


Compulsory private examinations and the art of war: a potent weapon in the right hands



Mike Pavitt and Theo Anderton examine the proper use of sections 236 and 366 Insolvency Act 1986 and urge IPs not to be afraid of using their powers.

Readers will be aware that the power to apply to court to compel reluctant or unco-operative parties to produce information on pain of arrest has long been one of the most valuable weapons in an office-holder's armory. By any measure its potential is immense, affording us the opportunity to force others to help us put together the missing pieces of a jigsaw that could allow us to produce a more acceptable return for creditors.

By and large, the power has stood the test of time, despite the rise of human rights legislation. Recent changes to the Insolvency Rules have left it largely untouched. On the face of it, the court's discretion is unfettered, yet the actual use of this power by practitioners remains comparatively rare.

An underused power

The power suffers from a perception among many lawyers that case law is now so well settled that the counter proposition (that an application would be oppressive or unnecessary) is generally arguable. Also, it is all too easy to advise that IPs cannot fairly be criticised if they elect not to proceed, particularly where the application would be unfunded. It can also suffer from a perception among many IPs that it is a risky and/or expensive route to follow.

Owing largely to these perceptions, the weapon's edge has become dulled by disuse. Although the sabre is often rattled, threats to bring an application are often seen for what they are, a blunt device employed by someone with limited funds and no real intention of spending them, designed to 'shake down' the easy target.

There is, of course, nothing wrong with threatening the use of the power in appropriate circumstances. This is particularly so where there is a realistic prospect of producing the desired information or evidence without recourse to the courts; if we can persuade the other party to produce the documents or attend

our offices for a transcribed interview, this will generally be the ideal outcome. However, to be effective, the threat must be real and we must therefore be ready and willing to follow through.

Time to break free

So how do we use these powers to best effect? Our suggestion is that – as with any swordplay – this can best be achieved by:

- preparing your weapons;
- training; and
- putting what you have learned into practice.

of the ECHR into English law through the Human Rights Act 1998.

The powers of compulsory examination have consistently passed scrutiny, even where applicants have sought to extend the scope of the section (for recent examples see *Pantmaenog Timber Co Ltd* [2004] 1 AC 158 (s236) and *Rottmann v. Brittain* [2009] EWCA Civ 473 (s366)). A detailed consideration of how human rights pervade the relevant case law is beyond the scope of this article but we would ask the reader to take it as a given that the tests employed by the English

“ Although the sabre is often rattled, threats to bring an application are often seen for what they are, a blunt device employed by someone with limited funds and no real intention of spending them. ”

Repeating these steps should help us to achieve the goal so that, when we threaten to make an application, most prospective respondents will co-operate. Those who ignore us will face an application that is well constructed and well aimed, and those who seek to deflect the application will be subjected to an order. We will achieve a successful outcome and an order for costs.

Step one: know your weapon

Before we even consider actually drawing the sword, we need to know if it is fit for purpose? Can we trust it not to shatter when it meets resistance?

Sections 236 and 366 have a long and distinguished pedigree. They have existed in some guise since before the birth of modern insolvency law, yet they sit squarely within the context of international and European law, and in particular human rights law. Here they have been tested both by direct challenge under the European Convention on Human Rights (ECHR) and by continuous application by the English courts notwithstanding the incorporation

courts reflect closely European thinking and that in order to predict the courts' approach to new issues practitioners would do well to look to Strasbourg.

Step two: it's how you use it

Even the surest of blades will be useless unless we also learn how to wield it, and how not to hurt ourselves in the process.

The parties entitled to use the power are a liquidator (including a provisional liquidator), an administrator, an administrative receiver or a trustee in bankruptcy. Even experienced practitioners need to remember the basic principles before embarking on a new application. They should start with the recognised legitimate purpose for which we are entitled to use the powers.

The best statement of the legitimate purpose, cited with approval by the House of Lords in *Re British & Commonwealth Holdings plc* [1993] AC 426 remains that of Buckley J in his 1968 judgment of in *Re Rolls Razor Ltd*, which can be summarised as follows:

- to help the office-holder 'discover the truth' of the circumstances of the insolvent

entity in order that they can, 'as effectively as possible and... with as little expense as possible... complete their function';

- to put the affairs of the insolvent estate in order;
- to identify and recover assets; and
- to discover facts surrounding potential claims, including claims against the potential respondent to the application.

Over time, the courts have also added additional and less obvious legitimate purposes:

- to reconstitute accounting or other business records;
- to obtain information from third parties to enable contracts to be completed; and
- to investigate the causes of failure and the conduct of the respondent in contributing thereto with a view, for example, to disqualification proceedings.

Getting a good footing

The skilled applicant will recognise that they are asking the court to make a delicate judgment between the competing interests of an office-holder in requiring information and/or documents and the need not to impose an unnecessary and unreasonable burden on any respondent. They will know that factors such as inconvenience, the burden of work upon a respondent or potential exposure to future claims are not a bar to an application, but factors that will weigh differently in the balance of whether an order should be made. They will appreciate that the more distant the connection between a respondent and the insolvent, the greater the justification they will be required to produce in order to obtain an order.

The skilful applicant will therefore have done a good deal of preparation before the application is issued, pursuing all appropriate and/or proportionate lines of investigation first in order to demonstrate to the court why the balance should be struck in their favour. They will normally have given an appropriate level of advance notice to the respondent and flushed out and/or dealt with any potential defences, such as privilege.

The unskilled applicant, by contrast, may get their footwork all wrong. For example, they may apply for the production of documents with the purpose of the insolvent entity benefiting from work to which it would not have been entitled but for the insolvency, as in *Colishaw v. O&D Building Contractors Ltd* [2009] EWHC 2445 (Ch), or by betraying a settled intention to pursue before they have all the information necessary.

Making your strike

The strike itself is all about timing and accuracy. If the applicant moves too fast or too soon (eg by issuing when they could easily and/or at lower cost have obtained some or all of the information from elsewhere) they will lose their balance and the strike will easily be deflected. If they miss their aim (eg by failing to follow the

rules on service of the order before an arrest warrant is issued), they will expose themselves to a counter-strike (eg an order for costs).

The application itself should be made by way of Form 7.1A. This and supporting evidence should identify the respondent and specify the order sought, including whether it is for an oral examination, clarification/additional information, a witness statement (with details of the matters the witness statement is to cover) or for production of books, papers or other records (in which case they should be specified). Merely requesting an account of all dealings by the respondent with the insolvent company/bankrupt will not suffice.

The application may be accompanied by others (where proper grounds exist) for ancillary orders in the form of interim injunctions, such as a 'no say' injunction (restraining the respondent from disclosing the order to third parties), an order restraining the respondent from leaving the jurisdiction pending examination or a search and seizure order.

- a desire to limit the scope of the order sought, in the first instance, to documents;
- a desire for the documents or classes thereof sought to be specified with particularity;
- a concern that the documents sought are voluminous such that their production might be sought and ordered in stages;
- the need to exclude sensitive information including evidence of criminal activity and/or money laundering reports; and
- where the cost of compliance with any order made is likely to be significant, the question of how the respondent's reasonable costs of compliance are to be met.

Demonstrating value by results

The insolvency profession is under increasing scrutiny, from the OFT and elsewhere, and is challenged to show that it provides value to creditors, particularly unsecured creditors. One way of

“There is no question that the judicious use of compulsory examination powers can and does yield increased returns.”

The skill in making a good application will often be shown in how the applicant presents their evidence in support, whether they include a separate annex confidential to the court, and whether they elect to apply with or (exceptionally) without notice.

Step three: know your opponent

Every new opponent deserves respect and differing opponents demand different styles. Even an inexperienced swordsman may defeat an unarmed man, but an unarmed opponent may employ a skilled blade, such as another IP or solicitor. Likewise, an armoured opponent will feel only the best aimed strike. The applicant must be wary of these special cases and plan their attack accordingly.

Banks and solicitors in particular may, in certain circumstances, have legitimate concerns about confidentiality. Often both will offer to co-operate so long as they are compelled to do so by court order and, if the terms of the proposed order can be agreed, they will often take a neutral stance. The legitimate concerns that need to be addressed to avoid a failed application and/or an expensive costs order in these cases include:

demonstrating value is by results. There is no question that the judicious use of compulsory examination powers can and does yield increased returns. In terms of the use of the powers to provide evidence in support of claims, very often the process will yield, at relatively minor cost compared with the cost of funding a full-blown piece of litigation, the evidence that will justify to solicitors, counsel and after-the-event insurers that a claim can properly be pursued on a conditional-fee basis. Therefore, it is a route to securing access to justice for creditors.

Creditors may also perceive that they have obtained value because directors or other respondents have been put through the ringer and forced to account for their actions. In appropriate cases, following *Re Pantmaenog*, these examinations may yield evidence that the Secretary of State can use to secure a disqualification.

We believe that the more frequent use of these powers will increase their effectiveness, not just in terms of the overall number of applications, but in terms of their impact on a case-by-case basis. If we have convinced you, we look forward to meeting you on the field of battle! □



Mike Pavitt (left) and Theo Anderton (right) are partners in the Insolvency and Business Recovery team at Blake Laphorn.