FRAUDULENT TRADING, DISCLOSURE AND ASSET TRACING.

By Susan Brown.

Introduction

1. Corporate fraud is on the increase and regulators are increasingly turning more of their attention to major frauds carried out under the disguise of respectable company names. The successful Libor prosecutions which imposed heavy sentences, huge fines for misselling by banks are just some examples of this in the current regulatory environment. Often fraud in the corporate environment is only uncovered on the insolvency of a company, and it is in this context that this paper seeks to remind us all of the provisions available to office holders as contained in section 213 of the Insolvency Act 1986 and section 246ZA inserted into the Insolvency Act 1986 by the Small Business Enterprise and Employment Act 2015 ("SBEE 2015").

2. Further there has recent attention been paid to the powers under section 236 of the Insolvency Act 1986 ("section 236") in relation to disclosure, and this paper aims to remind insolvency practitioners of the legal background behind the proper use of the powers under section 236.

3. Finally I review the recent case law relating to asset tracing. The following sections detail the legislative framework as well as reviewing case law.

FRAUDULENT TRADING

THE LEGISLATIVE FRAMEWORK

4. **Fraudulent Trading**

As practitioners will already know the insolvency legislation deals with fraudulent trading under section 213 of the Insolvency Act 1986. Let us remind ourselves of its provisions. Section 213 of the Insolvency Act 1986 states as follows –

"213 Fraudulent trading.

(1) If in the course of the winding up of a company it appears that any business of the company has been carried on with intent to defraud creditors of the company or creditors of any other person, or for any fraudulent purpose, the following has effect.

(2) The court, on the application of the liquidator may declare that any persons who were knowingly parties to the carrying on of the business in the manner above-mentioned are to be liable to make such contributions (if any) to the company's assets as the court thinks proper".

5. Historically the Companies Acts had for a long time contained provisions dealing with fraudulent trading. For example, in the previous Companies Act 1985 section 458 made it a criminal offence and by section 630 of the same Act a ground for imposing personal liability. Section 630 of the Companies Act 1985 was replaced by section 213 of the Insolvency Act 1986. Section 1295 Schedule 10 repealed section 458 above as from 1st October 2007 and the section was replaced by Section 993 of the Companies Act 2006 which states -

"993 Offence of fraudulent trading

(1) If any business of a company is carried on with intent to defraud creditors of the company or creditors of any other person, or for any fraudulent purpose, every person who is knowingly a party to the carrying on of the business in that manner commits an offence.

(2) This applies whether or not the company has been, or is in the course of being, wound up.

(3) A person guilty of an offence under this section is liable—

(a) on conviction on indictment, to imprisonment for a term not exceeding ten years or a fine (or both);

(b) on summary conviction—

(i) in England and Wales, to imprisonment for a term not exceeding twelve months or a fine not exceeding the statutory maximum (or both);

(ii) in Scotland or Northern Ireland, to imprisonment for a term not exceeding six months or a fine not exceeding the statutory maximum (or both)".

6. Contravention of section 993 of the Companies Act 1986 now has a maximum term of imprisonment of 10 years as a result of the amendment from 7 years caused by the Fraud Act 2006. Further its scope was also extended to include being a party to the fraudulent carrying on of a business by a sole trader or other person who is outside the reach of section 993(9) CA 2006.

7. Originally both the criminal and civil sanctions could be invoked only on a winding up, but the criminal provision, which is now contained in section 993 of the Companies Act 2006 above, has applied to the offence without limitation (see subsection 2 above). Further the section has been applied with modification to limited liability partnerships, unregistered companies, and charitable incorporated organisations by virtue of secondary legislation.

8. From 1st October 2015 the Small Business Enterprise and Employment Act 2015 has, under section 117 of that Act, extended the power under section 213 to Administrators. Section 117 states as follows –

"117 **Power for administrator to bring claim for fraudulent or wrongful trading**

(1) The Insolvency Act 1986 is amended as follows.

(2) After section 246 insert—

"Administration: penalisation of directors etc

246ZA Fraudulent trading: administration

(1) If while a company is in administration it appears that any business of the company has been carried on with intent to defraud creditors of the company or creditors of any other person, or for any fraudulent purpose, the following has effect.

(2) The court, on the application of the administrator, may declare that any persons who were knowingly parties to the carrying on of the business in the manner mentioned in subsection (1) are to be liable to make such contributions (if any) to the company's assets as the court thinks proper."

9. It inserts a new section 246Z into the Insolvency Act 1986 which came into force on 1st October 2015 (just over a year ago) under the second commencement regulations made under the SBEE 2015. It will be interesting to see how the courts will apply this additional extension of the traditional powers in the context of an administration. A claim during a company's administration may only be made under the new section 246ZA for fraudulent trading if the

company entered into administration on or after 1st October 2015. Prior to that date, a claim for fraudulent trading can be brought by a liquidator under section 213 of the Insolvency Act 1986.

10. However the new section has two changes from the former law. First that it is only the liquidator or the administrator who has standing to apply for relief. Prior to the new section, an individual creditor or contributory could also apply, but this was thought undesirable because it might encourage a creditor to put improper pressure upon a director to settle his claim personally Second the new wording means that any sums ordered to be paid by the court under this section must go into the general pot of assets held by the liquidator or administrator for the general body of creditors whereas previously the court had power to order that the sums be paid to a particular creditors (See Sealy and Milman 19th Edition page 225).

11. The cause of action under both sections 246ZA and section 213 above arises on the day that the company is either placed into administration or a winding up order is made, and the six-year limitation period for bringing a claim begins to run on that day. See Overnight Limited [2009] EWHC 601 (Ch.). The reasoning behind this is the fact that only a liquidator or an administrator is authorised to bring the claim. However, the acts which were part of the fraud may have taken place before the liquidator or administrator was appointed. It is only their appointment which completes the cause of action to found a claim.

12. Claims under section 213 of the Insolvency Act 1986 and the new section 246ZA of the Insolvency Act 1986 are not limited to claims against directors of the company in liquidation or administration but may be applied to **any person** who was knowingly a party to carrying on business with the intent to defraud creditors making the sections of very wide scope. It has been previously established that an employee of a company who does not exercise a managerial or controlling function in the business and does not actively run the company cannot be liable for fraudulent trading (See R v Miles [1992] Crim L.R. 657). In Morris v Banque Arabe Internationale d'Investissement SA (No.2.) [2002] B.C.C. 407 the court held that a company which carries on a bona fide business with a fraudulent company does not fall within section 213, but a company which is involved in, and assists and benefits from, that fraudulent business and does so knowingly, does, or at least can, fall within the scope of section 213. The court does have power to apportion liability jointly and severally but in Overnight Limited (In Liquidation) Re [2010] EWHC 613 (Ch.) decided on the fact to apportion by reference to the degree of control that each person had over the company's dealings and the benefit (if any) that each person gained as a result of the fraudulent trading.

13. **What qualifies as fraudulent purpose then?**

There must be actual dishonesty involving real moral blame (Re Patrick and Lyon Limited [1933] Ch. 786) continuing to trade whilst the company is insolvent is not enough. It is wide enough to include frauds against potential creditors (See R v Kemp [1988] QB 645), and fraudulent evasion of VAT. The legislative reforms which led to the enactment of the Insolvency Act 1986 left the burden of proof for fraudulent trading largely intact. The liquidator (and presumably now the Administrator) must plead and prove dishonesty and on the pleadings there must be clear evidence of dishonesty to succeed in a plea of fraud. The onus to prove fraud in section 213 proceedings lies on the liquidator and presumably also now on the Administrator.

14. Dishonesty can be inferred where the company carried on deliberately incurring debts which would never be settled or for which there was no intention to settle or where directors made deliberately misleading statements about their actions or intentions or took active steps to avoid paying debts. In Manifest Shipping Co Limited v Uni Polaris Insurance Co Limited (The Star Sea) [2001] UKHL 1 Lord Scott of Foscote held that turning a blind eye "blind eye" knowledge was sufficient to found a claim of fraud. He said:

> "In summary, blind-eye knowledge requires, in my opinion, a suspicion that the relevant facts do exist and a deliberate decision to avoid confirming that they exist. But a warning should be sounded. Suspicion is a word that can be used to describe a state-of-mind that may, at one extreme, be no more than a vague feeling of unease and, at the other extreme, reflect a firm belief in the existence of the relevant facts. In my opinion, in order for there to be blind-eye knowledge, the suspicion must be firmly grounded and targeted on specific facts. The deliberate decision must be a decision to avoid obtaining confirmation of facts in whose existence the individual has good reason to believe. To allow blind-eye knowledge to be constituted by a decision not to enquire into an untargeted or speculative suspicion would be to allow negligence, albeit gross, to be the basis of a finding of privity".

15. In the case of Christopher Morris v Bank of India [2005] EWCA Civ 693; [2005] B.C.C. 739 there was an allegation by Mr Morris as liquidator of Bank of Credit and Commerce SA ("BCCI") that the bank had knowingly participated in the fraudulent trading of BCCI. The Court of Appeal held that a senior manager of the bank had blind eye knowledge that some of the banks transaction were fraudulent. The court stated referring to section 213 of the Insolvency Act 1986 that:

> “There was no dispute about the relevant alleged knowledge in question being "blind-eye" knowledge. It was further agreed that the elements of what was required for this type of knowledge were accurately described in the speech of Lord Scott of Foscote in *Manifest Shipping Company Limited - v - Uni-Polaris Company Limited* [2003] 1 AC 469 at para. 116, which was quoted by Patten J, at para. 13 of the judgment in this case:
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> "In summary, blind-eye knowledge requires, in my opinion, a suspicion that the relevant facts do exist and a deliberate decision to avoid confirming that they exist. But a warning should be sounded. Suspicion is a word that can be used to describe a state-of-mind that may, at one extreme, be no more than a vague feeling of unease and, at the other extreme, reflect a firm belief in the existence of the relevant facts. In my opinion, in order for there to be blind-eye knowledge, the suspicion must be firmly grounded and targeted on specific facts. The deliberate decision must be a decision to avoid obtaining confirmation of facts in whose existence the individual has good reason to believe. To allow blind-eye knowledge to be constituted by a decision not to enquire into an untargeted or speculative suspicion would be to allow negligence, albeit gross, to be the basis of a finding of privity."

The Judge held that:

> "Dishonesty as such is not in terms a condition of liability under s.213. But if knowledge of the fraud in either of the senses indicated above is established, Mr. Hirst [Counsel then appearing for Bank of India] accepts that it must follow that Bank of India was dishonest."

16. The Court of Appeal further held that whether the knowledge of an employee was attributed to the defendant will depend on the facts of the case, and it was not necessary to show that any members of the board of the Bank of India had knowledge of the fraud. The Bank had been fixed with the knowledge of the employee, and it was irrelevant to the attribution of knowledge to the employer that the employee had acted dishonestly and in breach of his duty to his employer. But see now the passages below of Lord Sumption in Bilta on whether there will be attribution to the company in circumstances where the fraud was committed by an employee or company director.

What constitutes carrying on of business under section 213 of the Insolvency Act 1986?

17. In Carman v Cronos Group SA [2005] EWHC 2403(Ch.) [2006] B.C.C. 451 the court held that a company cannot be regarded as carrying on business for the purposes of section 213 after the date on which a winding up petition has been presented against it. As the section 246ZA is so new it has yet to be tested whether this will be the case in an administration where a company continues to trade. Some writers state that the point may not arise as an administration does not relate back to the administration application.

18. In Morphitis v Bernasconi [2002] EWCA Civ 289 the liquidator alleged that the trading became fraudulent by reason of lies to the creditor as to intention to pay rent and comply with obligations. Though the liquidator's claim referred to the tactic of seeking time to pay or the rescheduling of payments as a tactic designed to ensure that the creditor would not commence proceedings or the presentation of a winding up petition during the 12 month period, the deception was that the company intended to deceive the creditor into believing that it would be paid sums due under the leases or as rescheduled when it was known or intended that no monies would be paid after 23 December 1993. It was not understood that the liquidator sought to allege that the tactic of avoiding proceedings or a petition of itself was fraudulent trading. The Court of Appeal held that although a business may be found to have been carried on with intent to defraud creditors even if only one creditor is shown to have been defrauded that would be enough to establish liability under section 213 of the Insolvency Act 1986. In Morphitis the plea under section 213 IA 1986 was held not to have been made out. Lord Justice Chadwick said:

"A business may be found to have been carried on with intent to defraud creditors notwithstanding that only one creditor is shown to have been defrauded, and by a single transaction. The *Cooper Chemicals* case is an example of such a case. But, if (which I doubt) Mr Justice Templeman intended to suggest that, whenever a fraud on a creditor is perpetrated in the course of carrying on business, it must necessarily follow that the business is being carried on with intent to defraud creditors, I think he went too far. It is important to keep in mind that the pre-condition for the exercise of the court's powers under section 332(1) of the 1948 Act - as under section 213 of the 1986 Act – is that it should appear to the court "that any business of the company has been carried on with intent to defraud creditors of the company". Parliament did not provide that the powers under those sections might be exercisable whenever it appeared to the court "that any creditor of the company has been defrauded in the course of carrying on the business of the

company." And, to my mind, there are good reasons why it did not enact the sections in those terms".

19. A business may be regarded as being carried on despite the fact that the company has ceased active trading (see Sarflax Limited Re [1979] Ch. 592). For practical purposes all forms of fraudulent trading will be covered by wrongful trading with its less onerous standard of proof and the consequences will be the same. However, the section still has a role to play where allegations of fraudulent trading are made against other parties which is amply demonstrated by the series of cases brought by Christopher Morris against the Bank of India (see below).

Can the illegal actions of a company director be attributed to the company itself, and when directors of a company involve it in a fraudulent transaction is the company barred by the doctrine of illegality from suing them and their accessories for losses cause by their breach of duty?

20. The Supreme Court who gave judgement in J Bilta (UK) Limited (In Liquidation) and others v Nazir and others (No. 2) [2016] A.C.1. The facts were that the first and second defendants were the sole directors of the first claimant, a company incorporated in England and registered for the purposes of VAT. The company purchased carbon credits on the Danish Emissions Trading Agency from Traders carrying on business outside the United Kingdom, including a sixth Defendant, a company incorporated in Switzerland the sole director of which was the seventh defendant. Accordingly, the purchases were zero rated for VAT. The first and second defendants as directors owed fiduciary duties to the company under sections 172 and section 239 of the Companies Act 2006. The sixth and third claimants, the company's liquidators, claimed a conspiracy existed to injure and defraud the company by trading carbon credits and dealing with the resulting proceeds in such a way as to deprive the company of its ability to meet its VAT obligations on such trades. It was claimed that the defendants were knowingly parties to the business of the company with intent to defraud creditors and for other fraudulent purposes and should therefore be ordered under section 213 of the Insolvency Act 1986 to contribute to the company's assets. The sixth and seventh defendants who were claimed to have dishonestly assisted the conspiracy, applied for orders that the claim be summarily dismissed as against each of them on the grounds , among others, that (1) the claim by the company was precluded by the application of the maxim ex turpi causa no oritur actio (which means "No court will lend its aid to a man who founds his cause of action on an immoral or illegal act" i.e. the defence of illegality) on the basis that the pleaded conspiracy disclosed the use

of the company by its directors and their associates to carry out carousel fraud, the only victim of which was the Revenue and Customs Commissioners, and since the company was a party to the fraud it could not claim against the other conspirators for losses which it had suffered as a result of the fraud which it had carried out, and (2) the liquidators claim for fraudulent trading under section 213 of the 1986 Act was bound to fail because the section had no extraterritorial effect.

21. The most succinct authorative statement of the law on the defence of illegality was set out in Holman v Johnson 1 Cowp 341,343:

"No court will lend its aid to a man who founds his cause of action on an immoral illegal act. If, from the plaintiff's own stating or otherwise, the cause of action appears to arise ex turpi causa, or the transgression of a positive law of this country, there the court says that he has no right to assisted. It is on the ground the court goes; not for the sake of the defendant, but because they will not lend their aid to such a plaintiff. So if the plaintiff and defendant were to change sides, and the defendant was to bring his action against the plaintiff, the latter would then have the advantage of it; for where both are equally in fault, potior est conditio defendentis".

22. Thus stated, the law of illegality is a vindication of the public interest as against the legal rights of the parties. It is a defence arising out of public interest. The policy is one of judicial abstention, by which the judicial power of the state is withheld where its exercise in accordance with ordinary rules of private law would give effect to advantages derived from an illegal act (see Lord Sumption's speech in Bilta above). The question which applied in Bilta was whether the dishonesty which engages the illegality defence is to be attributed to Bilta for the specific purpose of defeating its claim against directors and their alleged coconspirators.

23. Lord Sumption determined that in principle the illegality defence applies to companies as it applies to natural persons stating –

"This is the combined effect of the company's legal personality and of the attribution to companies of the state of mind of those agents who for relevant purpose can be said to think for it. But the principles can only apply in modified form, for they are complex associations of natural persons with different interests, different legal relationships with the company and different degrees of involvement in it affairs. A natural person and his agent are autonomous in fact as well as in law. A company is autonomous in law but not in fact. Its decisions are determined by human agents, who may use that power for unlawful purposes. The question what persons are to be so far identified with a

company that their state of mind will be attributed to it does not admit of a single answer. The leading modern case is Meridian Global Funds Management Asia Limited v Securities Commission [1995] 2 AC 500. The primary rule of attribution is that a company must necessarily have attributed to it the state of mind of its directing organ under its constitution, i.e. board of directors acting as such or for some purposes the general body of shareholders.

24. The exception to the attribution is where the fraud is practiced by an agent even if it is being practiced by a person whose acts and state of mind would be attributable to it in other contexts. Thus it has been rejected by the courts that a company could be treated as knowing about a director's breach of duty or fraud by virtue only of the knowledge of the defaulting director himself. (See JC Houghton and Co v Nothard Lowe and Wills [1928] AC1).

25. In Bilta the action was brought to recover compensation for breach of duties which the directors owed to the company. They were alleged to have broken those duties by causing it to conduct its business in a manner calculated to prevent it from meeting its obligation to account to HMRC for VAT. The court stated that –

> "In particular, they are alleged to have caused the proceeds of sales to UK purchasers, together with the Vat charged on them, to be paid out to Jetivia. Those proceeds were either property of Bilta (in those cases where they reached Bilta's accounts) or were owed to Bilta (in those cases where they were paid by the UK purchasers directly Jetivia). In either case, they represented assets of Bilta. Since the issue thus stated arises directly between the company and its directors, the fraud exception applies and the illegality defence cannot lie. Whether the payment out to Jetivia of funds which may represent the fruits of the fraud is truly a loss may well be a difficult question, but it is a different question which will have to be examined in the light of all of the facts at a trial. It does not affect the application of the fraud exception."

Does section 213 of the Insolvency Act 1986 have ex territorial effect?

26. In Bilta above Lord Sumption stated that an argument that "any persons" means only persons in the United Kingdom is misconceived. Lord Sumption held as follows –

> "The English Court, when winding up an English company, claims worldwide jurisdiction over its assets and their proper distribution. That distribution is not universally recognized but it is recognized with the European Union by articles 3 and 16 of Council Regulation (EC) No.

1346/2000. In Schmit v Hertel (Case C – 328/12) [2104] 1 WLR 633 the Court of Justice of the European Union considered these articles in the context of the jurisdiction of the German Courts to make orders setting aside transactions with a bankrupt. It held not only that articles 3 and 16 applied to such orders, but that member states must be treated as having power to make them notwithstanding any limitations under its domestic law on the territorial application of its courts orders".

27. The Supreme Court held that section 213 of the Insolvency Act 1986 applied without territorial limitations. Lord Sumption's speech stated that the following considerations which applied in the case of Paramount Airways to section 238 of the Insolvency Act 1986 equally applied to section 213 and they were (1) that current patterns of cross border business weaken the presumption against extraterritorial effect as applied to the exercise of the court powers in conducting the liquidation of a United Kingdom company; (ii) that the absence in the statute of any test for what would constitute presence in the United Kingdom makes it unlikely that presence there was intended as a condition of the exercise of the power; and (iii) that the absence of a connection with the United Kingdom would be a factor in the exercise of the discretion to permit service out of the proceedings as well in the discretion whether to grant the relief, which was enough to prevent injustice.

The Order for a contribution.

28. In Morphitis v Bernasconi where the dishonesty was the representation that a further £10,000 would be paid off arrears of rent Lord Justice Chadwick held that the power under section 213(2) is to order that persons knowingly party to the carrying on of the company's business with intent to defraud make "such contributions (if any) to the company's assets" as the court thinks proper. He stated:

> "There must, as it seems to me, be some nexus between (i) the loss which has been caused to the company's creditors generally by the carrying on of the business in the manner which gives rise to the exercise of the power and (ii) the contribution which those knowingly party to the carrying on of the business in that manner should be ordered to make to the assets in which the company's creditors will share in the liquidation. An obvious case for contribution would be where the carrying on of the business with fraudulent intent had led to the misapplication, or misappropriation, of the company's assets. In such a case the appropriate order might be that those knowingly party to such misapplication or

misappropriation contribute an amount equal to the value of assets misapplied or misappropriated. Another obvious case would be where the carrying on of the business with fraudulent intent had led to claims against the company by those defrauded. In such a case the appropriate order might be that those knowingly party to the conduct which had given rise to those claims in the liquidation contribute an amount equal to the amount by which the existence of those claims would otherwise diminish the assets available for distribution to creditors generally; that is to say an amount equal to the amount which has to be applied out of the assets available for distribution to satisfy those claims. In the present case there is nothing to suggest either (i) that the deception which the judge found to have been practised on Ramac led to the misapplication or misappropriation of the company's assets, or (ii) that the letter of 12 November 1993 led Ramac to make a claim in the liquidation that it would not otherwise have had. In my view there was no material on which the judge could have reached the conclusion that it was correct to order contribution of £17,500, or any other sum"

29. The section does not include the power to include punitive as well as compensatory damages (See Morphitis v Bernasconi [2002] EWCA Civ 289). The punitive power was retained by virtue of section 993 of the Company's Act 2006. The court has power under section 215 of the Insolvency Act to make such further orders as may be necessary to give effect.

Can the right of action under section 213 of the Insolvency Act 1986 be assigned?

30. Under the previous law there was no power to assign the right to bring proceedings under section 213 and the fruits of those proceedings. However, this position has been reversed under the new section 246ZD of the SBEE 2015 which gives the power to the liquidator or administrator to assign a right of action under section 213 or 246ZA. Further the fruits of any action fall into the general assets held by the liquidator or administrator and are not caught by any floating charge (See the new section 176ZB(3)(a)). However the commercial incentive to take such an assignment must be limited if the fruits have then to be placed into the general pot of assets and the claimant not being entitled to any direct reward. Much will depend on the amount at stake and the benefit to be accrued by taking such an assignment by the assignee.

31. Finally there remains the power under the Directors Disqualification Act 1986 section 10 to make a disqualification order against a company director or shadow director. The maximum disqualification period is 15 years and it will depend on the severity of the contravention with any mitigating factors what

period the court chooses to impose. The Court once seized of the matter is able to make a disqualification order of its own motion.

DISCLOSURE

Disclosure and Section 236 of the Insolvency Act 1986.

32. As practitioners will already know this is one of the main weapons in an office holder's armory to deploy to obtain documents and knowledge to assist in the resolution of issues in an insolvency procedure. First the legislation which states:

"236 Inquiry into company's dealings, etc.

(1) This section applies as does section 234; and it also applies in the case of a company in respect of which a winding-up order has been made by the court in England and Wales as if references to the office-holder included the official receiver, whether or not he is the liquidator.

(2) The court may, on the application of the office-holder, summon to appear before it—

(a) any officer of the company,

(b) any person known or suspected to have in his possession any property of the company or supposed to be indebted to the company, or

(c) any person whom the court thinks capable of giving information concerning the promotion, formation, business, dealings, affairs or property of the company.

(3) The court may require any such person as is mentioned in subsection (2)(a) to (c) to submit [F1to the court] an account of his dealings with the company or to produce any books, papers or other records in his possession or under his control relating to the company or the matters mentioned in paragraph (c) of the subsection.

(3A) An account submitted to the court under subsection (3) must be contained in—

(a) a witness statement verified by a statement of truth (in England and Wales), and

(b) an affidavit (in Scotland).]

(4) The following applies in a case where—

(a) a person without reasonable excuse fails to appear before the court when he is summoned to do so under this section, or

(b) there are reasonable grounds for believing that a person has absconded, or is about to abscond, with a view to avoiding his appearance before the court under this section.

(5) The court may, for the purpose of bringing that person and anything in his possession before the court, cause a warrant to be issued to a constable or prescribed officer of the court—

(a) for the arrest of that person, and

(b) for the seizure of any books, papers, records, money or goods in that person's possession.

(6) The court 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 that person is brought before the court under the warrant or until such other time as the court may order".

33. The first point to note is that the section unlike its predecessor section 561 of the Companies Act 1985 is not confined in its scope to winding up but applies in other types of insolvency proceedings although not in a voluntary arrangement. As practitioners will be aware the examination is conducted in private and the court has an unfettered discretion. The major requirements are that it should be in the interests of the winding up and not be oppressive or unfair to the respondent. The office holder's views as to whether an examination is necessary are normally given a good deal of weight, and it is not a weapon to be used to give the office holder any special advantages. The fact that criminal charges have already been made is not an absolute bar to the making of an order (Re Arrows Limited (No.2) [1992] B.C.C 446). Where there are proceedings pending even if those of serious fraud and dishonesty the court will still consider whether to make an order for examination of the respondent where the need of the office holder for information to progress the winding up and get in the assets of the company outweighs any oppression which might be caused by ordering an examination before trial (See Daltel Europe Limited v Makki [2004] EWHC 726).

34. The privilege against self incrimination and its relationship with section 236 was well settled in the early 1990's with a series of cases involving directors or

former directors of insolvent companies including the Maxwell litigation and Saunders v United Kingdom [1997] B.C.C. 872 which held that the *use* in later criminal proceedings of statements obtained under compulsion was contrary to the European Convention on Human Rights. In practice the use of such statements is now banned by law and any objection on the ground of self incrimination is not likely to succeed as the danger of the statement being used in later criminal proceedings no longer exists. The privilege has been effectively abrogated by statue and the court may take this factor into account when exercising its discretion whether to order disclosure of documents and attendance for cross examination under section 236.

35. The information collected and disclosed under section 236 is confidential, but this confidentiality is not absolute and if the public interest requires disclosure say because the information collected reveals that a fraud has been committed then an office holder would be at liberty to pass the information on to the relevant prosecuting body. Before making such a disclosure the office holder would be wise to seek his own independent legal advice about whether it is arguable that disclosure of information obtained under compulsion is in the public interest or not.

36. In British Commonwealth Holdings plc (No.2) [1993] A.C. 426 the House of Lords held that a section 236 order could properly be made extending to all documents and information which the office holder reasonably requires to have to carry out his functions.

What if legal professional privilege is claimed in respect of the documents sought to be disclosed under section 236?

37. In Brook Martin and Co (Nominees) Limited [1993] B.C.L.C. the court held that no privilege attached to the documents of the company itself. In any event if there is evidence of fraud then it is likely that the public interest in disclosure would outweigh any claim of legal professional privilege. The prosecuting authorities such as the Serious Fraud Office have a procedure for dealing with privileged information in that all evidence collected by them in an investigation is screened by independent counsel before being released to the investigating teams. This procedure has received court approval despite objections from defendants, and is, on the whole, a fair way of dealing with the rights of potential defendants.

38. Interestingly the transcripts of an examination under section 236 attract legal professional privilege subject to the powers of the court to allow inspection thereof under Insolvency Rule 9.5(2).

Does Section 236 of the insolvency Act 1985 have extra territorial effect?

39. The most recent case under the section 236 was **Official Receiver v Norris [2015] EWHC 2697** where there was an application by the Official Receiver under section 236 of the Act as liquidator of a company (in winding up on public interest grounds) against a respondent, who was resident in Hong Kong. The application was to produce a witness statement, with supporting documents, detailing and exhibiting various business dealings affairs and property of the company. The issue for the court was whether section 236 had extra-territorial effect. Judge David Hodge set out the facts of the case briefly as follows –

> "The background to the present application can be shortly stated: The company, Omni Trustees Ltd, is the Trustee of an Occupational Pension Scheme known as the Henley Retirement Benefit Scheme. On or about 25th July 2014, at a time when the assets of the Henley Retirement Benefit Scheme held by the company amounted to some £8.6m sterling, a little over £3.7m sterling was transferred from the company to the Timoran Small Self-Administered Scheme located in Hong Kong. The transfer was effected by a firm of solicitors in Leeds, Metis Law LLP, acting on behalf of the company, apparently on the instructions of a Mr Karl Dunlop. The transferee, Timoran SSAS, apparently acted by Mr Tristram Michael Norriss. On the evidence, he would appear to be the principal, and possibly the sole, trustee of Timoran SSAS. The object of the present application is to find out what has happened to the sum of just over £3.7m that was so transferred to the Timoran SSAS".

40. The application first came before Judge Pelling on 17th June 2015. At that time there were questions as to the sufficiency of the service of the application upon Mr Norriss. Mr Norriss had written a letter to the court. The letter was placed before Judge Pelling. The letter from Mr Norriss described the application by the Official Receiver as "oppressive" and "unreasonable". The Official Receiver was said to have failed properly to serve Mr Norriss with the application and to have failed to give him proper or even reasonable – considering his residence in Hong Kong – notice of the hearing. Particulars of the failure to serve and to provide proper notice were given. Furthermore, the letter asserted that, in any event, Mr Norriss did not accept that the English court had jurisdiction to grant an order with such extra-territorial effect as the Official Receiver was then seeking. The application first came before Judge Pelling on 17th June 2015. At that time there were questions as to the sufficiency of the service of the application upon Mr Norriss. At that stage what was sought was not simply the production of a

witness statement, with supporting documents, addressing various identified matters but, in addition, that Mr Norriss, who had held himself out as being a trustee of the Timoran SSAS, should attend to be examined on oath at a place and time to be fixed by the court. The lack of jurisdiction to make an extra-territorial order was addressed in Mr Norriss's letter in these terms:

> *'In relation to jurisdiction I have been advised that the English court does not have the power to summon people from abroad to appear before it and that Section 236 Insolvency Act 1986 is not an exception to this rule and so I do not accept that the English court has the jurisdiction to grant the order sought. Even if it did have jurisdiction, which I do not accept, the terms of the order sought by your client appear to go well beyond the scope of what is seemingly permitted by Section 236.'*

41. Judge Pelling adjourned the hearing of the application and gave directions for service by email on Mr Norriss.

42. Eventually the requirement for a personal examination was dropped and the application was limited to the production of documents with a supporting witness statement. The court held as follows:

> "I am satisfied on the facts and evidence in the present case that, subject to the possible difficulty that Mr Norriss is resident and at present in Hong Kong, that it would be appropriate for the court to exercise its powers under Section 236 in relation to him in the manner sought by the Official Receiver in para. 3 of his Application Notice. I am satisfied that this is a case where the Official Receiver reasonably requires to see the documents he has identified in his Application Notice in order to carry out his statutory functions. I am also satisfied that production of the documents would not impose any unnecessary or unreasonable burden on Mr Norriss in the light of the Official Receiver's requirements. Indeed there is no suggestion in any of the letter or email exchanges I have seen coming from Mr Norriss that the production of the information sought would impose any unnecessary or unreasonable burden upon him. I am satisfied that the case is a proper one for the court to exercise its discretion to make an order in the terms sought if it has the necessary jurisdiction to do so. I am satisfied that the Official Receiver has discharged the onus of satisfying me that the relief sought comes within the powers conferred by Section 236 and that, as a matter of discretion, it is appropriate for the court to make the orders sought, provided, of course, that it has the necessary jurisdiction to do so. It is to that which I now turn".

43. To assist it in deciding the question of jurisdiction to make the order the court looked at the old decision of re Tucker (A Bankrupt) Ex. P. Tucker [1990] Ch. 148 where the person summoned for examination lived in Belgium. The trustee sought an order for his examination in Belgium under section 25(6) of the Bankruptcy Act 1914. In Tucker the Court of Appeal held that under section 25(1) of the Bankruptcy Act 1914 the court was only empowered to issue summonses against persons in England. As the examinee was resident in Belgium and not in England the court had no jurisdiction to issue the summonses against him. Lord Justice Dillon looked to see what Section 25(1) was about, and he saw that it was about summoning people to appear before an English court to be examined on oath and to produce documents. He noted that the general practice in international law was that the courts of a country only had power to summon before them persons who accepted service or were present within the territory of that country when served with the appropriate process. In other words, the thrust of the decision in *Re Tucker* is that the court will not compel someone to come to this jurisdiction to be examined on oath and to produce documents. The Court dismissed the trustee's application for examination in England. However in Norriss section 236 was under consideration not section 25 of the Bankruptcy Act 1914. The Judge held in Norriss that:

> "I am satisfied that Section 25 of the 1914 Act conferred a power on the court to order the production of documents which was merely ancillary to, and dependent upon, the principal power conferred by Section 25, which was to summon a respondent falling within the scope of the section to attend for examination before the court. In other words, the power to order the production of documents was ancillary to, and dependent upon, the power to summon an individual to attend for examination before the court. That is not the way in which Section 236 is structured. By subsection (2), the court may summon any of three categories of person to appear before it. By subsection (3), the court may require any such person to submit to the court an account of his dealings with the company, or to produce any books, papers or other records in his possession or under his control relating to the company or the matters mentioned in Section 236(2)(c). I am satisfied that Section 236 is structured differently to the former Section 25 of the Bankruptcy Act 1914, and that it confers a freestanding power, independent of the power to summon a person to appear before the court for examination, to submit to the court an account of dealings and to produce books, papers and records.....I decline to follow the decision of Mr Justice David Richards in the *MF Global (UK) Ltd* case. In my judgment, Section 236(3) of the 1986 Act does have extra-territorial effect; and provided the considerations identified by the House of Lords in the *British and Commonwealth* case are satisfied, the court does indeed have jurisdiction to require a person resident outside the jurisdiction to submit to the

court an account of his dealings with the company, or to produce any books, papers or other records in his possession or under his control relating to the company".

44. Thus orders sought under section 236 of the Insolvency Act 1986 can have extra territorial effect. An important consideration in a digital world where documents may be generated in another country as many companies outsource business to take advantage of lower costs.

The scope of an order for disclosure under section 236 of the Insolvency Act 1986.

45. I also refer to the recent case of Re Corporate Jet Realisations Limited (In Liquidation) Green v Chubb which is a decision of Registrar Briggs. It was an application pursuant to section 234,235 and/or 236 of the Insolvency Act 1986 by the liquidator of a company for immediate delivery up of all books and records and other documents of the company and all documents, files and other information which came into existence as a result of the respondents position as joint receivers and also asked that the respondents deliver up reports prepared by the joint receivers firm and details and documents relating to all work undertaken by the firm in relation to the company prior to it entering receivership. The application was granted in part and the court held that (a) section 236 was not limited to obtaining documents and records in order to reconstitute the company's knowledge. The jurisdiction was wide and applied to any person whom the court thought capable of giving information concerning the promotion formation, business dealings affairs or property of the company. The court had to carry out a balancing act that, after balancing all relevant factors, there was a proper case for an order to be made. There were limits to the section 236 jurisdiction and the court would need to be satisfied that the applicant in any case had a reasonable requirement for the material sought by the order, that the section was not being used abusively, and that the production did not impose an unnecessary and unreasonable burden on the respondent.

46. The court held that ordinarily the section should not be used to obtain sight of confidential material or communications between receiver sand debenture holders and it may not be used to obtain an insight into the strategy discussed and employed by the appointed administrative receivers. In this case there was a debate about who owned some of the documents sought.so the Court ordered that documents belonging the company be delivered up and is an issue arose as to the ownership of a particular document then the parties had permission to apply to the court. The parties were encouraged to seek a workable solution to achieve production of documents and records and in default the court would make an order.

47. The Court decided that the office holder was under no obligation to explain in detail what the liquidator was going to do with the documents, but that this should not be understood to minimise the need to show a reasonable requirement. A list of documents may be useful, but to create a list of thousands of e mails could lead to unnecessary expense, was likely to be disproportionate and oppressive and would not further the understanding of the liquidator or enable him to obtain advice as to whether to bring proceedings against the receivers or any other party. The liquidator had to explain why the documents sought were required to carry out his functions, for that requirement to be reasonable and the explanation needed to have substance.

48. Finally the court held that in order to obtain a comprehensive understanding of the company's affairs the liquidator should be able to inspect and copy the records and files created by the receivers during the course of the receivership, including documents and records that formed "property" of the company. The receivers objected on the basis that they had already delivered up a mass of documentation and any documents that remained appeared to reside in thousands of e mails. The court was willing to hear submissions regarding the cost of undertaking the exercise in relation to the e mails but the enormity of the task did not remove the obligation to serve the public interest by making disclosure when asked by an office holder. The receivers would not be under an obligation to deliver up the same documents twice.

49. In a digital world where most correspondence is by e mail and the disclosure of such documents can be heavy burden practitioners are warned that nevertheless disclosure can be ordered.

ASSET TRACING

Asset Tracing.

51. This is a very large area as far as the law is concerned but in this review I wish only to comment in the context of fraud on the recent case law regarding accessory liability and knowing receipt of property. In Alpha Sim Communications Limited and others [2014] EWHC 207 David Donaldson QC sitting as a deputy High Court Judge looked at the issue of honesty and dishonesty, and the knowledge required to found liability by the knowing receipt of a constructive trustee. The case was a missing trader intra community fraud, which revolved around the import and repeated resale and ultimate export of large quantities of high value mobile telephones. Between the 17th March 2006 and 23rd March 2006 Alpha, the first Claimant made sales of mobile phones totaling around 12.1 million. Alpha never accounted to HMRC for the VAT on

these sales namely £1,344,132.14 and £636,689.80. The sole director of Alpha at the time was a man called Imran Khan who was subsequently disqualified as a director for 12 years following the discovery of the fraud.

52. On the issue of honesty and dishonesty and the distinction between the two David Donaldson QC held as follows –

> "I take as a starting-point the oft-quoted observations of Lord Nicholls in *Royal Brunei Airlines v Tan* [1995] 2 AC 378 at p.389:
>
> *"Whatever may be the position in some criminal or other contexts..., in the context of the accessory liability principle acting dishonestly, or with a lack of probity, which is synonymous, means simply not acting as an honest person would in the circumstances. This is an objective standard. At first sight this may seem surprising. Honesty has a connotation of subjectivity, as distinct from the objectivity of negligence. Honesty, indeed, does have a strong subjective element in that it is a description of a type of conduct assessed in the light of what a person actually knew at the time, as distinct from what a reasonable person would have known or appreciated. Further, honesty and its counterpart dishonesty are mostly concerned with advertent conduct, not inadvertent conduct. Carelessness is not dishonesty. Thus for the most part dishonesty is to be equated with conscious impropriety. However, these subjective characteristics of honesty do not mean that individuals are free to set their own standards of honesty in particular circumstances. The standard of what constitutes honest conduct is not subjective. Honesty is not an optional scale, with higher or lower values according to the moral standards of each individual. If a person knowingly appropriates another's property, he will not escape a finding of dishonesty simply because he sees nothing wrong in such behaviour.*
>
> *In most situations there is little difficulty in identifying how an honest person would behave. Honest people do not intentionally deceive others to their detriment. Honest people do not knowingly take others... property. Unless there is a very good and compelling reason, an honest person does not participate in a transaction if he knows it involves a misapplication of trust assets to the detriment of the beneficiaries. Nor does an honest person in such a case deliberately close his eyes and ears, or deliberately not ask questions, lest he learn something he would rather not know, and then proceed regardless..."*
>
> That does not mean that liability only attaches if the defendant appreciates that his conduct would be regarded as dishonest by honest people. As explained by Lord Hoffman delivering the judgment of the Privy Council in *Barlow Clowes International Ltd v Eurotrust International*

Ltd [2006] 1 WLR 1476 at 1481 what is required is only *"(consciousness of those elements of the transaction which make participation transgress ordinary standards of honest behaviour"* without the need for the defendant to have thought about what those standards were. In this connection, as said by Peter Gibson J in *Baden v. Société Générale* [1993] 1 WLR 509 at 575, it need not be

"knowledge of the whole design: that would be an impossibly high requirement in most cases. What is crucial is that the alleged constructive trustee should know that a design having the character of being fraudulent and dishonest was being perpetrated. Further he must know that his act assisted in the implementation of such design."

There are similar comments by Lewison J in *Ultraframe (UK) Ltd v Fielding* [2006] FSR 17. For this purpose, as generally in the law, a conscious decision not to make inquiries which might result in knowledge can be treated analogously to actual knowledge, *a fortiori* when the court is forming a judgment as to honesty of conduct. (cf per Field J in *Stokors SA v IG Markets Ltd* [2013] EWHC 631 (Comm) at para.11)".

53. The above case statement provides office holders with a guide as to knowledge of the respondent that they will need to show to the court if they are to succeed in an application under section 213 of the Insolvency Act 1986 against a person who is not a member or director of the company but who has assisted in the disposal of property dishonestly.

Susan Brown.

6th October 2016.