Privy Council Appeal No. 44 of 1998

Deloitte & Touche AG *Appellant*

v.

(1) Christopher D. Johnson and
(2) John Dinan *Respondents*

FROM

THE COURT OF APPEAL OF
THE CAYMAN ISLANDS

JUDGMENT OF THE LORDS OF THE JUDICIAL COMMITTEE OF THE PRIVY COUNCIL,
Delivered the 10th June 1999

Present at the hearing:-

Lord Slynn of Hadley
Lord Hope of Craighead
Lord Hobhouse of Woodborough
Lord Millett
Sir John Balcombe

*[Delivered by **Lord Millett**]*

The question for decision in this appeal is whether a debtor or alleged debtor of a company in liquidation can apply for the removal of a liquidator, in whom the creditors and contributors of the company appear to have confidence, on the ground that he is subject to a conflict of interest. There is also a related question on which the appellants petition for special leave to appeal. This is whether the defendant to an action brought by a company in liquidation can ask the court to restrain the liquidator from prosecuting the action on the like ground.

The proceedings arise out of the liquidation of Omni Securities Ltd. ("the Company"), a company incorporated in the Cayman Islands and a member of the Omni Group

of companies. The Company was placed in voluntary liquidation in November 1991. By an order of the Grand Court of the Cayman Islands in March 1992 the liquidation was ordered to continue subject to the supervision of the court. A liquidation committee was formed in May 1996. The respondents to the present appeal are the joint liquidators of the Company. They are partners of the Cayman Islands practice of Coopers & Lybrand. An associated practice Coopers & Lybrand (Switzerland) is one of the liquidators of the Company's ultimate holding company.

In March 1995 the respondents caused the Company to bring proceedings in the Grand Court of the Cayman Islands (Cause No. 104 of 1995) against a number of defendants alleging negligence in the audit of the Company's financial statements for the years 1988 and 1989. The Cayman Islands practice of Deloitte Haskins & Sells (now Deloitte & Touche) were the Company's auditors. The field work relating to the audit of the Company's 1988 and 1989 financial statements was carried out in Switzerland on their behalf by the appellants, an associated firm carrying on business in Switzerland and then known as Deloitte Haskins & Sells AG (now Deloitte & Touche AG). The appellants also signed off the audit report for the Company's financial statements for 1990. They are the eighth defendants in Cause 104. The other defendants are all parties connected with the Cayman Island practice. The audit of most of the other companies in the Omni Group was carried out by the associated United Kingdom practice ("DH&S UK"). The appellants allege, and for the purposes of the present appeal the respondents accept, that if there was negligence in the audit of the Company's financial statements as alleged, DH&S UK were at fault in failing to provide the appellants with material information.

The writ in Cause 104 was served on the appellants in March 1996. They promptly applied by originating summons for an order removing the respondents as liquidators of the Company or alternatively restraining them from continuing the conduct of the proceedings against them by reason of their conflict of interest. No less promptly the respondents issued a summons to strike out the originating summons on the grounds that the

appellants had no *locus standi* or real interest in applying for the relief sought. Smellie J. dismissed the respondents' summons, but the Court of Appeal allowed the respondents' appeal and struck out the appellants' originating summons. The appellants now appeal to their Lordships' Board.

The appellants allege that the respondents are subject to a conflict of interest which arises in this way. In 1990 most of the international practices of Deloitte Haskins & Sells merged with those of Touche Ross to form the international organisation now known as Deloitte & Touche. DH&S UK, however, did not join the new group, but merged instead with the United Kingdom practice of Coopers & Lybrand, and now forms part of the international organisation of Coopers & Lybrand. The appellants contend that the fact that the respondents are partners in a firm which is a member of the same international organisation as DH&S UK (now Coopers & Lybrand UK) gives rise to a serious conflict of interest. The appellants complain that the respondents cannot carry out their functions as liquidators of the Company properly and impartially when the actions they take could have a significant bearing on the potential liability of their associates at Coopers & Lybrand. In particular they cannot be perceived to have given proper consideration to the question whether the Company should make a claim against Coopers & Lybrand UK or join them as defendants to Cause 104.

The appellants draw particular attention to the history of the proceedings in Cause 104 so far. The writ alleges that the defendants were guilty of negligence in relation to both the 1988 and 1989 audits. This would expose Coopers & Lybrand (UK) to the risk that the appellants would bring them into the action as third parties, particularly, it seems, in relation to the 1988 audit. The statement of claim, however, makes no allegations in relation to the 1988 audit. The appellants allege that this indicates a tailoring of the case by the respondents in the interest of their associated firm rather than in the interests of creditors of the Company.

The respondents deny that there is any conflict of interest, but they accept that, this being an application to

strike out the proceedings, the court must proceed on the footing that the appellants' allegations are true. The question on the appeal, therefore, is whether the appellants, who are neither creditors nor contributories, have any *locus standi* to invoke the statutory jurisdiction of the court to remove the respondents as liquidators of the Company. The question on the petition for special leave to appeal is whether, as defendants to existing proceedings, the appellants can invoke the inherent and supervisory jurisdiction of the court over its own officers to restrain the respondents from proceeding further with Cause 104. Their Lordships will consider these questions separately.

1. The statutory jurisdiction to remove a liquidator.

The companies legislation which was under consideration by the Court of Appeal was the Companies Law (1995) Revision. The legislation has since been consolidated and revised as the Companies Law (1998) Revision. The parties are agreed that there are no material differences between the two, though the section numbers have been altered as a result of the addition of a new section 4 in the 1998 Revision. Their Lordships will refer to the provisions of the 1995 Revision. The legislation is based upon the English Companies Act 1862.

Section 106(1) provides:-

> "(1) Any official liquidator may resign or be removed by the Court on due cause shown; and any vacancy in the office of an official liquidator appointed by the Court shall be filled by the Court."

It is common ground that this section applies not only to a compulsory liquidation but also (by virtue of section 153) to a liquidation which is continuing subject to the supervision of the court. The corresponding section which applies to a voluntary winding up is section 143. This provides:-

> "143. If, from any cause whatever, there is no liquidator acting in the case of a voluntary winding up, the Court may, on the application of a contributory appoint a liquidator or liquidators; and the Court may, on due cause shown, remove any liquidator and appoint another liquidator to act in the matter of a voluntary winding up."

Their Lordships make two observations on these sections. In the first place, each of the sections has two limbs, one enabling the court to appoint a liquidator to fill a vacancy, and the other enabling it to remove a liquidator for cause. In the second place, save in the case of the appointment of a liquidator in a voluntary winding up where the application must be made by a contributory, there is no express restriction on the category of person who may make the application. Where an insolvent company is being voluntarily wound up, it appears that a creditor who wishes to apply for the appointment of a liquidator must either petition for a compulsory winding up or apply for the liquidation to continue under the supervision of the court.

In the course of argument reference was made to the cases on the corresponding statutory provisions in England. For convenience, therefore, their Lordships set out the terms of the relevant English section which corresponds to section 106 of the 1995 Revision. This is section 108 of the Insolvency Act 1986, which provides:-

> "(1) If from any cause whatever there is no liquidator acting, the court may appoint a liquidator.
>
> (2) The court may, on cause shown, remove a liquidator and appoint another."

It will be seen that the two sections are in largely similar terms. Each contains the same two limbs; neither prescribes the person or persons who may make the application.

The appellants submit that as a matter of ordinary construction section 106 confers on the court a power to remove a liquidator for cause without any limitation on the category of person who may make the application. They draw a contrast with other sections of the Companies Law which do contain such a limitation. Section 95, for example, restricts the right to apply to the court for the winding up of a company to creditors and contributories. Sections 102 (application for a stay of proceedings), 140 (determination of questions in a winding up), and 143 (set out above) all contain express restrictions on the person or persons who may make the application. By contrast

section 106 contains no requirement that the applicant should be a creditor or contributory, or that he should have a direct financial interest in the conduct of the liquidation. There is certainly no express requirement and, it is said, none should be implied, since it is impossible to foresee all the circumstances which may justify the removal of a liquidator.

The appellants concede that not everyone is a proper person to make the application. They submit that any person who has an interest in making the application or who may be affected by its outcome is a proper person to make it. They say that they are such persons since they are critically affected by decisions which the liquidators will make in the conduct of the proceedings which the Company has brought against them. The real question is whether they can establish due cause for the removal of the respondents as liquidators. This, it is submitted, is a separate question which can only be determined after a full investigation of the grounds upon which the removal of the liquidator is sought. Unless obviously ill founded, they submit, an allegation of impropriety could not be summarily dismissed without investigation; and an alleged conflict of interest is in like case. It is not to be supposed that the court would lightly permit its own officers to place themselves in a position where their interest conflicts with their duty.

The appellants have cited numerous authorities on the circumstances in which the English Court will exercise its power to remove a liquidator for cause. Their Lordships do not find them helpful to the appellants. They show that impropriety is not necessary; that it is sufficient to satisfy the court that the removal of the liquidator will be for the general advantage of the persons interested in the liquidation; that in the absence of impropriety the court will have regard to the wishes of the majority of those interested; but that where impropriety is shown the court may override their wishes. They do, however, show that the court has consistently regarded the creditors (in the case of an insolvent liquidation) and the contributories (in the case of a solvent liquidation) as the proper persons to make the application, being the only persons interested in the liquidation. Their Lordships have not been shown any case in which the court has removed a liquidator who is

able and willing to act on the application of anyone who is not a creditor or contributory as the case may be.

The appellants place much reliance on recent cases in England under section 108(1) of the Insolvency Act 1986. They have been concerned with the situation which arises when an office-holder with numerous appointments is incapable of continuing in office. Where he has automatically vacated office on having his authorisation withdrawn, the court has appointed another office-holder in his place on the application of the former office-holder himself, his former partners, the Secretary of State, and the Insolvency Practitioners Association. The court has also acceded to an unopposed application by the former partners of an office-holder who has resigned from his firm and is unable to continue in consequence to remove him and appoint another partner in his place. In all these cases the applicant has had a professional or official responsibility to bring to the attention of the court the existence of a large number of vacancies which needed to be filled. The only question of substance was whether it was necessary to incur the expense and delay of calling meetings of the creditors in every case in order to fill them. The court was prepared to remove the office-holder and thus create the vacancies it was asked to fill only where the office-holder accepted that he was incapable of acting. In such a case it recognised the reality of the situation, which was that the office was to all intents and purposes already vacant. But it refused the application and left the decision to the creditors where the office-holder, though unwilling to continue in office, was capable of doing so: see *In re Sankey Furniture Ltd.* [1995] 2 B.C.L.C. 594 and *In re A. & C. Supplies Ltd.* [1998] 1 B.C.L.C. 603.

In their Lordships' opinion two different kinds of case must be distinguished when considering the question of a party's standing to make an application to the court. The first occurs when the court is asked to exercise a power conferred on it by statute. In such a case the court must examine the statute to see whether it identifies the category of person who may make the application. This goes to the jurisdiction of the court, for the court has no jurisdiction to exercise a statutory power except on the application of a person qualified by the statute to make it. The second is

more general. Where the court is asked to exercise a statutory power or its inherent jurisdiction, it will act only on the application of a party with a sufficient interest to make it. This is not a matter of jurisdiction. It is a matter of judicial restraint. Orders made by the court are coercive. Every order of the court affects the freedom of action of the party against whom it is made and sometimes (as in the present case) of other parties as well. It is, therefore, incumbent on the court to consider not only whether it has jurisdiction to make the order but whether the applicant is a proper person to invoke the jurisdiction.

Where the court is asked to exercise a statutory power, therefore, the applicant must show that he is a person qualified to make the application. But this does not conclude the question. He must also show that he is a proper person to make the application. This does not mean, as the appellants submit, that he "has an interest in making the application or may be affected by its outcome". It means that he has a legitimate interest *in the relief sought*. Thus even though the statute does not limit the category of person who may make the application, the court will not remove a liquidator of an insolvent company on the application of a contributory who is not also a creditor: see *In re Corbenstoke Ltd. (No.2)* (1989) 5 B.C.C. 767. This case was criticised by the appellants: their Lordships consider that it was correctly decided.

The standing of an applicant cannot therefore be considered separately and without regard to the nature of the relief for which the application is made. Section 106(1) does not limit the category of persons who may make the application. The appellants, therefore, do not lack a statutory qualification to invoke the section. But the question remains whether they have a legitimate interest in the relief which they seek. They are not asking the court to appoint a liquidator to fill a vacancy. They are asking the court to remove incumbent liquidators for cause. The English cases relied upon by the appellants show that an interest which is sufficient to support an application of the former kind may not be sufficient to support an application of the latter kind.

The Company is insolvent. The liquidation is continuing under the supervision of the court. The only

persons who could have any legitimate interest of their own in having the respondents removed from office as liquidators are the persons entitled to participate in the ultimate distribution of the Company's assets, that is to say the creditors. The respondents are willing and able to continue to act, and the creditors have taken no step to remove them. The appellants are not merely strangers to the liquidation; their interests are adverse to the liquidation and the interests of the creditors. In their Lordships' opinion, they have no legitimate interest in the identity of the liquidators, and are not proper persons to invoke the statutory jurisdiction of the court to remove the incumbent office-holders.

The appellants' case is not advanced by alleging that the respondents have a conflict of interest. This is not the same as impropriety or want of probity. Their Lordships observe that the expression "conflict of interest" is an abbreviation for "conflict of interest and duty". The rule is that a fiduciary may not without the informed consent of his principal place himself in a position where his interest may conflict with his duty to the principal. The danger is that his interest may affect him in the discharge of his duty to the prejudice of his principal. The only persons with a legitimate interest in complaining of a breach of the rule are the persons to whom the duty is owed; and they may waive the breach. The appellants do not allege that the respondents have an interest which conflicts with any duty owed *to them*. They do not plead any such duty. They allege that the respondents have an interest which conflicts with their duty to the Company and its creditors. If such a conflict exists, it is for the creditors alone to decide what if anything to do about it.

2. The inherent jurisdiction of the Court over its own officers.

As liquidators of the Company the respondents are officers of the court. The court's inherent jurisdiction to control the conduct of its own officers is beyond dispute. But it does not follow that the appellants are proper persons to invoke that jurisdiction. They say that the respondents are behaving unconscionably by reason of their conflict of interest. But they cannot say that the respondents are acting unconscionably *to them*.

The appellants complain of the manner in which the respondents have conducted the proceedings against them in Cause 104. Thus they make the application as defendants to existing proceedings. They do not allege that those proceedings disclose no cause of action or are an abuse of the process of the court. If such were the case, the appellants would have an obvious remedy. They complain that the respondents have not made Coopers & Lybrand UK defendants to Cause 104. But the appellants have the remedy in their own hands. If they want to make Coopers & Lybrand UK parties to the action, they can bring them in themselves as third parties. They complain that the respondents, being the persons in control of the proceedings on behalf of the Company, have interests which conflict with those of the Company and may accordingly not properly discharge their duties to the Company. It is strange to hear defendants complain that the proceedings against them may not be pursued with sufficient vigour. If the Company were not in liquidation, the appellants could not be heard to complain of such conduct on the part of its directors. It would be a matter within the exclusive competence of the shareholders. Their Lordships do not accept that the fact that the Company is in insolvent liquidation and that the liquidators' duties are owed to the creditors rather than the shareholders gives the appellants a standing to complain which they would not otherwise have had.

Their Lordships consider that the answer they have returned to the first question effectively disposes of this question also. They will humbly advise Her Majesty that the appeal and the petition for special leave should both be dismissed. The appellants must pay the respondents' costs of both the appeal and the petition before their Lordships' Board.