RECENT ISSUES IN CORPORATE AND PERSONAL INSOLVENCY

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1. This is a time of great potential change in insolvency. Towards the end of 2010 the Insolvency Service consulted on whether or not to continue its work on a full re-write of the 1986 Rules, as the final phase of work to modernise the Insolvency Rules. By a letter dated 20 April 2011, Anne Willcocks, Director of Insolvency Policy and Practitioner Regulation, confirmed:

"*Ministers have decided that work on a full new set of rules should continue, although those rules will not now come into force before October 2013. This will take into account some concerns expressed about the introduction of the new rules so soon after the changes introduced in April 2010. We plan to publish a full working draft of the new rules in the near future for the purpose of inviting feedback on the structure, content and detailed drafting. That will be the final open invitation stakeholders will have to help shape these new rules so I really would welcome as much feedback as you are able to provide."*

2. There have also been a number of interesting decisions handed down in the last six months. We have attempted to select some of the most important for discussion in this paper:

Balance Sheet Solvency

3. Traditionally, English law has employed two primary tests for determining whether a company or an individual is unable to pay their debts: the 'cash flow' insolvency and the 'balance sheet' insolvency tests. The limitations of adopting a purely commercial analysis of insolvency by simply applying a unitary cash flow approach are succinctly and ably summarised by Professor Goode in The Principles of Corporate Insolvency Law*:*

"The idea underlying [the balance sheet insolvency test]...is that it is not sufficient for the company to be able to meet its current obligations if its total liabilities can ultimately be met only by the realisation of its assets and these are insufficient for the purpose. If the cash flow test were the only relevant test then current and short-term creditors would in effect be paid at the expense of creditors to whom liabilities were incurred after the company had reached the point of no return because of an incurable deficiency in its assets."[1]

4. It has long been recognised that the court must have regard to a debtor's ability to meet prospective and contingent debts in determining whether a company is insolvent for the purposes of winding-up. This position is now firmly enshrined in s 123(2) of the Insolvency Act 1986 ("IA") which provides:

"A company is also deemed unable to pay its debts if it is proved to the satisfaction of the court that the value of the company's assets is less than the amount of its liabilities, taking into account its contingent and prospective liabilities."

5. This provision is unlikely to have come as a surprise to practitioners, given that comparatively similar wording had applied under the 1948 and 1985 Companies Acts (albeit with no express distinction drawn between cash flow and balance sheet insolvency).[2] This test is also applied in a number of other contexts under the 1986 Act, in particular in assessing solvency for the purposes of administration[3], and the transaction avoidance provisions applying to both corporate[4] and personal insolvency[5] However, it would appear that the proper interpretation of the requirements of this provision has not fallen for consideration by the court until the recent case of *BNY Corporate Trustee Services Ltd v Eurosail UK 2007* [2011] EWCA Civ 227, [2010] EWHC 2005 (Ch).

[1] Goode, The Principles of Corporate Insolvency Law, p
[2] For a useful summary of the position under previous legislation, see *Re Cheyne Finance Plc* [2008] 1 BCLC 732 at [30] – [36] per Briggs J
[3] Para 11(a), Sch B1, IA 86
[4] ss 238, 239, 245 IA 86
[5] s 339, 340 IA 86

Eurosail: The Facts

6. The issues for determination in *Eurosail* arose out of the collapse of Lehman Brothers in September and October 2008. Eurosail was a special purpose vehicle incorporated for the purpose of acquiring and holding a portfolio of UK Residential Non-Conforming Mortgage loans with a face value of £650 million to be used to meet the liabilities on interest-bearing notes issued by it as part of a securitisation transaction. The loan notes issued to creditors were of five classes (A-E), with descending priority rights. The A class was further divided into three subclasses (A1-A3) denominated in various currencies.

7. Eurosail's risk in relation to changes in interest and exchange rates was hedged by means of interest and currency rate swaps with Lehman Brothers companies. The transaction also included a Post Enforcement Call Option Agreement (PECO) aimed at rendering Eurosail 'insolvency remote' by limiting the Noteholders' rights of recourse in practice upon enforcement of the security for the notes. If on enforcement the security for the notes was found to be insufficient to pay all amounts due in respect of them, an associate company of Eurosail would have a call option in respect of the benefit of all the notes at a nominal price.

8. The arrangements governing the issue of the loan notes were set out in a number of transaction documents including a Trust Deed by which BNY Corporate Trustee Service Limited (BNY) was effectively constituted the trustee of the rights of the Noteholders against Eurosail, including the right to enforce rights contained in the Trust Deed.

9. As the underlying residential mortgages were redeemed or enforced, the proceeds were applied in accordance with one or other of two specified priorities, namely the priority of payments prior to or post enforcement. Prior to enforcement, the subclasses A1-A3 would be paid the principal amounts outstanding on the Notes in descending order of priority. However, if and when BNY served an enforcement notice on Eurosail upon the occurrence of an Event of Default the three-subclasses of Class A Notes would be collapsed into a single class, so that they would rank *pari passu* for the repayment of capital. The Trust Deed provided that an Event of Default included Eurosail being deemed unable to pay its debts within the meaning *of* Section 123(1) IA.

10. As a result of Lehman Brothers filing for protection under Chapter 11 of the US Bankruptcy Code, the swap agreements were terminated. The loss of the currency hedge proved disastrous because since August 2007 sterling depreciated significantly against both the euro and the dollar, resulting ultimately in a significant deficiency in the net asset position of Eurosail, although the class A1 Noteholders were repaid in full.

11. In May 2010, BNY issued a Part 8 Claim raising two specific questions, namely:

    (i) Whether, without regard to the PECO, Eurosail was unable to pay its debts within the meaning of s 123(2) for the purposes of the relevant condition; and if so;

    (ii) Whether the PECO had the effect that Eurosail was not unable to pay its debts.

12. Unsurprisingly, the A3 Noteholders, who stood to benefit from the application of the post enforcement priority of payments, argued that Eurosail should be deemed to be unable to pay its debts within the meaning of s 123(2) so as to constitute an event of default; the A2 Noteholders contended for the converse position.

'Taking Into Account' Prospective and Contingent Liabilities

13. At first instance, the Chancellor recognised that this appeared to be the first time the proper interpretation of the requirement to "take into account" the company's contingent and prospective liabilities had required such close consideration when determining whether the value of company's assets was less than the amount of its liabilities.

14. The A3 Noteholders advocated a somewhat strained interpretation of the requirements of s.123(2), arguing that the correct approach was to take the assets and liabilities of a company at

their respective face amounts (i.e. those in the company's balance sheet unless good reason was shown to the contrary), and if the aggregate of liabilities exceeds the aggregate of the assets, the company is deemed to be insolvent – literally to take an account. Applying the test in this way, Eurosail was plainly balance sheet insolvent as revealed by the successive deficits in its annual financial statements.

15. In support of this submission, the A3 Noteholders relied upon the earlier decision of *Byblos Bank SAL v Al-Khudhairy* [1987] BCLC 232, in which the Court of Appeal considered the proper interpretation of the requirements of s.223(d) of the Companies Act 1948. Taking the example of a company whose liabilities consisted of an obligation to repay a loan of £100,000 one year hence, and whose only assets were worth £10,000, Nicholls LJ stated:

"It is obvious that, taking into account its future liabilities, such a company does not have the present capacity to pay its debts and as such it 'is' unable to pay its debts."

16. Ultimately, the Chancellor rejected this approach, preferring the submissions of the A2 Noteholders. Having concluded that the decision in *Byblos* was not binding upon him given that it was a decision on legislation in materially different terms, but merely persuasive, and having also considered carefully the decisions of Nourse J in *Re a Company* [1986] BCLC 261 and Briggs J in *Re Cheyne Finance Plc (In Receivership)* [2008] 1 BCLC 741, the Chancellor identified a number of key propositions which could be derived:

(i) The assets to be valued are the present assets of the company (and not contingent or prospective assets). Presumably these are to be assessed at their value to the company but whether on a going concern or break-up basis is unclear;

(ii) The requirement to take account of contingent and prospective liabilities cannot require such liabilities to be aggregated at their face value with debts presently due. It follows that the conversion of prospective liabilities denominated in currencies other than sterling into sterling at the present spot rate is not required either; and

(iii) The content of 'taking account of' must be considered in the context of the overall question whether the company is to be deemed insolvent on a balance sheet basis. This will involve consideration of the relevant facts, including:

(a) when the prospective liability falls due;
(b) whether it is payable in sterling or some other currency;
(c) what assets will be available to meet it; and
(d) what (if any) provision is made for the allocation of losses in relation to those assets.

17. Applying these propositions to the facts, the Chancellor concluded that Eurosail was not balance sheet insolvent. In conducting the requisite balancing exercise, it was noted that Eurosail's financial statements failed to include claims Eurosail had in the Lehman Brothers liquidations in respect of the currency swap agreements in the value of its aggregate assets. Notwithstanding that normal accounting practice would omit a pending claim from an annual balance sheet on the basis that it is a contingent asset, the Chancellor was satisfied that these were present assets with a considerable value, irrespective of whether they were ultimately admitted.

18. Conversely, a substantial proportion of the total liabilities shown in the financial statements due to the conversion into sterling at the spot rate prevailing at the balance sheet date of future liabilities potentially not falling due for payment until 2045 was held to be 'entirely speculative', was not considered to be a prospective liability and was only contingent because it may or may not occur. The Chancellor declined to take account of that proportion at any material value.

19. Importantly, the Chancellor expressly rejected the suggestion that s.123(2) calls for the production of an annual balance sheet providing a snapshot of the affairs of a company at a given point in time. Further, the Chancellor opined that he was entitled to infer that there was no deficiency in Eurosail's assets such that it should be deemed insolvent because Eurosail was able to pay its debts as they fell due.

20. At first blush, it would appear that the reasoning underpinning the Chancellor's conclusion that s.123(2) was not engaged on an application of the relevant principles identified above has somewhat blurred the distinction to be drawn between the traditional dichotomy of 'cash flow' and 'balance sheet' insolvency, effectively rendering the latter a mere adjunct of the former.

21. It is true that Professor Goode has considered there to be a close link between the two tests and that a commercially solvent company has a much greater chance of satisfying the balance sheet test of solvency than one which is unable to pay its debts as they fall due.[6] This is relatively uncontroversial. Clearly, a company trading as a going concern whose business can be sold as such will have a higher value than one whose assets are sold on a break-up basis.

22. However, if one follows this logic of *Eurosail*, it could be argued that wherever a company is able to meet its debts as they fall due, the requirement to 'take into account' prospective and contingent liabilities is negated; one can infer from the commercial solvency of the company that its assets exceed its liabilities at any given point. It is suggested that the legislature cannot have intended that a company able to pay its short-term creditors at a time when it was readily apparent that there was no prospect that a long term loan would ever be repaid could avoid winding up unless and until the point at which it becomes cash flow insolvent.

PECO

23. Turning to the question, assuming that Eurosail was balance sheet insolvent, of the effect of the PECO, which was designed to prevent the Noteholders from taking steps to wind up Eurosail, the Chancellor considered that this could not remove any asset deficiency. Regardless of whether or not the PECO was exercised, Eurosail's liabilities which fell for consideration under s.123(2) would have remained the same.

Court of Appeal

24. The Chancellor's decision was appealed to the Court of Appeal by the A3 Noteholders in relation to interpretation of s.123 and the A2 Noteholders in relation to the PECO. The Court of Appeal upheld the decision at first instance on both grounds.

25. In considering the proper interpretation of s.123(2), Lord Neuberger MR made the following observations:

    (iv) The question whether s.123(2) applies does not simply turn on whether the liabilities of a company exceed its assets, however assessed. This would be commercially undesirable; most companies which are solvent and successful would be deemed unable to pay;

    (v) The purpose and applicable test of s.123(2) are accurately encapsulated by Professor Goode (set out above at paragraph 1). It is only when it can be said that a company's use of its cash or other assets for current purposes amounts to a 'fraud' on the future or contingent creditors that it can be said that it 'has reached the point of no return';

    (vi) s.123(2) does not amount to a wholly new, relatively mechanical "asset-based" basis for seeking to wind up a company. It can only be relied on by a prospective or contingent creditor of a company which has reached "the end of the road" or in respect of which the shutter should be "put up";

    (vii) The ultimate question for the court when considering whether s.123(2) applies is whether the company has reached the 'point of no return' based on commercial reality and commercial fairness; and

    (viii) The closer in time a future liability is to mature, or the more likely and greater the size of a contingency liability, the more probable it will be that s.123(2) will apply.

Conclusions

[6] Goode, The Principles of Corporate Insolvency Law, p 88

26. It would therefore appear that s.123(2) requires the court to adopt an objective test and reach a conclusion as to whether the company has reached the 'point of no return', notwithstanding the clear wording of that subsection, incorporating an element derived from the Cork Report and Principles of Insolvency Law, but conspicuously absent from the Insolvency Act.

27. In practice, this is likely to present significant difficulties. In the first instance, it will be difficult to advise with any certainty as to whether or not a company will be deemed insolvent pursuant to s.123(2) for the purposes of presenting or defending a winding up petition since calculating the point of no return without (and frequently with) the benefit of hindsight is entirely speculative. The situation is directly analogous with the comparative difficulties of determining the point at which directors ought to have known that there was no prospect of avoiding insolvent liquidation for the purposes of wrongful trading proceedings. Moreover, the task required to be undertaken by the court will become increasingly complex. For example, to what extent can the prospect of rescue by a White Knight be taken into account?

28. There is also a very real danger that the court will be tempted to put the cart before the horse, assessing whether the company has passed the point of no return based on cash flow considerations and then cherry picking which assets and liabilities should be taken into account in assessing its balance sheet solvency.

29. Whilst in practice petitions based on the balance sheet insolvency of a commercially solvent company are relatively rare, the implications of this decision are likely to impact on other areas where the balance sheet test is of relevance. It remains to be seen the extent to which the 'point of no return' test will apply in the context of transaction avoidance claims, in both the corporate and personal context. However, prima facie, it may prove more difficult for office holders to establish the requisite insolvency of a debtor in the context of transactions entered into with non-associates.

Costs - Two cautionary tales

Eurosail

30. In *Eurosail* Lord Neuberger went on to express his concern that BNY, which was ostensibly neutral on the issues before the court, had been represented by two counsel and at least one solicitor, a position that appeared on its face to be 'excessive'. He suggested that in circumstances such as this, it would normally be unnecessary for a neutral party to make submissions or be represented (save for instructing a note-taker) unless he had good reason to think that his actions would be subject to criticism or there was some other special reason. Directions could be sought at a relatively early stage to enable the party to make submissions (possibly written) if a point arises on which his assistance is required or on which he desires to have a say. Whilst *Eurosail* concerned a corporate trustee, it seems clear that similar principle will apply in the context of insolvency office-holders.

31. Another recent and high profile case dealing with the question of an office holder's costs is the decision of Richard Snowden QC, sitting as deputy judge of the High Court in *Re Capitol Films Limited* [2010] EHC 3223 (Ch) in which he ordered the administrators of the company to pay the costs of their unsuccessful application for permission to sell assets subject to a fixed charge under para 71 of Schedule B1 of the Insolvency Act and took the rare step of prohibiting them from recovering these costs as an administration expense from the assets of the Company.

In the Matter of Capitol Films Ltd

32. Capitol Films Limited ("Capitol") was a company involved in the business of producing and distributing motion pictures. It was owned by a Mr Bergstein who was also a director. Capitol owned rights in respect of various films some of which were subject to fixed charges held by a number of creditors. It assigned its rights in 81 films to Pangea, another company connected to Mr Bergstein. Mr Bergstein then resigned as a director of Capitol, which was shortly thereafter placed into administration by its new directors. The administrators sought to sell Capitol's film rights.

33. Early on in the administration Capitol's secured creditors raised the issue of the assignment of rights in films to Pangea and that investigation of the validity of this transaction would be crucial to valuing the assets of the company in preparation for any sale. This was a constant refrain from the secured creditors. Despite repeated prompting the administrators failed to scrutinise this transaction.

34. The administrators received an offer from Exodus Films Company ("Exodus"), another company connected with Mr Bergstein, to purchase Capitol's rights in respect of any films and all causes of action vesting in the company (this would include any rights still in its possession to the films it had purportedly assigned to Pangea and any claims against Mr Bergstein or Pangea). It was clear there would be no distribution to unsecured creditors and a shortfall in the security of the secured creditors. The administrators applied for permission to enter the sale transaction with Exodus pursuant to para 71 of Schedule B1 to the Insolvency Act. No consultation took place before this application was made. The secured creditors opposed the sale and the application.

35. Shortly before the application came on Exodus threatened to withdraw its offer unless a deal was entered into within 3 days. The administrators entered into a conditional contract with Exodus which it did not reveal to the creditors.

36. One of the secured creditors, Allied Irish Banks Plc ("AIB"), asked for permission to enforce its security over such rights as Capitol might have in one of the films purportedly assigned (The Edge of Love). The administrators eventually agreed but then immediately withdrew their consent without explanation. AIB applied to the Court for permission.

37. At the first hearing the Court was invited by the administrators to proceed on the basis that the assignment to Pangea had been effective to pass title and the assigned films therefore were not part of the sale (despite the fact that the administrators set out in their own evidence that they did not accept the assignment and it might have been improper). The Court rejected this on the basis that the applicant's evidence was manifestly incomplete in that it gave no account of the details or the background of the assignment to Pangea and gave no indication as to the administrator's opinion of the value of the company's rights in the films purportedly assigned.

    The Court could not determine without such evidence whether the sale contract would be effective to transfer the films purportedly assigned to Exodus, which impacted both upon the value of the assets and therefore the adequacy of the sale price and the way in which the sale proceeds should be distributed. There was no evidence upon which the Court could be satisfied that the terms upon which such sale was to take place, and upon which the proceeds were to be distributed, were properly protective of the rights of the holders of fixed charges over the Company's rights in respect of the assigned films. The Court allowed AIB's application. The administrator's application was adjourned to allow the administrators to reassess their position. The question of the costs of AIB's application was also adjourned to allow the administrators to file evidence to explain their conduct in relation to that application.

38. Shortly before the adjourned hearing the administrators notified the Court they no longer wished to pursue their application. They filed no evidence in respect of AIB's application. At the adjourned hearing the administrators sought an order that their own costs be payable as expenses of the administration and to resist a costs order being made against them in favour of the secured creditors on the basis that the application was a commercial decision taken to realise the assets of the company in administration and the Court should not challenge the commercial decision making of an office holder provided he behaved rationally (by analogy to *Unidare Plc v Cohen* [2006] BCC 26). Here the administrators had behaved rationally given the lack of funding in the administration, the forceful assertions of Mr Bergenstein that the assignment to Pangea was valid and the time pressure they were under from Exodus.

39. This argument was rejected. Richard Snowden QC held as follows in relation to the costs:

    (i) An application of this sort was essentially a contest between the administrators (usually seeking to advance the interests of the unsecured, the preferential creditors, the floating charge holders and override the rights of the secured creditors) and the secured creditors.

The secured creditors were successful and on general principles should be entitled to their costs [para. 82 and 85];

(ii) This type of application requires the court to balance the competing rights and interests of the holders of fixed charges with the rights and interests of the other creditors. On that type of issue, the court does not simply defer to the administrators' business judgment provided that it is rational; the court will decide for itself how to resolve the competing interests of creditors [paras 83-84];

(iii) In any event, in this case the administrators' behaviour had been neither reasonable nor rational. The purpose of this administration was to sell the secured assets for the benefit of the secured creditors, in essence in substitution for each of the charge holders conducting their own sales to realise their security. An application under para 71 represented a significant interference with the rights of the charge holders to realise their security at the time and in the manner of their choosing. However, the administrators had failed to engage constructively with the secured creditors prior to making the application and the application was pursued in the face of concerted opposition from the very creditors the administrators were supposed to be serving. Such interference in the face of resistance from the secured creditors might be justified where the proposed sale could lead to greater realisations for the unsecured creditors, but if the secured debts will not be paid in full, the administrators have no material group's interests to serve beyond the unsecured creditors [para 87];

(iv) The administrators had not behaved appropriately since they had informed the creditors they sought only to sell the films which had been retained by Capitol but in fact entered a conditional sale agreement which encompassed any rights Capitol had in the assigned films as well, but attempted to bypass consideration of this issue by inviting the Court to assume the assignment was valid when they did not accept this themselves [paras 88-90];

(v) The administrators had not adequately investigated the assignment to Pangea and could not provide any adequate reasons for failing to do so, despite guidance from the Court of Appeal in *Coyne v DRC Distribution Ltd* [2008] BCC 612 to the effect that in circumstances like this administrators should investigate and unravel such transactions before embarking on an asset sale. The administrators blamed lack of funds but this was rejected by the judge who stated that administrators should act with "robustness of purpose". They should have questioned Mr Bergstein about the assignment and obtained legal advice which would have provided a basis to negotiate the provision of further funds from the creditors to pursue any necessary action [para 90-93];

(vi) On the basis of the matters set out above the administrators were wrong to commence and pursue the application;

(vii) There has to be a significant level of unreasonableness or otherwise inappropriate behaviour before an order on an indemnity basis is appropriate. However, in this case the administrator's actions were irrational and misconceived (they sought approval of a sale without properly considering what it was they were selling or its value). They also adopted an "unco-operative and at times hostile attitude to the secured creditors in whose interests they were supposed to be acting." This was unreasonable to a sufficiently high level to justify a costs order on an indemnity basis.[paras 95-97];

(viii) The Court should exercise its discretion to deprive the administrators of their right to recoup the costs out of Capitol's assets. By analogy to cases on liquidation expenses this discretion should be exercised in cases of misconduct, serious mistake or where it would be unjust for other reasons to allow recoupment. In this case the application was irrational and misconceived which is in the same category as a serious mistake. Further, it would be unjust for the administrators to recoup themselves ahead of the floating charge holders or unsecured creditors who did not stand to benefit at all from the proposed sale; and

(ix) For similar reasons, the administrators were ordered to pay the costs of the charge holder's application for permission to appoint a receiver with no right of recoupment.

40. The facts of this case were unusually extreme: the administrators had inexplicably failed to investigate matters requiring investigation and instead had chosen to pursue doggedly a course of action which put them in direct conflict with the very group whose interests they were supposed to be serving. However, the important headline for all insolvency office holders is to be mindful of which group of creditors the action is intended to benefit and to consult them and ensure their approval is obtained where possible.

Remuneration of Office-Holders

41. Prior to the legislative reforms leading to the 1986 insolvency legislation, the only basis of remuneration for trustees in bankruptcy was a percentage of realisations and distributions.[7] Whilst successive Companies Acts permitted the court to fix remuneration on some other basis in the case of compulsory liquidations, remuneration on this basis remained the norm. This position was criticised by the Cork Report for leading in the case of easily realised assets to disproportionately high remuneration and in a complex case to poor recompense in relation to the amount of work involved.[8]

42. In consequence, by the Insolvency Rules 1986 remuneration is now permitted to be determined on a time basis as an alternative to a percentage of realisations and distributions, if so approved by the creditors' committee or by a resolution of a meeting of creditors, having regard to: (a) the complexity of the case; (b) whether there falls on the office-holder any responsibility of an exceptional kind or degree; (c) the effectiveness with which the office-holder appears to have carried out his duties; and (d) the value and nature of the assets in the estate with which he has to deal. In default of such decision, the former position prevails (i.e. a percentage of realisations).

43. The Rules also permit office-holders and creditors to challenge the remuneration if they believe it is too low or too high respectively and the court is empowered to vary the basis or amount of remuneration accordingly. Since 5 April 2010, a bankrupt is also now permitted to challenge the trustee's remuneration. However, there is no guidance in the rules as to how the court should exercise its powers.

44. The relevant principles first fell for judicial consideration in *Mirror Group Newspapers plc v Maxwell (No 2)* [1998] BCLC 638, in which the remuneration, legal fees and disbursements of the receivers of the estate of Robert Maxwell amounted to £1.63m as against realisations of £1.67m, but which has been applied equally to office-holders under the insolvency legislation. Ferris J determined that as an office-holder is a fiduciary owing a duty to account to creditors for both the way in which he exercises his powers and for the property with which he deals it is for him to justify the level of remuneration claimed. Ultimately, the aim of the court fixing remuneration was to reward the value of the services rendered by the office-holder, which does not necessarily equate to time spent.

45. In conducting an assessment of remuneration, three relevant principles could be identified:

    (i) The office-holder must expect to give full particulars in order to justify the amount of any claim for remuneration. However, the amount of detail required will be proportionate to the case;

    (ii) The office-holder must keep proper records of what he has done and why he has done it; and

    (iii) The test of whether an office-holder has acted properly in undertaking particular tasks at a particular cost in expenses or time spent is whether a reasonably prudent man, faced with the same circumstances in relation to his own affairs, would layout or hazards his own money in doing what the office-holder has done.

46. The requirement of proportionality was further espoused by the Report of the Ferris Working Party on Office Holders' Remuneration, commissioned prior to *Maxwell*, and published in July

[7] s 82(1) Bankruptcy Act 1914
[8] *Report on Insolvency Law and Practice* (1982 Cmnd. 8558), para 998

1998. It was concluded that the unlimited range of size and complexity of administrations undertaken by office-holders made it impossible to prescribe a universal approach applicable to all cases but that what was required by the principle of proportionality was the provision of "sufficient information to enable creditors or the court to have a clear view of what the office-holder has done or intends to do and of the value he has protected for creditors."[9]

47. It was further recommended that there be added to the criteria for approving remuneration a further criterion, namely the time properly given by the office-holder and his staff in attending the debtor's affairs.

Practice Statement

48. An important consequence of the Ferris Report was the revival of an Insolvency Court Users Committee, chaired by the Chancellor, which was instrumental in producing the Practice Statement: The Fixing and Approval of Remuneration and Appointees [2004] BCC 912, issued on 15 July 2004 with effect from 1 October 2004 with the stated objective of ensuring that the remuneration of office-holders fixed and approved by the court is fair, reasonable and commensurate with the nature and extent of the work properly undertaken in any given case and fixed and approved by reference to a consistent and predictable process.

49. Paragraph 2.1 of the Practice Statement provides, save to the extent and as may otherwise be ordered by the court, that it applies in respect of:

(i) any application to the court by an appointee for the fixing and approval of his remuneration where his remuneration has not otherwise already been fixed and approved;

(ii) any application to the court by an appointee for the fixing and approval of his remuneration in circumstances where he considers that the amount of his remuneration as fixed and approved by the creditors is insufficient; and

(iii) any application by a person who may be permitted to apply to supervise the conduct of an office-holder and is dissatisfied with the remuneration that has otherwise been fixed and approved on the basis that such remuneration is excessive.

50. Paragraph 3.4 identifies 8 guiding principles by reference to which application are to be considered:

(i) **Justification**: It is for the office-holder to justify his claim to remuneration;

(ii) **Benefit of Doubt**: Any element of doubt should be resolved against the office-holder;

(iii) **Professional Integrity**: The court should give weight to the fact that an office-holder is a member of a regulated profession and an officer of the court;

(iv) **Value of Service Rendered**: Remuneration should reflect the value of the service rendered and not simply reimburse the office-holder in respect of time expended and cost incurred;

(v) **Fair and Reasonable**: Remuneration should represent fair and reasonable remuneration for work properly undertaken/to be undertaken;

(vi) **Proportionality**: Information provided and remuneration fixed should be proportional to the nature, complexity and extent of the work to be completed;

(vii) **Professional Guidance**: The court may have regard to relevant statements of practice and the extent of compliance by the office-holder; and

[9] Ferris Report, para 4.3

(viii) **Impracticability**: Where an application to the court is not made as soon as reasonably practicable after appointment where it is not practicable to have remuneration fixed by creditors but the office-holder subsequently does so an explanation must be provided.

Super Aguri

51. A useful illustration of an application of the Practice Statement in practice is provided by the decision of Mr Registrar Jacques in *re Super Aguri F1 Ltd* [2011] BPIR 256, which concerned the administration and subsequent liquidation of Super Aguri F1 Ltd (SAL), whose principal business was running the Honda formula one racing team.

52. After attempting for a year to find a buyer for the business as a going concern, the directors of SAL appointed administrators in 2008 pursuant to para 22 of Schedule B1 IA with the stated aim of achieving a better result for creditors as a whole than in liquidation. Honda, the largest creditor representing 72% of SAL's total indebtedness, expressed its opposition to the appointment because it believed that the statutory purpose was not capable of achievement, preferring an immediate CVL, and that administration would only serve to increase costs. However, at no point did it seek to obtain an order under para 81 or 88 of Schedule B1 removing the administrators from office.

53. At a subsequent creditors' meeting, Honda used its overwhelming majority voting power to force the administrators to place the company into CVL, whereon they ceased to act. In October 2008, the former administrators applied to the court to fix their remuneration on a time cost basis in the sum of approximately £317,000 together with disbursements of £75,000. This application was challenged by the liquidators of SAL.

54. The liquidators raised two preliminary points in relation to the appointment of the administrators and their subsequent approach to the administration. In relation to the first point, it was suggested that the appointment should not have been made as: (1) it was made without any prior consultation with Honda whose wishes, as largest creditor, were supreme; (2) the directors did not abide by Honda's wishes to proceed to immediate CVL; and (3) the directors did not seek the directions of the court prior to appointment.

55. In relation to the second point, it was suggested that on appointment the administrators should have: (1) prepared proposals for submission to the creditors; (2) convened a meeting to consider those proposals; and (3) embark on their tasks as administrators, whereas in practice (2) and (3) were carried out in reverse order.

56. The Registrar rejected both arguments. However desirable it may be in any given case, there is no statutory duty on directors or administrators to carry out any of the steps set out above.

57. Turning to the question of the remuneration to be fixed by the court, the liquidators argued that if the court accepted that it was inappropriate and ill-judged for the administrators to implement their trading strategy without prior sanction, the court should not make any order permitting them to profit at the creditors' expense but should instead limit the remuneration to work that would have had to be carried out anyway and reduce that remuneration further to take account of losses that would have been incurred.

58. Again, the court rejected that argument on the basis that in the absence of any attack on the administrators' professional integrity or bona fides (no application having been made to challenge their appointment or strategy) it was not for the court to go beyond the signed statement confirming that it was reasonably likely that the purpose of administration would be achieved.

59. In relation to the application of the Practice Statement, the liquidators alleged ten reasons as to why the administrators' bills of costs failed to comply. However, the Registrar drew a distinction between an *ex parte* hearing, where full compliance with paragraph 5.2 is necessary because that will be the only evidence before the court, and an *inter partes* hearing where "any matters not dealt with in the written evidence can be fleshed out in the oral evidence."

60. Crucially, the liquidators provided no evidence themselves but relied on the evidence of their solicitor (who also represented Honda), who was dealing with a matter which fell outside his professional expertise and was criticised for appearing to have a hidden agenda. It is important not to overlook this factor in assessing the approach taken by the Registrar to the sufficiency of the evidence provided by the administrators; it may be that faced with more comprehensive evidence in opposition the significant number of omissions may not be so readily excused.

61. Ultimately, whilst the Registrar reduced the administrators' time costs slightly, to reflect a small element of duplication and some work being done by a senior manager which could have been delegated to a more junior member of the team, he allowed substantially the whole of the remuneration claimed. In particular, he allowed significant additional costs which had been caused not by the administrators' profligacy but by Honda's hostile conduct. In particular, in relation to the liquidators' criticism of costs incurred by the administrators in preparation for the holding of the creditors' meeting (allegedly in a 'Rolls Royce' fashion), the Registrar noted that the administration *"was conducted in an atmosphere akin to trench warfare, the hostile party being Honda, which did not brook any opposition to its wishes*".

Brook v Reed

62. The application of the Practice Statement has recently been considered by the Court of Appeal in the case of *Brook v Reed* [2011] EWCA Civ 331. On an appeal brought by a bankrupt against the decision of a district judge at first instance fixing the trustee's remuneration, legal costs and disbursements, HHJ Behrens had reduced the amount awarded by approximately half. However, no reference was made in either judgment to the Practice Statement. The bankrupt appealed, contending that both the trustee's fees and the legal costs should have been reduced to much lower figures. The question for determination was whether the remuneration allowed was disproportionately high in relation to the circumstances of the bankruptcy.

63. Giving the leading judgment, David Richards J indicated that a court hearing an application to fix or challenge the remuneration of an office-holder should proceed on the basis that the Practice Statement is to be applied, except in so far as in the circumstances of the particular case the party objecting to its application shows that it would be wrong to do so. He confirmed that the statement of guiding principles in the Statement is correct, although the particular circumstances might call for the formulation of a further principle. The real task for the court in any particular case is to balance these principles in their application to the facts and circumstances of the case.

64. As to the particular facts in the instant case, the bankrupt was made bankrupt in August 2007 on the petition of HMRC with the trustee appointed the same month. Her only assets of substance were a small retail flower business and a half-share in the matrimonial home. There were a small number of creditors amounting to approximately £25,000 and it was always clear that there was likely to be a substantial surplus. It was an obvious case for an annulment under s 282(1)(b) IA and an application was subsequently made by the bankrupt indicating that she wished to contest the amount of the trustee's remuneration and expenses, estimated at approximately £19,900. After various adjourned hearings it was ordered that the bankrupt be taken to have made her application under s 303 IA. At first instance, the district judge accepted the trustee's submission that the bankrupt had not raised any substantial points of dispute on which the court could adjudicate and allowed his remuneration in full.

65. On appeal HHJ Behrens held that there were a number of matters in the trustee's Bills of Costs that "cried out for investigation" and concluded that the overall costs where wholly disproportionate to what was involved and what had been achieved. He therefore substantially reduced the hours claimed on the grounds that they had not been properly and proportionately spent. However, in reaching this decision no reference was made to the Practice Statement.

66. In the Court of Appeal, whilst David Richards J considered that the Practice Statement should have been expressly applied, he held that HHJ Behrens had nevertheless applied what were fundamentally the relevant criteria to the facts of the case. It was not open to the Judge wholly to disregard the time spent by the trustee because it was a relevant (but not decisive) factor in any case and the basis of the trustee's remuneration was "time properly given". However, this basis did not absolve the trustee from scrutiny of his remuneration, as required by the word "properly".

Time is properly spent if it meets the criteria set out in the Practice Statement, applied with regard to all the circumstances of the case. The appeal was therefore dismissed.

67. The Court of Appeal accepted that, as the Practice Statement applies to two distinct situations – where an office-holder applies to the court to fix remuneration not otherwise payable (paras 2.1(1) and (2)) and where a creditor or debtor challenges remuneration already authorised (para 2(3)) – the procedure applicable in each case may be different. In particular, the evidence required by the court in each case is likely to differ. While the full range of information required by para 5.2 may normally be required on an application by the office-holder to fix remuneration, the information required on a challenge will vary according to the circumstances and if the office-holder has already provided sufficient detail to enable a well-informed challenge to be made, there may be little or nothing to be added.

Voluntary Arrangements and "Material Irregularity"

"*A resolution to approve the proposal or a modification is passed when a majority of three quarters of more (in value) of those present and voting in person or by proxy have voted in favour of it. "(rule 5.23(1) for IVAs, rule 1.19(2) for CVAs)".*

"Any resolution is invalid if those voting against it include more than half in value of the creditors, counting in these latter only those …who are not, to the best of the chairman's belief, [associates of the debtor] (rule 5.23(4) IA for IVAs)[persons connected with the company] (rule 1.19(4) IA for CVAs)".

68. The basic rule as to voting on a proposal for a voluntary arrangement, be it for an individual or a company, is that there needs to be a majority in favour of the proposal of 75% or more in value of those voting at the creditor's meeting. The basic rule is qualified such that any resolution is invalid if those voting against it include more than half in value of the creditors, excluding those who are associates of the debtor. It is for the chairman to ascertain the entitlement of persons wishing to vote and to decide if a person is an associate of the debtor or connected to the company. The Chairman's decision is subject to appeal to the Court (rule 5.22(5)/ 1.17(A)(5)) or can be challenged by an application under section 6IA (CVAs) or section 262IA (IVAs) on either or both of the following grounds:

(i) The voluntary arrangement approved unfairly prejudices the interests of a creditor of the debtor or a creditor, member or contributory of the company; and

(ii) That there has been some material irregularity at or in relation to the meeting of the creditors (or in the case of a CVA, at either the meeting of the creditors or the company).

69. These rules are open to abuse, as a number of decisions of the last six months illustrate:

Vote-rigging: *Gatnom Capitol & Finance Ltd*

70. One method, of which practitioners are well aware, is vote-rigging or hijacking whereby debts claimed as due from the debtor/ company to friendly creditors are inflated (or invented) to ensure the proposal is approved by 75% of the creditors by value. A fairly recent illustration of this practice can be found in the matter of *Gatnom Capitol & Finance Ltd* [2010] EWHC 3353 (Ch),(17/12/10) a decision of Roth J in the companies Court.

71. In this case the company, Gatnom Capitol and Finance Ltd ("*Gatnom*"), was indebted to Macaria Investments Ltd ("*Macaria*") which had filed a winding up petition in respect of that debt. This prompted Gatnom to file a proposal in court for a CVA. Gatnom produced a statement of affairs in support of its proposal which showed that the debt it owed to Macaria was dwarfed by the liability shown to two other creditors ("BKN") in respect of alleged contracts for the purchase and development of two plots of land in Russia on a joint venture basis (which together amounted to 80% of the total indebtedness). Macaria had concerns about the bona fides of these contracts and objected to the debts. The intended nominee nevertheless proceeded with the creditors' meeting, marking the votes of BKN as objected to by Marcaria pursuant to rule 1.17A(4). The

other creditors cast proxy votes in favour of the proposal, which was thereby approved by 83.5% of the creditors.

72. Macaria applied under s.6 IA to set aside the CVA on the grounds that there was material irregularity in relation to the creditors' meeting. It joined the supervisor of the CVA as the first respondent and Gatnom as the second. The supervisor was excused attendance at the trial. Marcaria submitted that the two land contracts were a sham, that they were unsupported by documentation and that the actual market value of the plots purchased was significantly less than the debt alleged. Without the support of BKN as vendors under those contracts, the proposal for a CVA would clearly not have received the necessary 75% majority and would have been rejected.

73. Roth J held that it seemed almost inconceivable that the contracts for the sale of the land on the scale of those alleged and discussions in relation to them had been entered into without examination of significant documentation. Gatnom had been given the opportunity to produce evidence rebutting Macaria's allegations but had failed to do so on the documents or by expert evidence on valuation, and it was accepted that the debt alleged was far greater than the market value of the sites. The almost complete lack of documentation was highly suspicious. Therefore, on the evidence, the Court found on the balance of probabilities that the two land contracts were indeed shams. Accordingly, the creditors under those alleged contracts were not entitled to vote at the creditors' meeting which approved the CVA. It was indisputable that a decision in a creditors' meeting to approve a CVA that was carried only because of the votes based on alleged liabilities that did not in truth exist constituted a material irregularity within the terms of s.6(1)(b) IA. Therefore, the Court had power under s.6(4) IA to revoke the decision of the meeting approving the CVA. In the circumstances it was clearly appropriate to exercise that power.

Vote trafficking: *National Westminster Bank v Kapoor*

74. A 75% majority in value of the creditors is necessary but not sufficient; it is also necessary for at least 50% of the un- associated or unconnected creditors to vote in favour of the proposal. A novel ploy to get around this rule is the trafficking in associated debt to pliable but ostensibly unconnected third parties, who can be relied on to use their un- associated or un-connected vote in favour of the proposal.

75. This was the case in *National Westminster Bank v Kapoor & Tang* [2011] EWHC 255 (Ch), a decision of Judge Hodge QC (20/01/11), described by the Court as raising "*interesting, novel, and not entirely straightforward issues as to the law and practice of creditors' meetings summoned for the purpose of deciding whether to approve a proposed individual voluntary arrangement, and, more generally, of the status for the purposes of the Insolvency Act and Rules 1986 of an equitable assignee of part of a debt*."

76. The debtor, Mr Kapoor, became insolvent. His creditors included Crosswood Ltd, a company owned by a trust which counted amongst the trustees the debtor's sister and mother. Crosswood Ltd was therefore an associate of the debtor within the meaning of s.435 of the Act. The debtor's total indebtedness was £10.38 million, of which £8.5 was owed to Crosswood Ltd. The other (unconnected) creditors were National Westminster Bank ("NWB") (debt: £1.835m) and HM Revenue and Customs (debt: £35,000). NWB served a statutory demand which was unsuccessfully opposed by the debtor and was given permission to present a bankruptcy petition not before 23 June 2009. On that day the debtor applied to court for an interim order in connection with a proposed IVA in which he claimed to have no assets at all and identified Crosswood Ltd as a creditor for £4.5M and a Mr Sanjev Chouhen for £4M. The IVA he proposed would result in an eventual return of c.5.48 pence in the pound as opposed to a nil dividend otherwise available in a bankruptcy. An interim order was made.

77. On 23 June 2009 Crosswood Ltd assigned £4M of it's debt to Mr Sanjev Chouden, a long standing friend of the debtor, for consideration of £50,000, a later payment of £50,000 (there was no evidence that this sum was ever paid) and 80% of any sums recovered from the debtor (in other words the assignor retained a very substantial economic interest in the assigned claim). The arrangement resulted in Mr Chouhen paying a premium of approximately £56,000 for the debt. This scheme was a deliberate device designed to ensure that the IVA was accepted by

more than 50% of the unconnected creditors. Indeed, at the meeting Crosswood Ltd and Mr Chouden voted in favour of the proposal and NWB and HMRC voted against. The nominee, as chairman of the creditors' meeting, accepted that this was the purpose of the assignment but saw nothing wrong in it and allowed Mr Chouden to vote in favour of the proposal as a non-associated creditor. The proposal was therefore accepted. If the debt had remained with the connected company, the requirement that the proposal be approved by 50% of the unconnected creditors would not have been satisfied.

78. NWB applied for an order under s.262 of the Insolvency Act 1986 that the approval be revoked on the grounds that there had been a material irregularity in relation to the meeting for three reasons. First, the lack of evidence in relation to the debt owed to Crosswood Ltd and part assigned meant there was no material from which the chairmen could have safely concluded the value of the debt and it should have been valued at £1 in accordance with rule 5.21(3). Second, the assignment could not be an absolute assignment since it was only part of a debt. On that basis it could only have operated in equity so that Crosswood remained the debtor holding £4m of the debt on trust for Mr Chouhen. Alternatively, Mr Chouhen was a trustee of 80% of the proceeds of the debt assigned to him and was therefore an associate of the debtor. Third, the purported assignment was an improper device designed to evade the requirements governing the treatment of votes of un-associated creditors and would clearly undermine the policy objective behind the rules as regards the voting of associated debt, as it would enable a debtor with a compliant friend, and with the express objective of enabling a debt to be counted which should not strictly be counted, to achieve the approval of an IVA.

79. Judge Hodge QC rejected the submission that the debt should have been valued at £1, there was sufficient evidence to conclude that the liability, while less than the £8.5M claimed, was in excess of £600,000 which was more than three quarters of the value of all creditors. He also rejected the submission that Mr Chouhen was a trustee for Crosswood Ltd and therefore associated with the debtor, since no trust relationship was contemplated and Crosswood Ltd had no proprietary right to 80% of the dividend, only a contractual right to a sum equal to 80%. However, he accepted that any assignment of part of a debt will only take effect as an equitable assignment and an equitable assignee of a legal chose in action could not give a valid discharge to the original debtor unless the assignment expressly empowered him to do so. In the absence of such an express provision, the assignee was not a creditor. Mr Chouhen was not the person to whom the debt is owed. The assignor, Crosswood Ltd, was the true creditor and Crosswood was an associate of the debtor. Allowing someone to vote at a meeting when they were not entitled to do so was capable of amounting to a material irregularity.

80. The judge gave further guidance that the concept of "material irregularity" is not limited to matters involving voting. It encompasses irregularities in the debtor's proposal or statement of affairs. The requirement of "material irregularity" is informed by the requirement for complete good faith and transparency and any conduct at or in relation to a creditor's meeting which infringed these requirements might fall foul of s.262. In this case the irregularity consisted in the counting of Mr Chouhen's vote when he was an equitable assignee of part of an associate's liability which assignment was taken on terms which were wholly non - commercial and with the express objective of voting in favour of the IVA where the equitable assignor's vote would otherwise fall to be discounted as that of an associate. In these circumstances there is a lack of good faith on the part of the debtor in promoting the arrangement and the assignee in participating. If this sort of device were to be endorsed by the Courts, it might become commonplace and entirely undermine the policy objective of rule 5.23(4) IA.

81. Accordingly, the approval of the IVA was revoked, and the bank was permitted to present a bankruptcy petition against the debtor.

82. Counsel for Mr Kapoor posed a number of difficult "slippery slope" style questions during the course of the trial, including whether it would be a material irregularity for a non associated creditor to buy associated debts where he had a legitimate business interest in avoiding a bankruptcy rather than to assist the debtor, which the judge sidestepped on the basis that they were not raised on the facts before him. It appears an important influence on the decision in this case was that there was a lack of good faith on the part of the debtor in promoting the IVA and a lack of good faith on the part of the "creditor" (by assignment) in participating in it. However, if the

assignment was of the whole debt and was on a commercial basis it may be that there would be no objection to the assignee of the debt voting and being treated as a non-associate. In future anybody attempting this manoeuvre might be prudent to bring the facts concerning the assignment to the attention of all the creditors to avoid the allegation of lack of good faith.

83. It should be noted that an appeal against the decision is due to be heard at the end of July 2011.

84. One further facet of this case deserves mention and that is the proper interpretation of the 50% of un-associated creditors rule. The wording is loose and confusing, and begs the question: does the rule apply with the effect that a proposal would only be rejected if those voting against it included more than half of the non-associated creditors who voted, or do those voting against it have to include more than half of the associated creditors in total, whether they voted or not? In *Kapoor*, the Court held as follows:

"*I was initially troubled by whether the phrase 'counting in these latter' referred back to the words 'the creditors' or referred to those voting against the resolution; but I am now satisfied that the reference to 'counting in these latter' governs the word 'creditors' rather than the phrase 'those voting against the resolution'. I do so, first, because that is the view expressed both in Sealy and Milman and in Weisgard; secondly because it seems to me to be the clear grammatical effect of the wording; and, thirdly, because if the phrase 'counting in these latter' were to qualify those voting against it, I can see little need for sub-paragraph (a) of Rule 5.23(4), counting in only those who have notice of the meeting. The alternative construction of the words 'counting in these latter' would seem to me to render sub-paragraph (a) of sub-rule 5.23(4) redundant. In other words, I accept that a proposal for an IVA must attract the support of the holders of 75% of the debt, and also of more than 50% of the independent or unconnected debt. As I say, it is common ground that Crosswood was an 'associate' of the debtor*"

Vote - Suppressing: *Revenue and Customs Commissioners v Earley*

85. A further ingenious ploy was attempted by the debtor in the very recent case of *Revenue and Customs Commissioners v Earley & Others* (11/05/11), a decision of Sir Andrew Morritt as yet unreported .

86. In this case the applicant commissioners conducted a number of assessments under the Tax Management Act 1970 and concluded that Mr Earley owed £4.6M in taxes. The assessments were upheld by the general commissioners but the High Court remitted the matter to the first tier tribunal for reconsideration. In the meantime Mr Earley proposed an IVA to his creditors, the effect of which, was to reduce the Revenue's alleged debt to £100,000. The Revenue notified the proposed joint nominees of its intention to reject the IVA proposal and pursue the full debt.

87. Subsequently, Mr Earley was adjudged bankrupt and obtained, without notice, an injunction restraining the commissioners from effectively voting against the IVA at the creditors' meeting (on the basis of errors of fact and law which Mr Earley later accepted). At the creditors' meeting, the commissioners did not vote and the IVA was approved.

88. When the injunction expired the commissioners applied to the High Court for the IVA to be revoked on the grounds that the IVA unfairly prejudiced them by unjustifiably reducing the debt and the creditors' meeting was conducted on the basis of a material irregularity, namely the fact that Mr Earley had, previously and without legal or factual basis, obtained an injunction which improperly fettered their voting rights, such that the court should exercise its discretion under s.262 of the 1986 Act to revoke the approval of the IVA.

89. The Judge held that, in the light of the fact that the Revenue held a large proportion of Mr Earley's overall debt no IVA could have been approved without its agreement. The Commissioners had been unfairly prejudiced by the approval of the IVA and the consequent reduction in their alleged debt without proper cause. Mr Earley had obtained the injunction without a proper factual or legal basis. As a consequence of that injunction, the Commissioners' voting rights were improperly restricted and that constituted a material irregularity. There was no reason why the Commissioners should not be entitled to insist upon their rights and rely on the repayment of the full debt owed by Mr Earley. Although the Commissioners could have applied

to discharge the injunction, there was no reason why they should be punished for not having done so where Mr Earley had applied for the injunction without basis in the first place.

90. As an interesting aside, the court further held that it was bound by the decision in *Clarke v Coutts & Co* [2002] EWCA Civ 943, [2002] BPIR 916 that the High Court had jurisdiction under s.373(1) to (4)IA to hear an application concerning an undischarged bankrupt notwithstanding r.5.14B(2) The Court also indicated (obiter) that it was intended, by operation of s.41 of the Senior Courts Act 1984, that the High Court should always have the power to divert to itself proceedings from the county court.

Entitlement to vote: When is an unsecured creditor secured?

91. In another very recent case, *Sofaer v Anglo Irish Finance Plc*, (26/5/2011), a decision of Lewison J (as yet unreported) the applicant attempted an ingenious manoeuvre to argue that the debts which were owed to the creditors that had blocked his IVA were in fact secured debts and should not be counted.

92. The applicant, Mr Sofaer, a property developer, executed a deed of guarantee and indemnity in favour of the Respondent creditors to secure the liabilities of various companies together with charges over 12 properties owned by those companies or their nominees. His liability was capped under the guarantee. The Respondents made a written demand to Mr Sofaer which was not complied with and appointed fixed charge receivers. They then served a statutory demand on Mr Sofaer stating that no sums had been received and the whole sum of £8.432m fell due under the guarantee. Mr Sofaer failed to have the demand set aside. In order to avoid being made bankrupt he proposed an IVA. At the creditor's meeting, the Respondents voted against the proposal and the IVA was rejected.

93. Mr Sofaer challenged the validity of the chairman's decision to allow AIF to vote on the basis that his liability under the guarantees was unascertained and un-liquidated. His appeal was summarily struck out by the Registrar.

94. Mr Sofaer also entered into a deed of assignment gaining an equity of redemption over the 12 charged properties. He argued that the result was that his debt to the Respondents was secured over these properties.

95. He appealed against the decision of the Registrar. On appeal, the Court held that the Registrar did not err in concluding that the nature of the debt was ascertained and for a liquidated amount: the amount of Mr Sofaer's liability under the guarantee was conclusively quantified.

96. The Court further held that the nature of the claim under the guarantee against Mr Sofaer was personal: under s.383(2) of the Act, to establish the debt was secured it was necessary to show that the person to whom the debt was owed held security for that specific debt over the property of the person by whom the debt was owed. In this case it could not be said that there was security held over Mr Sofaer's property. There could be no security over Mr Sofaer's acquisition of the equity of redemption on the charged properties, as they were residual rights. A change in ownership of the acquisition of the equity of redemption did not enlarge the scope of the security. Further, the fact that Mr Sofaer was assigned the equity of redemption of the charged properties after the creditor's meeting could not affect the characterisation or quantification of his liability based on which the Respondents were entitled to vote at that creditors' meeting. Rule 5.21(2) made it clear that the relevant date in relation to ascertaining the character of a debt was that of the creditors' meeting.

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