SQUIRE PATTON BOGGS

Lock v. Stanley – The Final Word on Assignment of Insolvency Claims?

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It is often the case that insolvency claims are pursued against former directors of the insolvent company or persons connected to them. It is also often the case that such claims are assigned to a litigation-funding company, given lack of funds in the insolvent estate to pursue them. This is what happened in Lock v. Stanley, where various claims against the former directors, their parents and a connected company were assigned to Manolete.

Having refused permission to appeal the Court of Appeal's decision, the Supreme Court has provided comfort to assignees of insolvency claims that defendants will not be able to avoid claims by seeking to attack the assignment where their interest is self-serving, and that liquidators are not obliged to offer to assign an insolvency claim to a proposed defendant.

It also reminds liquidators that, although s168(5) of the Insolvency Act 1986 (Act) allows aggrieved persons to challenge their decisions, unless the applicant has a legitimate interest and there will be a benefit to creditors as a whole in reversing or modifying the liquidator's decision, an applicant is unlikely to have standing to challenge.

Background

Proceedings were issued by Manolete against the former director, Mrs Lock, and other family members, and listed for trial in December 2021, but Mrs Lock sought to set aside the assignment to Manolete on the basis that she and her family were not given an opportunity to purchase the claims against them.

The claims alleged transactions at undervalue, misfeasance and preference to the tune of £1.2 million, which, if successful, were estimated to see a return to the insolvency estate of circa £800,000.

Mrs Lock had suggested, in an early meeting, that she might be interested in buying the claims, but (1) she did not follow this up, (2) was aware of the liquidator's intention to litigate against her parents (even if not her at that point), (3) the intention to assign the claims to a litigation funder, and (4) there was no reason to think that Mrs Lock or her parents could offer a better deal.

Basis of Challenge

Section 168(5) of the Act enables a creditor, debtor or other aggrieved person to challenge an act or decision of a liquidator, which the court can then confirm, reverse or modify. Mrs Lock was also a creditor of the insolvent company, so it was on this basis that she relied on s168(5) and sought to set aside the liquidator's assignment of the claims.

Although Mrs Lock was a creditor, the Court of Appeal confirmed the approach taken in previous authorities that being a creditor is not, on its own, sufficient to apply for relief under s168(5) – an applicant must also have "a legitimate interest in the relief sought".

What is a legitimate interest?

What it is not, is where the applicant's interest is adverse to the liquidation and the interests of creditors.

In this case, Mrs Lock could not act as both creditor and defendant because, on the one hand, as a creditor, she had an interest in the claims being upheld and turned into as much money as possible, whereas, on the other hand, as defendant, her interest was to defend the claim and pay as little as possible.

Mrs Lock's interests were not, therefore, aligned with the interests of creditors generally, which were to maximise the recovery to the estate and, as such, she did not have a legitimate interest in the relief sought. Mrs Lock's interest was to protect herself and her family from the claims being pursued. In light of this, the court, at first instance, had held that Mrs Lock did not have standing to make the application, and the Court of Appeal up held this on appeal.

When might someone have standing to challenge a liquidator's decision?

It is clear from cases such as *Re Edennote* that an outsider to the liquidation has no standing to bring proceedings under s168(5). Others (creditors, debtors or aggrieved persons) do have such standing, but relief must be in the interests of all creditors, and not for other motivation or reason. This will, of course, be a question of fact, but, if an aggrieved person is seeking to protect, prevent or otherwise advance the interests of others (not creditors), then a court is likely to find that they do not have standing to challenge the act or decision of a liquidator in the first instance.

Even if someone has standing to challenge a decision, the court, as also confirmed in *Lock v. Stanley*, will rarely interfere with that decision unless it is perverse, i.e. it was unreasonable and no other liquidator would have made that decision.

In this case, the fact that Mrs Lock never followed up her suggestion to buy the claims and was aware of the pending litigation, and that no offer was on the table, meant that the liquidator's decision to assign the claims to Manolete was not perverse.

Should office holders give proposed defendants the opportunity to make an offer to purchase a claim before assigning it?

The Court of Appeal judgment in this case said it may be sensible or good practice, but office holders are not under a duty to do so, and failure to give a defendant an opportunity to acquire a claim is not necessarily wrong. That said, office holders should consider the position carefully, because if a defendant is in a position to propose a better deal, failing to properly explore that option could leave the office holder's decision open to challenge.

Sensibly, therefore, office holders should explore the possibility that a defendant might be willing to make a better offer in return for the claims being assigned. However, whether an offer is better is a bit more tricky to judge. For example, an offer that proposes a lower payment but which removes the litigation risk of pursuing the claim could, in some cases be better.

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