

## Insolvent Clients and Solicitors' Liens:

### *Candey Limited v Tonstate Group Limited* [2021] EWHC 1826 (Ch)

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***Section 73 of the Solicitors Act 1974 allows the court to grant a charging order in favour of a solicitor over property recovered or preserved in litigation. This supplements, but does not replace, the solicitor's common law right to a lien.***

In *Candey Limited v Tonstate Group Limited* [2021] EWHC 1826 (Ch), the High Court clarified the priority of the solicitor's lien as against charging orders and bankruptcy generally. As such, the case provides useful guidance to solicitors looking to enforce claims against insolvent clients, and in particular the different outcomes for solicitors acting for claimants and solicitors acting for defendants.

#### The background

The judgment is the latest round in a long-running shareholders dispute, which has already generated two useful precedents for insolvency lawyers and a further one for costs lawyers.

- In *Tonstate Group Limited v Wojakovski* [2019] EWHC 3363 (Ch), the court held that the Duomatic principle cannot be used to ratify payments to directors made for the purpose of tax evasion. The principle does not apply to payments which the company itself could not lawfully have made.
- In *Re Wojakovski* [2020] EWHC 2737 (Ch), the court held that where there are supporting creditors and the debtor is able to pay the petition debt within a reasonable time, the court should only adjourn a bankruptcy petition where the supporting creditors can also be paid within a reasonable time. That follows from bankruptcy being a class remedy.
- By the time the latest case reached court, W, one of the parties to the shareholders' dispute was bankrupt. He had failed to recover anything from the other parties, but had partly succeeded in defending a claim against him, which resulted in him retaining part of his shareholding in the company. W's solicitors claimed an equitable charge over his shares as security for fees said to be due to them under a damages based agreement. In the judgment reported at [2021] EWHC 1122 (Ch), Zacaroli J held that a DBA can only apply to recoveries made for a claimant, not to assets preserved for a defendant, and so the solicitors' claim failed.

The latest judgment deals with the priority between a solicitor's lien and a charging order creditor. It was delivered in anticipation of an appeal against the finding that the DBA was invalid.

#### Solicitors' liens and charging orders

Solicitors are entitled to two different categories of lien.

- They have a legal lien for their costs over client's property and papers held by them. This is a true lien, which depends on possession.
- Solicitors also have a right at common law and under section 73 of the Solicitors Act 1974 to security over property recovered or preserved through their instrumentality. This is an equitable lien and does not depend on possession. Among other things, the court can order an unsuccessful defendant to pay money due to a successful claimant to the claimant's solicitors in order to prevent the claimant depriving the solicitors of their fees.

The solicitor's right to the equitable lien arises as soon as there is a "fund in sight", ie when property can be said to have

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been recovered or preserved and when there is something in the nature of a fund against which equity can recognise the claim. That will usually be when judgment is given or when a settlement is reached (see para [30] of the judgment).

### **The judgment in relation to priorities**

Priorities in relation to the equitable lien depend on notice. The solicitor's claim will fail against a bona fide purchaser for value without notice.

In the case of a solicitor acting for a claimant, it is unlikely that a third party who acquires an interest in a fund over which a solicitor asserts a lien will be able to claim priority.

If the third party is aware that the solicitor is acting for the claimant, that will be enough to give the third party notice of the solicitor's interest.

The equitable lien is akin to salvage. The recoveries in the action arise as a result of the solicitor's efforts, so the solicitor ought to have a right to those recoveries as security for fees ahead of the client. The solicitor should also have a right to recover of fees ahead of the third party who obtains a charge on the recoveries, because the recoveries are only there because the solicitor has done the work.

The result is that the equitable lien survives the insolvency of the client. The insolvent estate cannot take the benefit of the recoveries without bearing the expense of making them (see paras [34] to [38]).

Zacaroli J held that the position is different where a third party creditor obtains a charging order over assets which are involved in the litigation, in this case the shareholding which W was allowed to retain. He held that because the shares had always belonged to W, they were not "recoveries" which triggered the salvage principle (para [39]) and that the charging order creditor was not on notice of the lien simply by reason of knowing that the solicitors were acting, and acting on a DBA (para [40]).

### **Commentary on the decision**

The reasoning as to the difference between claimants and defendants is open to criticism. Had the solicitors not acted, W's shareholding would not have been preserved. It is hard to see any principled distinction between the estate being enriched by a recovery from a third party, and the estate's value being maintained by retaining identifiable property from a third party.

If that proposition is eventually accepted by the Court of Appeal, then a third party with notice that a solicitor is acting in a dispute as to identifiable property should have sufficient notice of the solicitor's lien to be bound by it.

### **Practical Points**

Solicitors and insolvency practitioners might want to consider the following practical points:

- Any solicitor acting for a client whose ability to pay is uncertain should consider taking security over any identifiable assets. Provided that the necessary formalities are complied with, it is possible to take security over future as well as present assets.
- If security has not been taken and there is an identifiable fund, a prompt application under the [Solicitors Act 1974](#) may result in security being granted in the solicitor's favour.
- Solicitors who have acted for insolvent claimants should consider whether they can assert a salvage claim against the insolvent estate and insolvency practitioners should be aware of that possibility.
- The sooner a charging order application for a creditor is made, the more likely it is that the charging order will take priority over any competing interests.