim against a liquidator for misfeasance and that as the illegality was peripheral to that remedy the illegality defence simply did not arise.

Conclusion

The circumstances of the case were extreme, a combination of a negligent liquidator and fraudulent directors resulted in payments out from the company's frozen assets of sums to a variety of nominees' overseas accounts. The case does however usefully clarify the liquidator's common law and statutory duties and illustrate the effectiveness of s.212 of the 1986 Act as a tool to uphold those duties. The liquidator's plea that an order to repay the sum would ruin her did not find favour with the judge.