12192 of 2006

Neutral Citation Number: [2009] EWHC 2414 (Ch)
IN THE HIGH COURT OF JUSTICE
CHANCERY DIVISION

Royal Courts of Justice
Strand
London WC2A 2LL

Thursday, 16 July 2009

BEFORE:

MR JUSTICE SALES

BETWEEN:

KEVIN JOHN HELLARD

Applicant

- and -

SPENCER MICHAEL

First Respondent

FAIRVIEW NEW HOMES FARNBOROUGH LIMITED

Second Respondent

MR A BESWETHERICK (instructed by Wedlake Bell) appeared on behalf of the Claimant

MR D OLIVER QC & MR A KHAN (instructed by Hoffman) appeared on behalf of the First Respondent

MR J ARKUSH (instructed by Finers Stephens Innocent) appeared on behalf of the Second Respondent

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Approved Judgment
(As Approved by the Court)

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MR JUSTICE SALES:

1. This is an application by the trustee in bankruptcy ("the trustee") of Spencer Michael ("Mr Michael") for directions in relation to the disposal of the principal valuable asset in his estate, a counterclaim he has against Fairview New Homes (Farnborough) Limited ("Fairview") in an action brought by Fairview against him.

2. That action relates to a dispute between Fairview and Mr Michael concerning a transaction in which Mr Michael was to acquire a substantial number of properties from Fairview. He did not complete the transaction - he maintains for good reason - and Fairview claims to be entitled to forfeit deposits payable by him. Fairview commenced proceedings to recover the balance of the deposits. Mr Michael counterclaimed against Fairview for breach of contract. The asset in the estate of Mr Michael in relation to which the trustee seeks directions is the thing in action consisting of his rights against Fairview under that counterclaim ("the counterclaim"). The action by Fairview was commenced in 2006 and Mr Michael brought his counterclaim also in 2006. The value of the counterclaim was pleaded as £121,250 plus interest.

3. On 29 March 2007 Mr Michael was made bankrupt by order of Mr Registrar Rawson on the application of a third party creditor. As a result of that order, Fairview's action and Mr Michael's counterclaim were stayed. Mr Michael's counterclaim constitutes property for the purposes of the Insolvency Act 1986 (see section 463) and is part of his estate now vested in the trustee (see section 283(1)(a) and section 306).

4. Section 305(2) of the Insolvency Act provides:

> "The function of the trustee is to get in, realise and distribute the bankrupt's estate in accordance with the following provisions of this chapter; and in the carrying out of that function and in the management of the bankrupt's estate the trustee is entitled, subject to those provisions, to use his own discretion."

5. Section 314(1) of the Insolvency Act provides:

> "The trustee may:
> (a) with the permission of the creditors' committee or the court, exercise any of the powers specified in Part I of Schedule 5 to this Act, and
> (b) without that permission, exercise any of the general powers specified in Part II of that Schedule."

6. Paragraphs 3 and 6 of Part 1 of Schedule 5 to the Act provide:

> "(3) Power to accept as the consideration for the sale of any property comprised in the bankrupt's estate a sum of money payable at a future time subject to such stipulations as to security or otherwise as the creditors' committee or the court thinks fit. …
> (6) Power to refer to arbitration, or compromise on such terms as may be agreed on, any debts, claims or liabilities subsisting or supposed to subsist between the bankrupt and any person who may have incurred any liability to the bankrupt."

7. Applications may be made to court for directions to a trustee in bankruptcy by persons aggrieved by or interested in decisions made by a trustee or by a trustee himself (see section 303(1) and (2) respectively). The present application is made by the trustee under section 303(2). Mr Beswetherick for the trustee submits, and I accept, that the test according to which the court will intervene to overturn decisions of a trustee in the administration of a bankrupt's estate, is the same whether an application is made by a person under section 303(1) or by the trustee himself under section 303(2). (Of course, a trustee might also apply for directions under section 303(2) where he has made no decision himself on the commercial merits of a particular course of action, but that is not this case).

8. The usual test is that laid down in Re Edennote Limited [1996] 2 BCLC 389 (CA), which concerned the actions of the liquidator of a company. It is common ground that the same test applies in relation to the actions of a trustee in bankruptcy in a case of personal insolvency. The test for intervention by the court was put in this way by the Court of Appeal, as summarised in the head note:

> "Fraud and bad faith apart, the court will only interfere with the act of a liquidator if he has done something so utterly unreasonable and absurd that no reasonable person would have done it."

The basic approach is that the court should be very slow to second-guess commercial decisions made by a trustee in bankruptcy in the exercise of the statutory discretion conferred on him by section 305(2) of the Insolvency Act.

9. In my view, however, the test in Re Edennote Limited does not exhaustively state the grounds for intervention by the court. As is clear from the provisions of the Insolvency Act 1986, the court retains a general supervisory jurisdiction in respect of trustees in bankruptcy to ensure they behave properly and fairly as between persons affected by their decisions. That wider jurisdiction is in issue in the facts of this case.

10. An account of the bankruptcy of Mr Michael is given in the witness statement of the trustee. Upon his appointment as trustee in bankruptcy after a meeting of creditors on 28 June 2007, the trustee investigated Mr Michael's financial position. Mr Michael had very few assets which vested in the trustee. The only asset he had which was potentially of significant value was the counterclaim.

11. The trustee described the bankruptcy thus at paragraphs 16 to 19 of his witness statement:

> "This has been a very time consuming and in many ways difficult bankruptcy. The progress of the bankruptcy was hampered in the early stages by a number of meritless applications to court by the Bankrupt. I do not believe the nature of those applications is relevant to this application save to say that they were meritless and were curtailed when the Bankrupt consented to a Civil Restraint Order following advice from Leading Counsel, acting in a pro bono capacity ….
>
> It should be noted that the bankruptcy has no funding and so my firm has incurred the costs of defending those applications.
>
> The Bankrupt also purported to appoint a director of his companies prior to his bankruptcy to represent the interests of the companies in winding up petitions brought by the Public Interest Unit

against all of the companies of which he was a director. Mr Justice Jarvis QC ruled on 25 October 2007 that the purported new director had not been validly appointed prior to the bankruptcy (any appointment post bankruptcy being invalid). It appeared therefore that the Bankrupt effectively tried to appoint the new director (invalidly after his bankruptcy) to represent the companies and thwart the winding up petitions.

The bankruptcy was also hampered (by way of example) by the Bankrupt's attempts to frustrate my investigations. In particular, attempts to prevent the repossession of certain properties (including dealing with an allegation that the Bankrupt specifically took money and a deposit from a tenant only the day before the scheduled and notified repossession – in an attempt to prevent the repossession). This matter was dealt with by the local police."

12. The current position in the bankruptcy is explained at paragraph 34 of his witness statement:

> "As explained above, this bankruptcy has been difficult and complicated. We have made investigations into 26 properties that were either owned by the Bankrupt on his own, jointly with his wife or solely by this wife. Two of these properties were being rented out at the time of my appointment and one was of course the marital home. Five of the properties had been sold prior to my appointment and the rest had been or were in the process of being repossessed. Since my appointment the tenanted properties and the marital home have also been repossessed. The mortgages were mainly on a buy to let basis and had been taken out with various banking institutions. My firm's work in progress is approximately £108,669 plus disbursements of £1,664.86 (outstanding). The work in progress of Wedlake Bell is over £100,000 with disbursement of over £1,900. In addition, due to the protracted proceedings which took place following the bankruptcy petition, the petitioning creditor's costs are roughly £36,000 plus VAT. Any realisations into the estate will be used in the first instance to meet petitioning creditor costs and legal costs should there be availability. The Trustee in Bankruptcy will not receive any settlement of his costs in this case and unfortunately, the creditors of the bankruptcy will not receive a dividend from the assignment of the Fairview Proceedings or the bankruptcy as a whole. This is also the case if the Bankrupt was to succeed with his offer and ultimately succeed with the Counterclaim."

13. The trustee is considerably out of pocket on this bankruptcy. The trustee's fees and expenses will rank in preference to any claims by creditors.

14. The trustee took legal advice about the merits of the counterclaim. The detail of that advice is not disclosed for reasons of legal professional privilege. The trustee's decision was that he should not pursue the counterclaim due to problems with its merits, as he had been advised, and the fact that the bankruptcy is unfunded. He instead decided that it would be in the best interests of the bankruptcy to offer the counterclaim for assignment. He considered that each of Mr Michael and Fairview might be interested in bidding for the counterclaim: Mr Michael, because he

maintained, on legal advice he had obtained, that it was a valuable claim; Fairview, because if it (putting it colloquially) bought the counterclaim it would, in substance, be released from any obligations it might have in respect of the counterclaim.

15. On 8 July 2008 the solicitors for the trustee wrote in these terms to Mr Michael:

> "1. The assignment will relate to the proceedings commenced by Fairview New Homes (Farnborough) Limited against you with claim number HC0500153 in which you have a substantial counterclaim.
> 2. Any pursuit of the Fairview Proceedings must be fully assigned and progressed in the name of the assignee.
> 3. As Trustee, our client is unable to give any warranty, undertaking, covenant for title or otherwise in relation to the causes of action contained in the Fairview Proceedings and the Trustee will bear no personal liability whatsoever.
> 4. Any assignee will have to agree to provide full indemnity to the Trustee against all actions, claims, costs, demands and losses arising in relation to the Fairview Proceedings.
> 5. The assignee must pay the legal costs of the Trustee associated with drafting the assignment and an application to court for an order that the Trustee be permitted to assign the claim.
> Accordingly, you (and other third parties of whom you are aware) are invited to put forward an offer by no later than 8 August 2008 to take assignment of the Fairview Proceedings."

A letter in similar terms was also sent to Fairview.

16. On 18 July 2008 the solicitors for the trustee sent an email to the solicitors for Fairview in these terms:

> "In our conversation you asked what the likely costs of the assignment and application would be. We would be prepared to cap these at £5000 (plus VAT) although I do not expect it will cost this much (more likely £2000 to £4000). However, the same cap will have to apply to Spencer Michael and it is likely that coming to an agreement may be more difficult with him and therefore we need to factor this in to prevent further wasted costs on this case."

17. Although the solicitors for the trustee acknowledged there that the same cap in relation to the costs referred to in point 5 of the letter of 8 July 2008 should apply to Mr Michael, it appears on the evidence before me that he was not told of this.

18. On 4 August 2008 - it seems in response to a query from Mr Michael - the solicitors for the trustee capped the indemnity referred to in the letter of 8 July 2008 (at point 4) at £3,000 and indicated that adjustment to the terms of the letter to both Mr Michael and Fairview.

19. The position in respect of the bids invited by the trustee, therefore, was that Fairview and Mr Michael both knew that the indemnity at point 4 of the letter of 8 July was capped at £3,000 and that Fairview, but not Mr Michael, knew that the costs at point 5 of that letter were capped at £5,000.

20. The time for bids was extended eventually to 25 November 2008. On 24 November 2008 the solicitor for the trustee emailed Mr Michael referring to a conversation between them and continuing:

> "1. You have asked whether the Trustee will accept a % of recovery (or a mix of % of recovery and cash). The Trustee cannot advise you of the terms of your offer. You must make the offer that you consider most appropriate (and that you can actually meet). However, I would say that I think it unlikely that the Trustee would be attracted to an assignment on the basis of % of recovery. This could be for lots of reasons including uncertainty of the merits of your defence and counterclaim and the further continuation of the bankruptcy.
> 2. The bid process will be fair and honest. You were concerned that the Trustee may see your offer of £1 (your example) and that the Trustee would ask Fairview to make a higher bid (eg £1.10 (your example)). As set out in our original letter, there is the opportunity for one bid only. Your bid (as with Fairview) must be your best bid as the Trustee will consider that bid only.
> As stated before, it is at the Trustee's discretion whether to accept your bid or Fairview's bid (or to accept an offer at all). However, if the Trustee does accept a bid, he will apply to court for approval of the assignment. I have explained that either party that is unsatisfied with the result of the bid can play a role in that application."

21. Mr Michael was therefore given a clear indication that the trustee would be unlikely to find an offer based on a percentage of the recovery under the counterclaim attractive. He was also put on notice that the application to court contemplated by point 5 of the letter of 8 July might be contested by any party dissatisfied with the outcome of the bid process.

22. On the deadline of 25 November 2008, Mr Michael put in an offer by email for the assignment of the counterclaim to him, in these terms:

> "I submit an offer of 50% of all sums recovered by the defendant [i.e. Mr Michael] (excluding costs) in the action or £100,000 cash from all sums recovered by the defendant (excluding costs) in the action whichever is the lesser.
> There should not be any delay in concluding the trial of this action since it was ready for trial in May 2006.
> I draw to your attention the existence of legal authorities acknowledging the validity of offers to take on the assignment of trusteeship assets based on a percentage of recovery in litigation."

23. The email did not refer to the terms set out in points 4 and 5 of the letter of 8 July, but on an objective approach to construction of the email against the background of that letter Mr Michael accepted the terms set out there (with the indemnity at point 4 capped at £3,000 as he knew, but so far as he was aware the costs at point 5 being uncapped).

24. The same day the solicitors for Fairview put in an offer on behalf of Fairview in these terms:

> "… we are instructed to offer the sum of £11,751 for the assignment of the counterclaim in the Fairview Proceedings."

25. Fairview's offer was on the basis of a cap of the indemnity in point 4 of the letter of 8 July of £3,000 and of the costs in point 5 of £5,000.

26. The trustee considered both bids and decided that the bid by Fairview was the more attractive. The trustee's decision was notified to Mr Michael and Fairview by letters of 16 December 2008 which included the following:

> "The Trustee has given consideration to these offers in line with his duty to act in the best interest of creditors. As a result of this, the Trustee proposes to accept the offer from Fairview for the fixed sum of £11,751. That offer is in accordance with the terms set out in our letter of 8 July 2008 and includes payment of the Trustee's costs of the application to court and assignment.
>
> The primary reason for accepting the offer from Fairview is that of certainty. The Trustee obtained the advice of Counsel on the merits of the counterclaim. As a result of that advice the Trustee took the decision that he was not prepared to pursue or fund the counterclaim as the merits of success were not sufficiently certain to warrant that exposure. The Trustee considered that the prospects of success were not sufficiently high to warrant further work in relation to that matter. The Trustee was therefore faced with a decision to accept an offer of certain (albeit lower) fixed sum or a sum based on a percentage of recovery by you in the counterclaim. It remains that the Trustee does not, on balance, believe that you will recover any sums if you were given the opportunity to fight the counterclaim and therefore there would be no benefit to the Bankruptcy. In those circumstances, the Trustee considered that it was more appropriate to accept the certain fixed sum into the Bankruptcy rather than an offer that was based on a very uncertain and probably unlikely recovery in the counterclaim.
>
> As outlined at paragraph 5 of our letter dated 8 July 2008, the Trustee proposes to make an application to Court for approval of the assignment in principal to the successful bidding party. The Trustee considered that this was an important step given the very contentious nature of the Fairview Proceedings and the subsequent Bankruptcy."

27. The present application to the court, pursuant to the trustee's decision, was issued on 24 April 2009. The trustee put in a witness statement dated 14 April 2009 which disclosed relevant documents, including the email of 18 July capping the costs in point 5 of the letter of 8 July at £5,000.

28. Mr Michael filed a witness statement dated 22 May 2009 in reply. In paragraphs 32 to 35 of that witness statement he called attention to the email of 18 July, of which he had been unaware. He said that the cap on the trustee's costs set out in that email "must have enabled Fairview to adjust the nature of their proposed offer" and complained that that was unfair. He said that had he been aware of this feature of the offer the trustee was prepared to accept he would have made a cash offer with the benefit of third party financial assistance which he said he had now obtained from a Mr Choudhury. Mr Michael exhibited a statement from Mr Choudhury in which he said:

> "I confirm that I have entered into a business arrangement with Mr Spencer Michael in which I have agreed to pay him cash for the lump sum offer of £12,000. I have also agreed to pay him such further cash sum as is necessary to secure the expedited assignment of the counterclaim in his name and to further fund the assignment and counterclaim proceedings in all courts. I also agree to pay the Trustee his fees for the forthcoming hearing in the Chancery Division for the purposes of deciding whether the counterclaim should be assigned to Mr Michael as per his agreement with Mr Michel in the event that the counterclaim is assigned to Mr Michael. I am happy to provide evidence of my ability to provide funding."

29. In Mr Michael's witness statement of 22 May, at paragraph 38, Mr Michael offered an immediate lump sum cash payment of £12,000 for assignment of the counterclaim plus £38,000 payable out of recoveries under the counterclaim.

30. Fairview, for its part, submits that the outcome of the original bid process should be determinative. In the alternative, it has indicated that if the bid process culminating with the bids on 25 November 2008 is not to be treated as binding it would wish to make a further bid.

31. The trustee's position is that a further round of final bids from each of Mr Michael and Fairview should now take place and proposes a draft order with a proposed bid process regulated in terms of a schedule to that order as follows:

> "1. Any offer for the assignment and/or the compromise of the Counterclaim must be made in accordance with the following provisions.
> 2. The offer must be made in writing and be delivered to the Trustee's solicitors by 10.30am on 23 July 2009.
> 3. The offer must specify the sum of money (as a fixed sum which is ascertainable from the offer document itself) that the party making the offer is prepared to pay in order to purchase an assignment of and/or to compromise the Counterclaim ("the sum").
> 4. The offer must contain confirmation that, if its offer is accepted, the party making the offer will undertake to indemnify the Trustee (up to a cap of £3,000) in respect of any actions, claims costs, demands and losses arising, whether before or after the assignment or compromise, in relation to the proceedings brought under Claim No. HC05C00153.
> 5. The offer must contain confirmation that the party making the offer will undertake to contribute to the Trustee's reasonable costs of the assignment and/or compromise and in relation to the Application, capped at £5,000 plus VAT, such costs to be assessed if not agreed.
> 6. The offer must contain an undertaking by the party making the offer to pay to the Trustee the Sum within seven days of notification by the Trustee that he proposes to accept that party's offer."

32. Mr Michael submits that the original bid process should not be treated as determinative for two reasons. First, he says it was not conducted fairly since Fairview was told, but he was not, that there was to be a cap of £5,000 in respect of the trustee's costs in

point 5 of the letter of 8 July. Secondly, he says the bids sought by the trustee from Fairview were in respect of an assignment of the counterclaim and he contends that an assignment of a claim or counterclaim to the person against whom that claim or counterclaim is made is a legal impossibility.

33. I accept Mr Michael's submission on the first point but not on the second. As for the second, whatever the legal niceties in relation to assignment of a claim to the person against whom it is brought, it is clear from paragraph 6 of Schedule 5 to the Insolvency Act 1986 that the trustee could compromise the counterclaim by accepting payment from Fairview. That, in substance, was what was lawfully and properly proposed by the trustee, and it is not necessary for me to go into the detail of the technicalities of the law on assignment put before me by Mr Oliver QC for Mr Michael to deal with that second submission.

34. However, on Mr Michael's first submission, I consider that there was a material unfairness in the conduct of the bidding, to the detriment of Mr Michael. Fairview knew that the costs in point 5 of the letter of 8 July 2008 were capped at £5,000; Mr Michael did not. Fairview was therefore in a position to calculate its bid on that basis (i.e. knowing that its potential liability for costs under point 5 was limited), Mr Michael was not. Mr Michael's evidence is that if he had known about that cap he would have reformulated his bid.

35. I have some doubt about whether in fact Mr Michael would have been able or would have chosen to do so. However, I am concerned that he was not afforded the same opportunity as Fairview to decide how to formulate his bid at the time, knowing that the potential exposure under point 5 was limited. This was not a trivial matter. The trustee had indicated that the application under point 5 might be contested. Mr Michael was a bankrupt and might have wished to seek monies from third parties to fund any offer by him. In relation to such approaches to third parties, knowledge of the limit placed on any potential liability under point 5 of the letter of 8 July 2008 could have been important.

36. Therefore, I cannot on the evidence exclude the possibility that knowledge of that cap may have made a difference to the formulation of Mr Michael's bid. I cannot conclude that he would inevitably have lost the auction even if he had been properly informed about the terms on which it was being conducted. In those circumstances, I consider that it would not be fair or appropriate to require or allow the trustee to dispose of the counterclaim in accordance with the outcome of the first bid process. Putting this in another way, if it were necessary to do so: in light of the unfairness to Mr Michael of the way in which the first bid process was conducted, it would, in my view, be utterly unreasonable (within the terms of the Court of Appeal's judgment in Re Edennote Limited) for the trustee now to proceed to give effect to that bid process.

37. The question arises, therefore, what should happen now? Mr Michael submits that the trustee should now dispose of the counterclaim to him, since the best extant offer is that put forward by him in his witness statement. I reject that submission. Such an approach would be very unfair to Fairview, which from its perspective participated in what appeared to be a fair and orderly bidding process in which each party was to make one bid without knowing what the other party had bid. Mr Michael's current offer was made outside that process, and with knowledge of what Fairview had bid. Now that

process is in effect to be set aside, Fairview is entitled to expect that there should be another fair and orderly bidding process.

38. That conclusion also corresponds with the trustee's judgment that it would represent the best further conduct of the bankruptcy for a further orderly bidding process to take place. That is a judgment which cannot be faulted. I agree with it. Even if I did not myself agree with it, I consider that it is a judgment of the trustee on the commercial merits regarding the steps to be taken in the situation which has arisen, and that on the basis of the principles in Re Edennote Limited the court should not interfere with the trustee's decision as to how to proceed.

39. If there is to be a further bid round, Mr Oliver submits that paragraph 3 of the schedule to the draft order should be amended to read:

> "The offer must specify a sum of money (as a fixed sum which is ascertainable from the offer document itself) whether or not in conjunction with a proportion of the proceeds of any recovery. That the party making the offer is prepared to pay in order to purchase an assignment of and/or to compromise the counter claim ..."

40. The trustee resists this proposed amendment. He is concerned to ensure that the further bid round produces a clear and certain result in relation to which there is minimal scope for argument in future.

41. In my view, the trustee is entitled to adopt this approach and I reject Mr Oliver's submission. The trustee's judgment on this issue must prevail in accordance with the principles in Re Edennote Limited. There are a number of factors relevant to this assessment.

42. It is desirable that there should be a clear, common basis for bids to go in at this stage so as to ensure certainty of outcome and transparency of the process and to minimise scope for expensive argument later. The background to this bankruptcy, which I have already set out above, underlines the importance of these factors. The trustee has assessed the litigation risk in respect of the counterclaim and does not wish to bear it. The trustee wishes the bankruptcy to be brought to an end as early as possible. The bankruptcy has been a difficult one and the trustee's unfunded costs have been high. There is no realistic prospect that they will be met in full, whatever is offered in exchange for the assignment of the counterclaim. Therefore, the trustee's judgment about what should happen is entitled to be assessed as having a particularly strong weight in this case, since essentially the trustee is deciding what should happen with an asset held for his own benefit. Further, the trustee legitimately wishes to close the bankruptcy and avoid the further costs associated with keeping it open if a bid were made on terms offering a percentage of the recovery under the counterclaim. In addition, Mr Michael has already shown that he is in a position to make a cash bid. It is not unfair to him to limit the terms of the proposed schedule in the manner set out by the trustee.

43. I do not think it is necessary to build a provision into the proposed schedule to allow for a bid based on percentage recovery under the counterclaim, to deal with the unlikely event there might be a tiebreak in terms of the bids that are made (i.e. to allow Mr Michael to make a cash bid, with an alternative offer if his cash bid exactly

matched that made by Fairview that he would in addition pay the trustee a percentage of the recovery under the counterclaim). The fair course in such a situation would be likely to be an invitation by the trustee to the parties to participate in a further round of bidding, but that would be a matter for assessment by the trustee should the problem ever arise, and one in relation to which the trustee would be entitled to form his own judgment.

44. For these reasons I make an order in the terms of the draft order and schedule as put before me on behalf of the trustee.

[After further argument]

45. An application is made by Mr Michael against Fairview for an order that Fairview should bear his costs, or a substantial part of his costs, of this application. I reject that application. The fair outcome is that both Fairview and Mr Michael should bear their own costs. Fairview lost on the substantive argument that it put forward, which (if accepted) would have been to the detriment of Mr Michael. Mr Michael lost on a substantive argument he put forward against Fairview (i.e. that the trustee should simply be required to accept his current offer, as set out in his witness statement) which (if accepted) would have been to the detriment of Fairview. Honours between them were essentially even and it is not appropriate for any costs order to be made.

[After further argument]

46. A further application is made by Mr Michael for permission to appeal in relation to the timetable set out in the order. It is a hopeless application and no permission is granted for that.