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Case Comment

Section 236 of the Insolvency Act and directors' disqualification

Adrian Walters

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Legislation: Insolvency Act 1986 s.236

Company Directors Disqualification Act 1986 s.7

Cases: Pantmaenog Timber Co Ltd, Re [2001] EWCA Civ 1227; [2002] Ch. 239 (CA (Civ Div))

Pantmaenog Timber Co Ltd, Re [2003] UKHL 49; [2004] 1 A.C. 158 (HL)

**Comp. Law. 90* Introduction

The question for the House of Lords in *Re Pantmaenog Timber Co Ltd, Official Receiver v Wadge Rapps and Hunt* [1] was whether the powers conferred by s.236 of the Insolvency Act 1986 ("IA") can lawfully be exercised solely or principally to obtain evidence for use in disqualification proceedings under the Company Directors' Disqualification Act 1986 ("CDDA"). It is important to stress that the question was simply one of *jurisdiction* : on the application of an administrator, administrative receiver, liquidator, provisional liquidator or the official receiver does the court have the power to summon any of the categories of person described in s.236(2) to provide the applicant with information and/or documents where the information and/or documents are required solely or principally in connection with disqualification proceedings that are being contemplated or are already pending?

Facts

The company was ordered to be compulsorily wound up in June 1999, whereupon the official receiver initially took office as liquidator.[2] In fulfilment of his obligation under CDDA, s.7(3)(a), the official receiver reported to the Secretary of State that, in his view, the conduct of two of the directors was such as to make them unfit to be concerned in the management of a company for the purposes of CDDA, s.6(1). The Secretary of State directed the official receiver to commence disqualification proceedings against the two directors and these were instituted in February 2000. The proceedings were later transferred to the High Court and the Secretary of State substituted as applicant. Having ceased to be liquidator on the appointment of a licensed insolvency practitioner in June 1999, the official receiver made an application in the winding up under IA, s.236 for orders seeking the production of documents by two firms of solicitors and a firm of accountants that had acted for the company during its trading life. The official receiver conceded that his only purpose in applying for the orders was to obtain evidence for use by the Secretary of State in the pending disqualification proceedings. Nonetheless, his case throughout was that the court could allow him recourse to s.236 to enable him to discharge his statutory functions, including his functions under s.7 of the CDDA.

The Court of Appeal's decision

The district judge made the orders as asked but was overturned on the appeal of one of the directors in the High Court. The Court of Appeal dismissed the official receiver's appeal against the judge's decision, holding that the court did not have jurisdiction to make orders under s.236 solely for the purposes of disqualification proceedings. Chadwick L.J. gave the judgment of the court and advanced two reasons for the conclusion that the court had no power to make the orders:

First, in a case where the company was not being wound up by the court, the applicant in disqualification proceedings could only be the Secretary of State and, it was significant that the Secretary of State did not have standing to make an application under IA, s.236. The powers

conferred by IA, ss.235-236 could not have been conferred to enable the Secretary of State to obtain indirectly information and documents that Parliament had not thought it necessary or appropriate to enable him to obtain directly. Moreover, there was no reason to think that Parliament intended that the powers to obtain information and documents for use in disqualification proceedings should be any greater in a case where the company was being wound up the court in England and Wales than in a case where the company was in voluntary liquidation. (The essence of this reasoning lies in the difference of approach to compulsory and voluntary liquidation. Given that the Secretary of State, through lack of standing, cannot invoke s.236 to gather information for use in disqualification proceedings against directors of a company that has gone into voluntary liquidation, why should the official receiver be allowed to invoke the provision for the purposes of disqualification proceedings against directors of a company that has gone into compulsory liquidation?).

Secondly, in a case where the company is being wound up by the court in England and Wales, the official receiver is under a statutory duty to investigate the company's affairs and the causes of its failure and, should he think fit, to make a report to the court (IA, s.132). By giving the official receiver standing to invoke IA, ss.235-236, Parliament intended only that he should be able to use those provisions for the purpose of discharging that function. It may well be that he will obtain information in discharging his function under IA, s.132 that can be used in making a report to the Secretary of State under CDDA, s.7(3)(a) or, in disqualification proceedings, should he be directed to bring them under CDDA, s.7(1)(b). However, the official receiver cannot have been intended to invoke the powers in IA, ss.235-236 either for the purpose of discharging his reporting obligation under CDDA, s.7(3) or for the purpose of obtaining evidence for use in disqualification proceedings brought in his name under CDDA, s.7(1)(b) save in so far as those purposes are incidental to his function under IA, s.132. The reason for this lay in CDDA, s.7(4) which provides that:

“The Secretary of State or the official receiver may require the liquidator, administrator or administrative receiver of a company, or the former liquidator, administrator or administrative receiver of a company--(a) to furnish him with such information with respect to any person's conduct as a director of the company, and (b) to produce and permit inspection of such books, papers and other records relevant to that person's conduct as such a director, as the Secretary of State or the official receiver may reasonably require for the purpose of determining whether to exercise, or of exercising, any function of his under this section”.

Comp. Law. 91 If the court could make a s.236 order solely in connection with disqualification proceedings, this would render CDDA, s.7(4) otiose: any information or documents required by the official receiver could be obtained from the office holder under IA, ss.235-236 without the need to rely on the specific information gathering power in the CDDA.

Two observations can be made about the Court of Appeal's decision. First, in its refusal to treat the official receiver's reporting obligation under the CDDA as part and parcel of his overall statutory functions under IA, s.132, the court took rather a narrow view of the official receiver's role. The question of whether the other office holders who have standing could apply for an order under s.236 solely to gather information for the better discharge of their CDDA reporting obligations was not expressly addressed. It should be noted, however, that the court could only have reached the same conclusion on this question by taking a restricted view of the role of administrators, administrative receivers and liquidators, effectively treating their statutory obligation to report directorial misconduct under CDDA, s.7(3) as falling *outside* the functions of the particular office holder. Secondly, although the scope of IA, s.236 is wider than CDDA, s.7(4) in terms of the persons who can be required to provide information and/or produce documents, the court regarded the two provisions as mutually exclusive rather than complementary.

The House of Lords' decision

A unanimous House of Lords reversed the Court of Appeal's decision. All three of their lordships who delivered judgments (Lords Millett, Hope and Walker--Lords Steyn and Hoffmann simply agreed with the others) started from the premise that the Court of Appeal had taken too narrow a view of the functions of office holders under the Insolvency Act. Thus, as Lord Millett pointed out, while the gathering of evidence for use in disqualification proceedings is not strictly part of a liquidator's functions in the winding up, “[t]he liquidator's functions in relation to the company which is being wound up are not and never have been limited to the recovery and distribution of the company's assets”.[3] The law of winding up has always had a dual purpose: (1) to facilitate the collection and realisation of the company's assets and the orderly settlement of its liabilities and (2) the investigation

of the company's affairs and imposition in the public interest of criminal or civil sanctions on wrongdoers, in particular, on company directors found to have abused the privilege of limited liability.[4] Thus the office holder, whether he be a liquidator, administrator or receiver, has what may be termed a “public interest” function in that the purposes of the particular insolvency regime must, by virtue of CDDA, s.7(3), include the gathering of information to enable office holders to discharge their reporting obligations.[5] In the absence of any express limitation in the wording of s.236, it followed that office holders must be able to invoke the provision solely with a view to discharging their CDDA reporting obligations as these obligations form part of their overall functions.[6] Lord Millett added that it would be odd if the court could direct a public examination on the application of a liquidator of a company in voluntary liquidation[7] but, conversely, could not direct a private examination on the application of the same party under s.236 in the wider public interest.[8] On this premise, their lordships proceeded to unpick the reasoning of the Court of Appeal, making the following additional points:

(1) Section 236(1) expressly authorises the official receiver to make an application under the provision “whether or not he is the liquidator”. As the official receiver may expressly invoke s.236 after he has ceased to be the company's liquidator, it followed that the provision could not only be available to assist him in the collection and distribution of the assets. It must also be available to enable him to carry out his wider investigative and reporting functions, including his functions under CDDA, s.7.[9]

(2) The fact that the Secretary of State could not make an application under s.236 did not lead to the inference that Parliament intended that she should not have recourse to the section at all, even indirectly. It has never been the function of the Secretary of State to conduct investigations or gather information. These functions are delegated to others, namely the official receiver and other office holders.[10]

(3) IA, s.236 and CDDA, s.7(4) are complementary rather than mutually exclusive.[11] Moreover, CDDA, s.7(4) was not rendered otiose for two reasons. First, it may be reasonable in a given case for an office holder to refuse to invoke section 236 at the expense of the insolvent estate where the sole purpose of the application is to assist the authorities in bringing or continuing disqualification proceedings.[12] Secondly, disqualification proceedings may concern the conduct of a director in relation to more than one company: under CDDA, s.6(1) the issue of whether the defendant's conduct makes him unfit can be assessed by reference to the insolvent company which has triggered the court's jurisdiction together with his conduct “as a director of any other company or companies”. Unless the other companies are also in compulsory liquidation, s.236 will not enable the official receiver to obtain information in respect of them. However, such information could be obtained from the relevant office holder under CDDA, s.7(4) assuming that the other companies are, or have been, in voluntary liquidation, administration or administrative receivership.

There were also strong policy reasons supporting the conclusion reached. As Lord Millett put it:

“The consequences of the Court of Appeal's decision would be most unfortunate and cannot have been intended by Parliament. Where the company had no assets worth recovering, neither the official receiver nor the office holder would be able to invoke section 236 for the purpose of investigating the conduct of the former directors, since this would not be incidental to ‘his functions in the winding up’ as the Court of Appeal conceived them to be. Serious misconduct would go undetected and the public unprotected. Moreover applications under section 236 would be complicated by the need for detailed consideration of the reasons for the application, and in particular whether the information was sought for the benefit of creditors and contributories (and only incidentally for the purpose of disqualification proceedings) or solely for the purpose of disqualification proceedings. Not only would this inevitably delay the disqualification proceedings … but it would make the collection of the necessary ***Comp. Law. 92*** evidence serendipitous and the protection of the public adventitious.”[13]

Comment

It is submitted that the House of Lords started from the correct premise. Insolvency law has both a public and private face and the functions of office holders are clearly not confined to dealing with the assets of the particular company (so, for example, a liquidator is also obliged by IA, s.218, within defined parameters, to report possible criminal misconduct to the authorities). Similarly, the view that IA, s.236 and CDDA, s.7(4) are complementary can be defended by reference to the settled principle that the two Acts should be regarded as a single, unitary body of law.[14] The immediate consequences are as follows:

(1) The official receiver and office holders can have recourse to IA, s.236 with a view to the better

discharge of their reporting obligations under CDDA, s.7(3).

(2) The official receiver can also have recourse to IA, s.236 with a view to gathering information for use in disqualification proceedings brought by him under CDDA, s.7(1)(b).

The practical importance of the ruling for the official receiver is twofold. First, the category of persons that can be required to give information or produce documents is wider under IA, s.236 than it is under CDDA, s.7(4). The former extends to “any person whom the court thinks capable of giving information concerning the promotion, formation, business, dealings, affairs or property of the company” (s.236(3)(c)) whereas the latter is confined to current and former office holders. Secondly, it would now be open to the official receiver to use s.236 to obtain information and documents from this wide category of persons where proceedings are being contemplated, rather than having to issue the proceedings and then obtain the material by means of a witness summons. Even so, it must be remembered that the House of Lords ruling goes only to jurisdiction. The court may still decline to make an order on the ground that to do so would be oppressive to the person concerned.[15] For this reason, it is likely that the official receiver will use s.236 sparingly and then only with a view to the production of documents.

One question touched upon by the House of Lords, but not directly resolved, is whether the Secretary of State or official receiver could compel office holders to seek a s.236 order for the purposes of pending or contemplated disqualification proceedings through the mechanism of CDDA, s.7(4). The writer has argued elsewhere that such compulsion is theoretically possible.[16] Lord Millett was rather more equivocal:

“Section 7(4) is not expressly limited to information and documents in the office holder's possession; and I see no ground for implying such a limitation. I do not think that section 7(4) obliges the office holder to invoke section 236 in order to obtain the information for which the Secretary of State has asked: it may not be reasonable for him to do so at the expense of the estate. But section 7(4) certainly does not forbid it; on the contrary, it brings the provision of such information to the Secretary of State for the purpose of disqualification proceedings squarely within the function of the liquidator.”[17]

Clearly, it is now open to an office holder, in theory, to apply of his own volition for a s.236 order solely for CDDA purposes. However, it is difficult to conceive of circumstances in which an office holder will be prepared to make such an application voluntarily. As s.7(4) is not confined to information and documents in the office holder's possession, it is submitted that there is no reason, in principle, why the provision could not be used to pressurise an office holder into using s.236 as a means of obtaining material from third parties that may assist the authorities. In granting the Secretary of State or official receiver's application under s.7(4), the court would, no doubt, insist on the provision of an indemnity in relation to the office holder's costs.

Adrian Walters *Editorial Board*

Comp. Law. 2004, 25(3), 90-92

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1. [2003] UKHL 49, [2003] W.L.R 767, [2003] 4 All E.R. 18, [2003] B.C.C. 659, [2003] 2 B.C.L.C 257.

2. IA, s.136(2).

3. n.1 above, at para. [63].

4. See to this effect *ibid.,* paras [8], [11], [15], [51]-[52], [64], [77], [87].

5. See also *Re Polly Peck International Plc* [1994] B.C.C. 15 at 16A-B and *Bishopsgate Investment Management Ltd v Maxwell* [1993] Ch. 1 at 47-48, CA.

6. n.1 above, at paras [16], [64]-[65], [67].

7. As is the case under the court's powers in IA, s.112: see *In re Campbell Coverings Ltd* [1953] Ch. 488, CA; *In re Campbell Coverings Ltd (No.2)* [1954] Ch. 255 and *Bishopsgate Investment Management Ltd v Maxwell,* n.5 above, at 24 and 46.

8. n.1 above, at para. [63].

9. *ibid.,* at paras [7] and [66].

10. *ibid.,* at para. [68]. It can be added that Chadwick L.J.'s point about greater powers being available to the authorities in cases of compulsory liquidation is met because the liquidator of a company in voluntary liquidation can himself apply for a s.236 order in line with the reasoning on the wider functions of office holders already discussed.

11. *ibid.,* at paras [14], [71]-[73].

12. The implication is that CDDA, s.7(4) is needed to introduce an element of coercion, albeit subject to safeguards of reasonableness and relevance. The point is picked up below in the concluding comments.

13. *ibid.,* at para, [74]. See also paras [15]-[16] in the speech of Lord Hope.

14. *ibid.,* at para. [87] *per* Lord Walker.

15. See discussion in *Re British & Commonwealth Holdings Plc* [1993] A.C. 426.

16. A. Walters and M. Davis-White, *Directors? Disqualification: Law and Practice* (Sweet & Maxwell, 1999), pp.40-41.

17. n.1 above at para. [71].