

## Breach of duty claims against the liquidator



BY ANDREW AMOS  
associate,  
Jones Day

THIS BRIEFING LOOKS AT THE JUDGMENT IN *HAGUE & anor v Nam Tai Electronics* [2008] (the *NTE* case), a February 2008 decision in which the Privy Council ruled that a creditor's claim of breach of duty against the liquidator was misconceived because liquidators do not owe a duty of care to individual creditors. In the light of this decision, this briefing considers the other remedies that are open to individual creditors who wish to allege breach of duty by a liquidator. The conclusion is that individual creditors can bring misfeasance proceedings against the liquidator under s212 of the Insolvency Act 1986 (the 1986 Act) if the company has suffered loss as a result of a breach of duty by the liquidator. As such, proceedings are brought by the creditor on behalf of the company and any damages will be distributed among all creditors in the usual way according to the statutory priority of payments. Any junior creditor contemplating a claim under s212 is therefore advised to first secure agreement for an increased share of the proceeds of the claim from other creditors.

### BACKGROUND

Section 143(1) of the 1986 Act states:

'The functions of the liquidator of a company which is being wound up by the court are to secure that the assets of the company are got in, realised and distributed to the company's creditors and, if there is a surplus, to the persons entitled to it.'

While a creditor has no legal or equitable interest in particular property of the company controlled by the liquidator, there is clear authority that a creditor has a right to have the assets duly administered by the liquidator (see *Banque Nationale de Paris plc v Montman Ltd* [2000]).

Against such background, it is understandable that individual creditors might speculate that they have a cause of action against the liquidator if it breaches its duty of care in the administration of the company's assets in liquidation. The Privy Council's decision in the *NTE* case has put an end to such speculation by confirming that liquidators do not owe a duty of care to individual creditors.

### FACTS OF THE NTE CASE

The case arose out of the liquidation of Tele-Art Inc, a company incorporated in the British Virgin Islands (BVI), but which traded primarily in Hong Kong. Tele-Art was placed into compulsory liquidation in the BVI in July 1998, on the petition of NTE, an unsecured creditor of Tele-Art. Mr David Hague of PricewaterhouseCoopers (PwC) was appointed as the liquidator.

### NTE'S RELATIONSHIP WITH THE LIQUIDATOR

In February 1999, NTE applied to have Mr Hague removed from his office of liquidator. The application was dismissed. NTE sought leave to appeal but these applications were also dismissed. In March 2001, NTE applied again to have the liquidator removed from his office. It was not necessary for NTE to progress this application beyond July 2002, because the liquidator was given leave to resign from his office at this time. In August 2002, Mr Hague provided a report on his conduct of the liquidation. In December 2002, his resignation was accepted by the court monitoring the liquidation in the BVI.

### NTE'S CLAIM AGAINST THE LIQUIDATOR

The claim that led to the appeal to the Privy Council was commenced by NTE in September 2002, after the liquidator had reported on his conduct of the liquidation, but before his resignation was complete.

NTE alleged that the liquidator and PwC, as the liquidator's agent, were guilty of improprieties in the conduct of the liquidation. It was pleaded that the liquidator was under a duty to obtain control of Tele-Art's assets and apply those assets in discharge of Tele-Art's liabilities. It was also pleaded that the liquidator and PwC owed NTE a common law duty of care to exercise the powers conferred by the court:

- 1) within a reasonable time; and
- 2) for the benefit of the creditors as a whole (including NTE).

Specific breaches of duty were pleaded, including that the liquidator failed to:

- 1) collect certain assets of Tele-Art; and
- 2) exercise his powers to protect Tele-Art's assets and the entitlement of its creditors in a timely manner.

NTE alleged that as a result of these breaches of statutory duty and/or common law duty (negligence), it had suffered loss in being unable to recover judgment debts due from Tele-Art to NTE. It was pleaded in the alternative that the liquidator had committed a breach of trust by failing to collect certain assets of Tele-Art, which constituted trust property that was to be held by the liquidator on trust to meet the claims of Tele-Art's creditors.

By way of relief, NTE sought both an account of Tele-Art's assets that the liquidator failed to collect, which it claimed on behalf of Tele-Art, and damages, although it was not clear whether NTE claimed the damages on its own behalf or on behalf of Tele-Art.

**APPLICATION TO SERVE CLAIMS OUTSIDE THE BVI**

In October 2002, NTE successfully sought leave to serve the claim on both the liquidator and PwC in Hong Kong. NTE's application was brought under a civil procedure rule that allows claims to be served outside of the BVI if:

- 1) the claim is a claim in tort; and
- 2) the act causing damage was committed within the BVI or the damage was sustained within the BVI.

In December 2002, the liquidator and PwC applied to set aside the service on them on the basis that the service was not permitted under the relevant civil procedure rule because:

- 1) neither the claim based on breach of statutory duty nor the claim based on breach of trust fell within the relevant rule; and
- 2) the claim based on negligence was not in respect of either an act committed in the BVI or an act causing damage in the BVI and, in any event, was misconceived.

The liquidator and PwC's application was dismissed both at first instance and on appeal to the Court of Appeal in the BVI on the basis that the relevant rule for service out of the jurisdiction had been satisfied and that NTE's claim made out a serious issue to be tried. This second element arose from the decision in *Seaconsar Far East Ltd v Bank Markazsi Jomhuri Islami Iran* [1994], which is authority for the fact that the court's discretion to grant leave to serve outside of the jurisdiction should not be exercised in circumstances where the claim in question is misconceived or otherwise bound to fail.

The liquidator and PwC then appealed to the Privy Council.

**DECISION OF THE PRIVY COUNCIL**

The Privy Council agreed with the conclusions of the Court of first instance and the Court of Appeal in the BVI that:

- 1) the liquidator was an officer of the court of the BVI and that complaints about the discharge of his duties as liquidator should be litigated in the courts of the BVI; and
- 2) the liquidator, having agreed to act as an officer of the court of the BVI could not contest the jurisdiction of that court to examine his conduct as liquidator.

The Privy Council did not agree, however, that NTE's claim made out a serious issue to be tried. It explained that this was because the breaches of duty pleaded in NTE's claim were breaches of duties owed to Tele-Art (and, arguably, to the creditors of Tele-Art as a class) but they were not duties owed by the liquidator to individual creditors:

'A culpable failure by a liquidator to collect in or preserve or take control of the assets of a company in liquidation may diminish the value of the fund available for distribution *pro rata* among the creditors but is not, in their Lordships' opinion, a breach of a duty owed to each creditor as an individual.'

The Privy Council relied upon *Kyrris v Oldham* [2004] and *Grand Gain Investment Ltd v Borrelli* [2006], which provide authority for the fact that, in the absence of a special relationship, an administrator/liquidator does not owe a duty of care to individual creditors in respect of its conduct of the administration/liquidation.

The Privy Council therefore ruled that NTE's claim was misconceived and disclosed no cause of action vested in NTE and that, applying the rule in the *Seaconsar* case, leave to serve out of the jurisdiction should not have been granted in this case.

**WHAT DOES THIS MEAN FOR CREDITORS?**

If individual creditors cannot bring a claim for breach of duty against the liquidator, what remedy is available to creditors when the company in liquidation has suffered loss in consequence of a breach of duty by the liquidator?

In the absence of a special relationship with the liquidator, the only remedy that individual creditors will have in respect of an alleged breach of duty in the conduct of the liquidation will be a claim under s212 of the 1986 Act.

Section 212 of the 1986 Act provides, *inter alia*, a remedy to companies in liquidation for the payment of damages for breach of statutory duty or negligence by the liquidator. Individual creditors have standing to bring proceedings under s212 on >

'In the absence of a special relationship, an administrator/liquidator does not owe a duty of care to individual creditors in respect of its conduct of the administration/liquidation.'

behalf of the relevant company, although any order will be in favour of the company and not the individual bringing the proceedings.

Paragraph 75 of Schedule B1 to the 1986 Act provides the same remedy for companies in administration in respect of breaches of duty by the administrator and grants individual creditors standing to bring a claim on behalf of the company.

Section 212 and paragraph 75 do not give an individual creditor a cause of action against the liquidator/administrator in its own right. They merely give that creditor standing to bring a claim on behalf of the relevant company. In consequence, the creditor will only have a right to share in the proceeds of any damages awarded to the company to the extent that it is entitled to a dividend as a creditor.

Claims under s212 and paragraph 75 are, therefore, only likely to be attractive to either senior secured

creditors, or a junior creditor who can agree with all other creditors that it should receive an increased share of the proceeds of any successful claim that is commensurate with the costs risk it will assume by bringing that claim against the liquidator/administrator.

#### CONCLUSION

The Privy Council has confirmed in the *NTE* case that liquidators do not owe individual creditors a duty of care. Creditors who have suffered loss in consequence of a breach of duty by the liquidator in its conduct of the liquidation may commence a claim under s212 of the 1986 Act (paragraph 75 of Schedule B1 to the 1986 Act for administrations) but they will be prosecuting the claim on behalf of the company and will only share in the proceeds of that claim to the extent that they are entitled to a dividend in the liquidation.

By Andrew Amos, associate, Jones Day.  
E-mail: aamos@jonesday.com.

---

*Banque Nationale de Paris plc v Montman Ltd* [2000] 1 BCLC 576

---

*Grand Gain Investment Ltd v Borrelli* [2006] HKCU 872

---

*Hague & anor v Nam Tai Electronics* [2008] UKPC 13

---

*Kyrris v Oldham* [2004] 1 BCLC 305

---

*Seaconsar Far East Ltd v Bank Markazsi Jomhuri Islami Iran* [1994] 1 AC 438